The Future Of The Timeshare Industry: Will The Brands Dominate? A Summary Of The Vacation Ownership Industry And An Analysis Of The Advantages That The Brands Have Over Smaller Independent Developers

By

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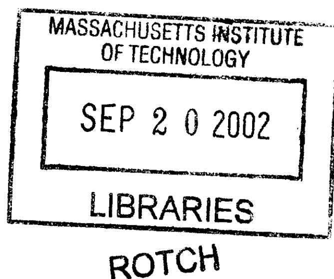

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ABSTRACT

The timeshare industry has transformed since its introduction to the United States nearly thirty years ago. Suffering from its early beginnings of dubious business practices and negative consumer perception, timesharing has evolved into a credible and growing source to the real estate industry. The concept of timeshare, at its simplest level, is dividing up condominium style residences into weekly increments, commonly referred to as intervals, which are sold to consumers in perpetuity or for a period of time. Timesharing has experienced explosive growth reaching four billion dollars in U.S sales in 2001 with compounded annual growth of over fourteen percent during the past twenty years. Over eighty-five percent of all timeshare owners are satisfied with their purchases. It is estimated that less than two percent of the U.S population own timeshares. With the convergence of the baby-boomer generation fueled with disposable income to spend on vacation experiences, the potential for growth is enormous.

Industry insiders and the public mainly credit growth and consumer acceptance of timesharing due to the entry of large branded companies such as Marriott, Starwood, Disney, and Hilton. These companies have brought a degree of credibility and innovation to the industry that was lacking in the earlier part of its existence. Today, the industry is dominated by smaller independent companies who account for seventy-five percent of the market, but the brands continue to increase their market share. Will the timeshare industry mimic the consolidation of the hotel industry thirty years ago?

This thesis paper will synthesize the pertinent aspects of the timeshare industry in order to establish a framework for those readers unfamiliar with the industry. It will also investigate and analyze the key reasons and competitive advantages that brands have over smaller independent developers. The thesis concludes that brands will dominate the timeshare industry due to five key factors: credibility/quality/ brand awareness; financial and economic advantages; sales and marketing; liquidity and flexibility; and consolidation.

Thesis Supervisor: William C. Wheaton

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1. INTRODUCTION

1.1 Background

The timeshare industry has transformed since its introduction to the United States nearly thirty years ago. Suffering from its early beginnings of dubious business practices and negative consumer perception, timesharing has evolved into a credible and growing source to the real estate industry. The concept of timeshare, at its simplest level, is dividing up condominium style residences into weekly increments, commonly referred to as intervals, which are sold to consumers in perpetuity or for a period of time. The main advantages that it provides to consumers is a vacation home at a fraction of the cost of full vacation ownership with no management responsibilities, and it allows them the opportunity to exchange their interval for a different vacation spot any where in the world.

Timesharing has experienced explosive growth reaching four and a half billion dollars in U.S sales in 2001 with compounded annual growth of over fourteen percent during the past twenty years. The industry has matched consumer preferences offering them greater flexibility and liquidity by means of multiple ownership products as well as elaborate and tantalizing developments. Over eighty-five percent of all timeshare owners are satisfied with their purchases. It is estimated that less than two percent of the U.S population own timeshares. With the convergence of the baby-boomer generation fueled with disposable income to spend on vacation experiences, the potential for growth is enormous (Ragatz, Richard).

Timeshare developers run the gamut from poorly financed, marginal operations to well-known travel and leisure corporations such as Marriott International and Disney Corporation. If done right, timeshare development is extremely profitable, allowing for profits up to five times the amount of an ordinary real estate sale.

Industry insiders and the public mainly credit growth and consumer acceptance of timesharing due to the entry of large branded companies such as Marriott, Starwood, Disney, and Hilton. These companies have brought a degree of credibility and innovation to the industry that was lacking in the earlier part of its existence. Branded companies have grown substantially in the industry, moving from seven percent of total sales in 1995 to twenty-five percent in 2001 (Minor, Steve). Today, the industry is dominated by smaller independent companies who account for seventy-five percent of the market, but the brands continue to increase their market share. Will the timeshare industry mimic the consolidation of the hotel industry thirty years ago?

