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Mary Quek
University of Hertfordshire

Financing international hotel growth in the aftermath of the Second World War

Apologies: There is a change of content from the abstract. This paper discusses only one hotel company – Intercontinental Hotels Corporation instead of two.

I. Introduction

The creation and development of the Intercontinental Hotels Corporation (IHC) after the Second World War, and its development into part of the largest hotel company in the world today may be attributed to luck and hard work. Since most countries after the Second World War were hoping that international tourists would bring in the much needed American dollars, the host governments were in favor of and supportive towards the foreign hotel companies, in this case IHC. At the same time, the parent company of IHC was able to provide the necessary financial and network support. Hotels of classical tradition outside the US before the Second World War were usually family- or small enterprise- owned or operated. They provided quality service and were preferred by the experienced international travellers. However, the size or capacity was not designed to meet the needs of the jet age. Since the majority of the tourists who were travelling then were Americans who had the financial ability to spend, countries hoping to attract American tourists were in favor of the development of American-style hotels and management in their countries[1].

The major problem at that time (post-World War II) with internationalization development was a lack of investors. The hotel business shares the characteristics of a heavy asset industry; in addition, it has a slow return of investment which makes it difficult to justify itself to its investors. This was particularly the case in developing countries, where venture capital was looking for an immediate return of 15-25% per year rather than an expected 6-15% return in four to six years after the initial capital paid in. Therefore, it became essential to draw on individuals or organizations with other collateral interests such as government, transportation companies, land developers, banks or other community-minded parties to participate in hotel projects[2]. The IHC utilized management contract extensively to grow its hotels. The company provided design, construction and technical assistance as well as operations management and local owners pay IHC a percentage of the earnings as rent or management fee[3]. Ideally, each hotel was owned by businessmen in the communities where they were located. The hotel bookings and promotion was handled in the US by IHC. The IHC also operated hotels by arrangement of lease and, on exceptional occasions, own the hotel; for example, the Reforma in Mexico[4].

This conference paper aims to illustrate how common methods of expansion used currently were uncommon in the advent of international hotel development. For example, management contract was deemed an uncommon method for hotel development in European and Latin American countries due to the dominance of small- and medium- sized operators or family operators. Moreover, looking for financial capital was particularly difficult at a time when most countries were recovering from war and rebuilding their economies. The case of IHC[5] is used to highlight the innovative application of financing methods for building their international hotels, illuminating the important roles played by host and home government for enabling the growth of foreign hotel and tourism industries. The next section discusses financing methods used by IHC and problems encountered, particularly with relevance to home and host governments' relationships.

II. Financing IHC

Two methods are examined in this section: the first is the funding of the Export-Import Bank by the US Government. Second, IHC's parent company, Pan American Airways (Pan Am) provided financial support which was possible in the first decade of IHC's international development because of Pan Am's financial strength as a world-leading passenger and cargo airline company.

Export-Import Bank

The basis of IHC's role included introducing, planning, designing and operating new hotels. The financing of hotel building was supported in part through the Export-Import Bank and in part by local capital[6]. The IHC helped local hotel owners to secure Export-Import Bank loans for purchase of construction materials and equipment. The IHC was created by Pan Am, partly encouraged by the financial support which the US government had arranged for the company with the Export-Import Bank[7]. The agreement between the Export-Import Bank and Pan Am was to allow each hotel-owning company designated by Pan Am a maximum loan amount of $25 million on the condition of a 20-year repayment period and a two-year moratorium from its first draw-down of funds.[8] The Export-Import Bank also limited the loan to 50% of the cost of equipment, materials, supplies and services in the respective hotels. In addition, the hotel companies had to pay an interest rate of 4% per annum on outstanding balances. Furthermore, either the Government of the host country within which the hotel was to be constructed or an accredited banking institution had to guarantee unconditionally the repayment of advances against any line of credit established between the Export-Import Bank and the hotel units concerned.

Tamanaco Hotel (Caracas, Venezuela)

In 1947, at the invitation of the Venezuelan government, representatives of IHC visited Caracas to study and discuss the city's critical hotel problem[9]. Tamanaco Hotel CA was then created in Venezuela and IHC helped to negotiate with the Export-Import Bank to obtain a loan of US$2,337,000 to purchase equipment in the US for building the Tamanaco Hotel in Caracas.

The total cost of the hotel was estimated at US$5,600,000 million and the other funds were supplied by the hotel company itself. Repayment was over 20 years, interest was 4% and the loan was guaranteed by the Government of Venezuela[10]. The IHC signed a contract with Hotel Tamanaco CA to supervise the design and construction of the hotel, and to manage it after its completion[11].