1.2 Research Objectives

Timeshare is a very complex product involving multiple disciplines in order to be successful including real estate, hospitality, finance, sales and marketing, and travel. It has to be promoted, sold, and serviced over a life time. This paper will attempt to convey three objectives. The first is to synthesize the pertinent aspects of the timeshare industry in order to establish a framework for those readers unfamiliar with the industry. The second objective is to investigate and analyze the key reasons why brands have begun to dominate the industry and analyze the

competitive advantage that they have over the smaller independent developers. The third and final objective is to conclude the findings of the study.

1.3 Organization of the Study

The main sources for this thesis are industry executives representing independent and branded timeshare developers as well as published data on the industry. The thesis consists of four chapters. Chapter one outlines the main objectives and general framework for this thesis. Chapter two begins by describing the history and characteristics of the timeshare industry. It then explains the different timeshare products and avenues for exchanging timeshare intervals. The key disciplines of sales and marketing, finance, and legal framework are also described in detail. Chapter three explores the five key areas which offer brands competitive advantages over independents. These areas are: credibility/quality/ brand awareness; financial and economic advantages; sales and marketing; liquidity and flexibility; and consolidation. By analyzing these areas in detail, the author will attempt to demonstrate whether or not brands will eventually dominate the timeshare industry. The fourth and final chapter will summarize the findings of the thesis.

2. THE TIMESHARE INDUSTRY

2.1 History

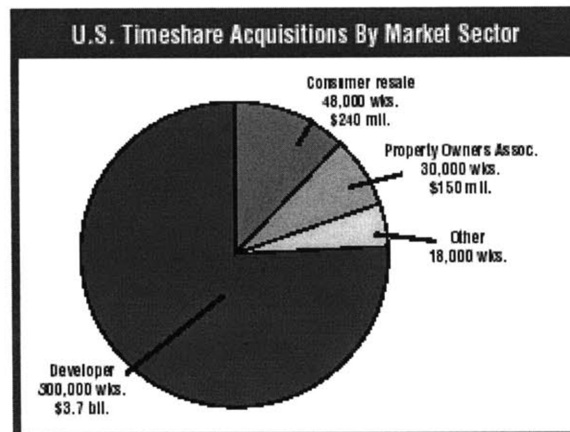
According to Steve Minor of RCI Consulting, the concept of timeshare began in the 1960's at a ski resort in the French Alps. The first development in the United States occurred in Florida during the late 1960's as a response to a glut of overbuilding and consequently underperforming assets. By converting these developments into time share intervals that could be sold as intervals, consumers were able to affordably purchase unsold inventory while netting developers and property owner's substantially greater profits than outright sales. A major concern in the early days of the industry was a consumer resistance to vacationing in the same time and in the same place each year. This problem was successfully addressed by the formation of two primary exchange programs in the mid-1970's that created liquidity for the intervals that could be exchanged at other affiliated properties around the world.

Early timeshare products were often converted motel or hotel properties of poor construction, which along with high pressure and unethical sales tactics contributed to a bad reputation for the industry as a whole. The establishment of The American Resort Development Association (ARDA) along with stricter state legislation has brought a degree of discipline to the industry, although it still suffers today from earlier unsavory practices. The entry of national and international brand name hospitality companies in the past ten years have helped to reshape and invigorate the industry by making it more competitive, quality-conscious, and creative(ARDA, et all). Brand participants have also added a high degree of consumer awareness and confidence for timeshare products along with product innovation, flexibility, and greater perceived value. Because of the bad impression many people have of timesharing, timeshare developers have developed other names for timeshare projects, such as "Vacation Ownership" or "Fractional Ownership".

2.2 Industry and Consumer Characteristics

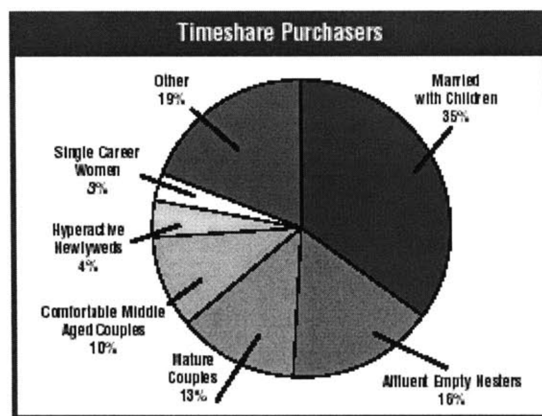
Timeshare and vacation ownership in its short thirty year history has evolved into the most rapidly growing and creative segment in the real estate industry. Between 1980 and 2001, annual world-wide sales volume grew from $490 million to an estimated $6.5 billion, representing compound annual growth of over fourteen percent (ARDA, etal). The U.S. is the leader in the worldwide vacation ownership resort market, with over 1,800 resorts and over 3 million vacation owners. This stupendous growth has been fueled by the acceptance of timesharing by the public and the abundance of wealthy baby boomers with disposable income to spend on vacations (Ragatz, Richard). As the breadth of time share offerings and visibility increases, the opportunities for future growth and market penetration remain strong.

The following facts are based on a study[1] conducted by RCI Consulting in April 2000. For the purchaser, the primary advantage for owning a timeshare versus a second home is affordability. According to the study, timeshares purchased from developers average $13,300 per week of annual use; $11,700 if resales purchased from property owners associations and other sources are included. Since 1978, prices have escalated at a rate of about four percent a year, or roughly the same as the rate of inflation.



Source: RCI Consulting, 2000

Purchases from developers continue to represent the most important sector of the market for U.S. timeshares. Purchases of new timeshares from developers accounted for about 300,000 U.S. timeshare weeks a year, during the study period[1]. This totals about $3.7 billion in volume. There has been an increase in non-developer transactions, mostly resales by property owner associations, consumer-to-consumer, or transferred as gifts or inheritances.



Source: RCI Consulting, 2000

As an aggregate profile, the typical vacation owner is an upper-middle-income, middle-aged, well educated couple. Seventy percent of U.S. vacation owners have incomes over $50,000, sixty-eight percent are fifty years of age or older, and sixty-five percent are college educated.

The largest percentage of timeshare purchasers are married couples with children still at home. These household types account for thirty-five percent of all timeshare purchasers. They

are followed by affluent empty-nesters (sixteen percent), mature couples (thirteen percent), comfortable middle-aged couples, (ten percent), hyperactive newlyweds (four percent) and single career women (three percent). The above statistics are based upon Looking Glass Cohorts®, an innovative system for classifying U.S. households.

Timeshare vacationers have a median income that is eighty percent higher than all U.S. households. They stay longer in the destination, nine nights on average, compared to the average resort hotel stay of five nights. Most timeshare owners travel with family and/or friends, an average of four people per party. Timeshare owners and their guests spend an estimated $4.4 billion annually in U.S. resort areas on their timeshare vacations.

Timeshare owners also pay more than $1.2 billion in annual maintenance fees, which positively impacts the local resorts and their communities. These dollars pay employee salaries and purchase supplies and services for the resort. Owners also pay an estimated $250 million in local property taxes, which help sustain local schools and other services (ARDA etal).

According to ARDA, Florida is the single-most preferred state by Americans for a recreational property purchase. The next five most preferred states are Hawaii, California, Colorado, North Carolina, and Arizona. Of more than 2,653 U.S. vacation owners surveyed, over eighty-five percent claimed to be very satisfied with their vacation purchases.