The influence of the host government is apparent in this case because the President of Hotel Tamanaco CA, Dr Gustaveo A San Romana was a lawyer, engineer, industrialist and General Manager of VICA, a large development company operating in the Las Mercedes region of Caracas. He was consistently seen beside the then President of Venezuela (Colonel Marcos Pérez Jiménez, 1952-1958)[12]. The enthusiasm of the Venezuelan Government to diversify its economic structure by supporting hotel development may be attributed to the realization of the vulnerability of the country during the Second World War when trade was interrupted. The war brought about a shortage of imports that exposed the external vulnerability of the country**.**

Venezuela's refining capacity increased tenfold between 1945 and 1960 from 100,000 barrels per day in 1945 to 1.4 million barrels per day in 1960[13]. This led to a boom in the trans-shipment of oil and both the oil companies and the government were interested in ensuring that adequate facilities were provided. In turn, hotel development was favored in anticipation of increased tourist traffic, attracted to these growing cities with the provision of adequate accommodation. For example, Maracaibo was Venezuela's second largest city in size, and the oil capital of western Venezuela. The Chambers of Commerce of Maracaibo formulated the plan to finance the Maracaibo Hotel and consolidated a group of local Venezuelans, State government, the Hotel Tamanaco Company of Caracas and the IHC to subscribe the capital to build the 150-room Hotel[14]. The IHC's Venezuela hotel development was one of the success stories of the times, related to the cooperation between home and host governments and the local communities that facilitated the financial support to IHC.

Unfortunately, the financing of the IHC by loan from the Export-Import Bank was stalled for many years after the mid-1950s. In 1955, when the Senate House voted to give Pan Am $17,769,000, an increase of $12,500,000 over the original House-approved subsidy, a complaint was made by Senator Paul Douglas[15]. Senator Douglas claimed that 'American taxpayers apparently are being saddled with such ventures as hotel chains and real estate developing companies through the device of airline subsidiaries'[16]. He further maintained that Pan Am was using the taxpayers' money to subsidize IHC to operate luxury hotels operations throughout South America[17]. 'Subsequent to that debate, the Export-Import Bank tightened its hotel loan criteria to consider only 'non-luxury' hotels on a highly selective case-by-case basis and a number of loan applications for hotels projects were refused[18]. The hotel development was particularly affected in underdeveloped areas as the investment climate in some areas worsened and no alternative sources of financing were available[19].

The slow response from the Export-Import Bank was of particular concern for IHC because a number of projects started in 1955 incurred costs for field representatives, engineering, operating studies, legal fees, options, cost of administrations and so on in excess of $1.2 million. The IHC expected the expenditure to reach $1.5 million by the end of 1959. The company had submitted several loan applications to the Export-Import Bank in 1958, but was yet to hear from the Bank. The other major concern that the IHC had was over the long waiting periods regarding maintaining the work relationships and commitments that the company had entered into with equity partners, financial institutions in the countries where the hotels are to be located, and the governments of those countries with respect to tax concessions and convertibility assurances, and so on[20].

In conjunction with the waiting, IHC's parent company, Pan Am lobbied for political support and its break came after a report was written by Clarence B. Randall, Special Assistant to the President of the US. Randall's report on international travel pointed out; 'The shortage of foreign hotel accommodations threatens to become one of the most formidable barriers to international travel'[21]. Subsequently, a number of IHC hotels in countries such as Jordan, India, Thailand and Australia received financial support, facilitated in part by the Export-Import Bank[22].

In contrast to the 'promise' to fund IHC's hotel development in Latin America by the government, which was how IHC was created, only two hotels in Latin America were supported by the Export-Import Bank. In 1964, the source of finance by the Export-Import Bank was considered no longer appropriate in most countries in Latin America. The advances of dollar loans from the Export-Import Bank were meant for purchasing materials, equipment and services of US origin which were not available locally[23]. However, almost two decades after the end of the Second World War, in Brazil and Argentina particularly, and increasingly in other countries, hotels were able to find locally produced materials, equipment and furnishings for constructions, thus requiring little hard currency component in the costs involved[24].