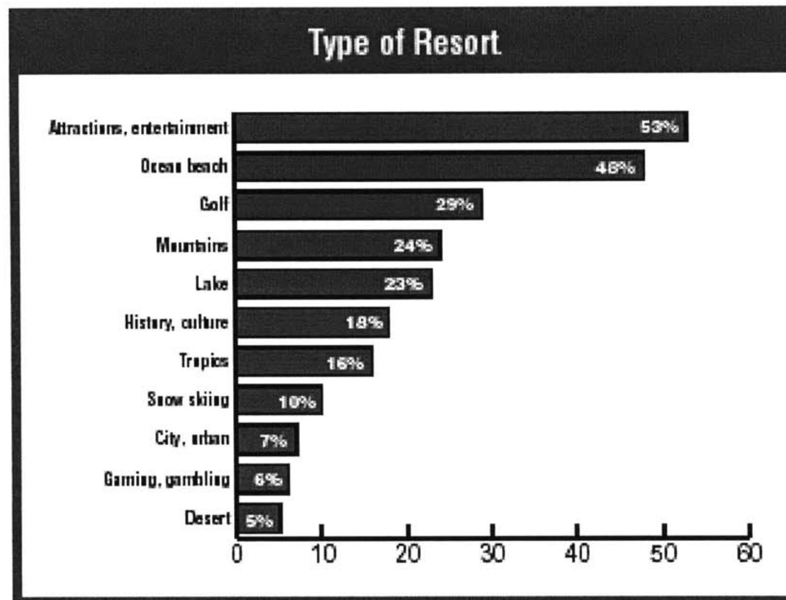
Most important among the motivational benefits cited by U.S. owners in their decision to purchase vacations were the flexibility offered through vacation exchange opportunities, followed by being able to save money on future vacation costs, and finally the high quality accommodations of the resorts at which they own.

Approximately two percent of all U.S. households own a timeshare interval, representing more than 1.9 million households (Ragatz, Richard). Of these households, about 1.5 million have incomes over $50,000. Intuitively, if one looks at all households in the U.S. with incomes over $50,000 (30 million) and assumes a 10% penetration rate, this represents a remaining 1.5 million households. If we then multiply this by the average number of weeks purchased of 1.8 by the average interval price of $11,700, we come up with a potential $36 billion of sales (Curran, Bill). If we assume a twenty percent penetration rate, then there is a potential $72 billion of sales. The current world market sales in 2001 were less than $7 billion. Expansion possibilities are huge.

2.3 Design and Development

Current planning and design of timeshare projects are characterized by creative and quality conscious developments. Consumers demand from their interval purchases a higher perceived value, particularly in the visible aspects of design such as amenities, architecture, interiors, and landscaping. All successful projects are designed around a central theme that differentiates the resort from competitors and typically include some form of entertainment or attraction as a core development feature. In addition, plush landscaping on large community grounds conveys a strong sense of place and enhances the vacation experience. Outdoor

amenities such as pools and health and fitness facilities are also important (Scoviak-Lerner, Mary).



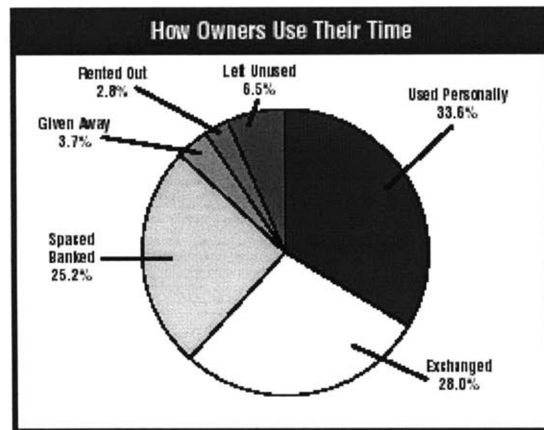
Source: RCI Consulting, 2000

According to the RCI study[1] conducted in April 2000, attraction and entertainment-oriented resort areas, such as Orlando, Branson, Las Vegas and Gatlinburg, rank top in sales (fifty-three percent). Ocean beach areas run a close second, followed by golf, mountains, and lakes. Many resorts include multiple amenities. There is a rising trend to construct successful urban projects in major metropolitan markets, such as Marriott Vacation Clubs Custom House re-development in downtown Boston Massachusetts.

Timeshare projects have characteristics that are similar to hotels and traditional condominium projects, but also differ in many ways (Minoug, Jack). They are more similar to condominiums as they include multiple bedrooms, full kitchens, and balconies. They also include a substantial interior package, with high end furnishings, multiple televisions, high speed internet access and cordless phones. Unlike hotels, maid service is weekly instead of daily. Check ins are also more concentrated in timeshare since most turnover happens weekly versus single day stays in hotels. Timeshare projects, like hotels, include a central facilities building for check in and guest services, activity and food areas, and a central reservation system. The values of units are affected by the number of people that the unit can accommodate. Common configurations are studios and one to three bedroom units ranging between 900 and 2,400 SF. Hotel rooms are usually less than 400 SF and do not include any of the above features.

Another common feature is a lockout unit (ARDA etal)). In a lockout unit, the floor plan of the unit allows the unit to be divided into two subunits, each of which can be occupied separately. Typically, a two-bedroom lockout unit usually splits into a hotel unit and a one-bedroom unit. The lockout feature greatly increases one's flexibility in using the unit. For

example, in a year one could occupy the unit as a full two-bedroom unit. In another year, if there were fewer people in their party, one could decide to occupy just the one-bedroom portion and deposit the hotel unit with an exchange company and rent it or use it as currency to facilitate an exchange or upgrade to a better resort.



Source: RCI Consulting, 2000

Timeshare intervals owned by consumers are occupied ninety-four percent of the time, which far exceeds typical occupancy of resort hotels (about seventy percent). When they don't use their units themselves, timeshare owners exchange them, give them to friends or relatives or rent out their time. High timeshare occupancy rates result in strong year-round utilization, which reduces seasonal fluctuations in employment in the local resort communities (Callaghan, Dave).

In addition to the initial purchase of a timeshare interval, owners are required to pay a yearly maintenance fee that maintains the quality and future value of the resort. Maintenance fees are used to pay an operating company to manage the property, replace furniture, fixtures and equipment, and maintain the properties common areas and amenities. Maintenance fees are levied based on the size of the unit, interval of use, and are shared by all owners (Minouge, Jack). Due to the fact that timeshare units are large and handsomely decorated, occupied more often and for longer periods, and common areas and amenities are large and elaborate, maintenance fees are relatively high and can range from $500 per week to $1,200 per week on average. Sometimes, one time assessments are necessary to pay for large capital items such as a new roof or mechanical system. An issue that is a deterrent to the industry are rising maintenance fees. Often when a timeshare project is being sold, the developer subsidizes the fees until sell out. Later, since the fees were artificially low in order to attract more buyers, the maintenance fees accelerate to the surprise and dismay of owners. They have no choice but to pay (Minouge, Jack).

By building a timeshare development in phases, it allows the seller to build and sell at the same time, relieving some of the financial burden and increasing profitability (Grissius, Tim). Therefore, phasing is a critical element in timeshare development. The development has huge sunk cost in the beginning with traditional hard and soft costs, main pool complex, and other amenities. However, in large projects that have multiple attractions such as golf courses and

elaborate landscaping and grounds, these components can be built in phases as intervals are sold. For example, when Marriott built its 510 room Cypress Harbor Resort in Orlando Florida, it did it in five phases of 100 units a phase. According to Grissius, It took them approximately six years to build and five years to sell out. By phasing the project, they were able to increase profitability by internally financing the construction from the sales revenue. Conversely if they chose to do it one phase, they would have to carry all of the fixed costs and subsidized maintenance fees until the units were sold. Phasing also allows for a smoother sales and marketing process that keeps demand high.