Parent company's 'unlimited' financial support

The 'unlimited' financial support given by the parent company was most apparent when Pan Am executives suggested that the existing method of financing IHC equity investments in new hotel companies by Pan Am making advances to IHC should not be continued because of the substantial amount of money involved, and the accounting problem involved[25]. Pan Am created IHC with $1 million in 1947 and a further investment of $1 million in 1951. This was followed by several millions of dollar advances to IHC between 1954 and 1959[26]. It was evident that Pan Am did not have a clear procedure for the various forms of support it provided to IHC until a reorganization took place in 1959/60. For instance, there was no comprehensive contract between Pan Am and IHC whereby Pan Am will be reimbursed for making available to IHC the use of Pan Am's worldwide communications network for hotel reservation purposes[27]. Pan Am supported IHC via means of its airline network, establishing a marketing and Public Relations system and providing 'unlimited' financial support. Pan Am enjoyed the air travel growth after WWII, with the increased numbers of middle class tourists, complemented by the advancement of airline technology that made travelling time shorter and fares cheaper[28]. The various kinds of support helped IHC to develop and expand the company's international hotel chain quickly[29].

The 'unlimited' financial support eventually came to an end, indirectly caused by the home government's intervention with Pan Am's airline subsidies. Pan Am's subsidies were cut subsequent to the criticism voiced by Senator Douglas. At the time, Pan Am's financial performance was suffering from intensified price competition with foreign airlines. In 1957, Pan Am experienced a sharp decline in its net profit ($14,238,000 in 1956 and $8,241,000 in 1957[30]. Similarly, IHC's net profit was falling ($497,000 in 1956 and $243,000 in 1957). The IHC's poor financial performance was also caused by problems that arose from high taxation rates and increased difficulties in converting and transferring local currency to the USA[31]. Pan Am and the IHC both came under increasing pressure to produce results in order to ensure continuous financial support. Juan Trippe[32] (Trippe) was concerned with the financial state of the IHC and instructed executives to 'get them [IHC hotels] into satisfactory condition to withstand the critical eyes of not only prospective investors in hotel projects, but also the Export-Import Bank, the Development Loan Fund and the foreign exchange authorities and tax authorities in countries in which the hotel will be located.'[33]. Subsequently, Pan Am's policy towards IHC became more structured and stringent and they insisted they would not commit equity money to IHC unless 'reasonable IHC or Pan Am control' is retained[34]. Pan Am proposed that IHC should run its own affairs, and at the same time, it proposed that the IHC's decision-making powers should be limited; for example, the IHC would need to seek the approval of Pan Am for new investment. 'IHC should run its own affairs by using its own cash, paying off the Pan Am debt from time to time as surplus funds develop'[35].

III. Conclusion

In the aftermath of the Second World War, it was difficult for international hotels to expand because there was a lack of risk capital for hotel equity investments or there was no developed capital market for hotel shares and stocks. Seeking government's funding and lobbying for political influence to gain financial support was considered innovative, and a staple for international hotel development. It became necessary to seek help from the government or to development organisations to provide the long-term loans required. However, IHC was caught in a catch-22 situation when trying to apply for the Export-Import Bank's funding because the Bank required host governments to act as guarantors of loans; while negotiating with host government required proof of the financial support provided by the home governments concerned. Although financial sectors in most countries were later deregulated which enabled a greater range of more available funds to support the building of hotels. It is still vital to build good relationships with home and host communities in order to explore more innovative funding to support a capital-intensive business such as the hotel industry.

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[1] Pan American. 'International Hotel Development'.
[2] Ibid.
[3] Hammer (1957). 'Hotel chains push overseas expansion'; New York Times (1947). '11 hotels to rise in Latin America'.
[4] New York Times (1957), 'Building room hits the sunbelt'.
[5] IHC was created by Pan American World Airways (Pan Am) in 1947 after the company was invited by the Government to establish hotels in South America in order to facilitate good social and economic relationships with their neighboring countries. See Quek (2012) for a detailed report on the beginning of IHC and for drivers of global hotel growth after Second World War.
[6] Louchheim (1950), 'New design proves worth in hotels'.
[7] The Export-Import Bank was created under the Reconstruction Finance Corporation (RFC) to finance US export sales (Potter, 1996: 10-11).
[8] Pan American. 'Correspondence from Wayne, C. Taylor to Juan T. Trippe'.
[9] Pan American. 'News from IHC 'Caracas''.
[10] Trundle, 1950: 120.
[11] Pan American. 'News from IHC 'Caracas''.
[12] Astorga, 2000.
[13] Ibid
[14] Pan American. 'New hotels in Venezuelan Oil Centre'.
[15] Although Pan Am sent a telegram to the publisher, published next to the same article, claiming that 'No subsidized money goes to Pan Am's hotel subsidiary. The hotel company currently makes a profit which the CAB [Civil Aeronautics Board] claims in full and applies to reduce public support for air services'. Pearson (1955). 'Holland Champions Airline Subidy'.
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