The main cost components for a timeshare development are capital construction costs, marketing and sales expense, overhead, and profit margin. Estimates of the proportion of unit sales price attributable to each cost factor vary by source, but most people agree that product costs account for twenty-five to thirty percent of unit sales price; sales and marketing about fifty to fifty-five percent; administrative costs about ten percent; and gross profits fifteen to twenty percent (ARDA, etall). The above figures vary greatly depending on size, efficiency, financial capacity, and nature of the developer. This will be discussed in greater detail in Chapter three.

2.4 Timeshare Product Types

While all timeshare programs provide you, as the owner, a right to occupy a facility for a given period (usually one week every year or every other year), there are many differences in how this is done. Timeshare products have evolved from the original fixed week purchase. Flexibility and exchange opportunities are the main drivers of these product innovations, allowing consumers the opportunity to vacation in different locations at different times of the year at even shorter interval stays. The main characteristic of the innovations are the ability to monetize the interval and make it as flexible as possible to serve the consumer effectively (Burlingame John). In today's marketplace, fixed and floating intervals represent approximately half of all products sold, but points and vacation clubs are starting to dominate the industry. The following section discusses some of the major variations among timeshare programs.

Fixed, Floating and Rotating Weeks

Fixed, Floating, and Rotating weeks are the original time share products and together make the most common timeshare purchase.

In a fixed week system, the occupancy right is for the same week, and usually the same unit, every year. For example, if a timeshare ownership were for week twenty-five in Unit 180, one would have a guaranteed right to occupy Unit 180 for the twenty-fifth week of every year. As can be expected, some weeks are more popular than others; this is usually reflected in the purchase price of the timeshare unit (www.timeshare.com).

In a floating week system, one has the right to use a unit during a specified period (the "float" season or "flex" time), but one must contact the resort to reserve a specific week during the float period (Noonan, Jeff). A floating right is useful if one doesn't want their usage restricted to a given week every year. Since all other owners that share a float period can reserve

any time during that period, one must make reservations far in advance or could lose the opportunity to lose their interval that year.

A few timeshare projects use a rotating week system. In this type of program, usage weeks change from year to year on a fixed schedule. For example, with a three-year rotating schedule, in year one your usage might be for week six, in year two your usage would be for week thirty-two, and in year three your usage would be for week fifty-two. In Year four, the cycle would start over again with week six. Rotating weeks allow all owners an opportunity to use the resort during the most popular periods (Noonan, Jeff).

Vacation Clubs

Vacation clubs are another timesharing variation. A vacation club is an organization that owns multiple timeshare properties in different locations. Vacation clubs are the vehicle most commonly used by the largest developers in the industry whose long term strategy involves developing multiple projects (Weitz, Stephen). Vacation clubs allow developers to bring consistency and quality to their customers exchange experience, capture additional sales from existing customers, and develop a targeted marketing network for marketing projects at offsite locations. Marriott Vacation Club is the largest vacation club in the world with fifty-seven resorts.

If you are a club member, you can reserve space at the various resorts that are part of the club in accordance with club rules. You pay annual fees, and there is an initial cost to join the vacation club. Club memberships can usually be bought, sold, or passed to heirs. There can be different levels of membership, with some membership levels receiving higher priority in reserving certain units or having access to larger units. Sometimes memberships may be associated with a "home" resort, with club members receiving priority in reserving space in their "home" resort (www.marriottvacationclub.com).

According to McMichals, ownership of properties included in a club are usually structured in one of two ways: the developer (or its successors) owns the properties, with the club having access to the properties via a contractual relationship with the owner. The developer transfers ownership of the properties to the club after they are built. In this case, the properties would be owned by the club collectively and not by members individually. If one's club membership also gives one a fractional ownership in the club, then you will own the properties indirectly through the club. In either case, if the club ceases operations, you can easily lose your right to use the properties without compensation. In some clubs, the properties are placed into a trust that owns the properties on behalf of the club members. This arrangement provides some added security to the club members if the club ceases operations.

Points Programs

In a typical points program, one joins the program by purchasing a membership. One then receives a specified number of points every year, with the number of points received established by the terms of the membership purchased. One can then exchange these points for accommodations at the resorts that participate in the points program. One also must pay an

annual fee for upkeep and maintenance; the amount of the fee will usually depend on the number of points one owns (Callaghan, Dave).

As with vacation clubs, most points programs offer multiple resorts in where weeks can be reserved. The number of points required to obtain accommodations will usually vary with the accommodations selected. Factors influencing the number of points required for your requested accommodations include: the popularity of the resort; the size of the accommodations; the number of nights of occupancy; the specific nights requested (weekend and holiday nights usually require more points per night than do mid-week nights); and the season of the year (Callaghan, Dave).

Some points programs also sell different types of points, with the more valuable points having higher priority in reserving accommodations during peak demand periods. Most points programs will allow you to accumulate points over two or more years, so that you can trade to a larger unit or more popular resort if you are willing to travel less often. Some points programs will also allow owners to occupy a resort for less than a full week at a reduced number of required points.

Recently, some points programs have started allowing members to redeem their points for other travel related services, such as airline tickets and automobile rentals (Burlingame, John). Frequent traveler programs operated by travel companies such as airlines and hotel chains have established tie-ins with timeshare points programs to further extend point generation and redemption opportunities.

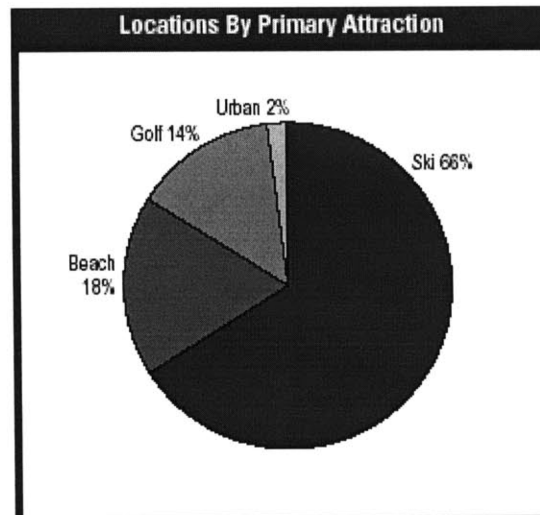
Points programs can be run by a program operator, or can be part of a vacation club timesharing program. Disney's vacation club is based on a points system. Recently, some exchange companies have started developing points programs to combat the vacation clubs popularity (Noonan, Jeff). This will be discussed in further detail in chapter 3.5.

An important concern with points programs is the long-term "value" of points in reserving accommodations. If the program operator is able to increase the number of points required to reserve units at participating resorts or to obtain other services, the value of points will erode, and one may be forced to purchase more points to be able to continue to reserve the units desired. Points represent the most liquid ownership option and maximum flexibility.
It is appropriate to think of points in terms of a foreign currency. Every time you make an exchange, you lose some value due to commissions and sales costs. As points are monetized, there is a drag that decreases the exchange value (Burlingame, John).

Fractional Ownership

Fractional interests are the selling of resort real estate in intervals of more than one week of use per year, but less than whole ownership. Typical fractionals are for 1/12 ownership. High-end fractional interests, often known as "private residence clubs," typically offer an array of services and benefits similar to an elite private country club, with the added benefit of owning luxurious vacation accommodations. Compared to other segments of the resort industry, it is still very small. According to a study[2] done by RCI Consulting in April 2002, sixty-one high-end

fractional interest projects have been identified in the United States, Canada, Mexico and the Caribbean, with twelve in the planning stages. However, this sector is expected to experience rapid growth in the future. A major attraction of this product is that 2/3 of all owners pay for their intervals in cash with no financing. Most are in western ski areas, but golf, oceanfront, and urban locations are increasingly popular. Because fractional products range between $150,000 and $250,000 per interval with management fees ranging between $25,000 and $40,000, the market is limited to only the wealthiest consumers



Source: RCI Consulting, 2002

2.5 Exchange

Perhaps the most attractive aspect of timesharing is the ability to exchange a timeshare week for a week at a different timeshare. In this way, one can use their timeshare week to obtain vacation accommodations at different times and locations throughout the world. Exchange companies are companies that act as a clearinghouse for timeshare owners to exchange their weeks for weeks at other timeshare resorts.

The exchange concept was pioneered by two companies in the mid 1970's that still dominate the industry today. The industry consists of two large exchange companies, Resort Condominiums International (RCI) and Interval International (II), and a number of smaller, independent exchange companies. Generally, the independent exchange companies operate without affiliation agreements; hence their designation as "independent" exchange companies. Some of these independent companies, such as "Better Vacations" do have affiliation agreements with some resorts and can operate in both modes.

According to Jeff Noonan of RCI, "affiliated" exchange companies are exchange companies that establish formal relationships with resorts to manage exchanges involving that resort. When a resort affiliates with an exchange company, the exchange company will include the resort as a member resort in its materials (such as a resort catalog). The developer usually

establishes this affiliation when the resort is constructed, since the developer will use the exchange benefits to help sell the timeshare units at the resort.

As noted previously, RCI and II are the two principal timeshare exchange companies that operate primarily as affiliated companies. Since their affiliation arrangements provide much greater access to timeshares, these two companies are by far the largest exchange companies. Both RCI and II are pivotal in creating the exchange value for member resorts (Minor, Steve). Both companies inspect and rate resorts based on a simple rating system, then assign a certain value to the resort that determines exchange value. Included in this rating system are resort amenities, size and quality of units, and overall appeal. A high rating becomes a key selling point for the resort due to the high value that the intervals will have on the exchange market. For example, RCI's highest distinction is the "RCI Gold Crown Resort" (Noonan, Jeff). At the time of this writing, RCI had 3,700 affiliated resorts with over three 3 members and over 2 million confirmed exchanges in 2001. II is smaller with 1,900 member resorts, two million members, and 700,000 confirmed exchanges in 2001(www.timeshares.com).

Most exchange companies charge a fee for each exchange completed. Many, including RCI and II, also charge an additional annual membership fee to participate in their exchange programs. There may be some exchange companies that charge a fee to join or to list timeshares, but do not impose a fee for exchanges. As might be expected, exchange companies regularly increase their fees. In 2001, average owner membership fees were approximately $90 annually, and average exchange fees were $120 (Noonan, Jeff).

Methods

The three primary methods for exchanging timeshare are through a direct exchange between owners, by directly exchanging through a resort management group or vacation club, and finally exchanging through an exchange company (Noonan, Jeff, www.rci.com).

The simplest exchange approach is to find a timeshare owner who is interested in exchanging his or her week for your week. Each of you then notifies your respective resort that the other owner will be using his or her week at that resort.

Another exchange option occurs when your timeshare ownership is part of a vacation club that includes multiple resorts in different locations. In these arrangements, one can exchange their week for a week at another resort within the group. Many timeshare management companies that operate resorts in different locations offer this type of exchange service as part of their management services. In some vacation clubs, this is the only way that you can have a week assigned to you.

The most common exchange method is through a timeshare exchange company (www.rci.com). To do this, one "deposits" their week with the exchange company. As other owners deposit their weeks (and as resorts deposit unsold weeks with the exchange company), the exchange company builds up an inventory of weeks that are available for exchanges. The exchange company then makes available to you weeks from its inventory that the exchange company considers comparable to your deposited week. The exchange company thus serves as a

clearinghouse for people making exchanges. As a result, direct exchanges among owners almost never occurs.

Exchange value is an important concept to understand for successful timeshare exchanging. Both internal exchange programs and exchange companies generally operate on the basis of exchanging timeshares of like value. This practice is what prevents the owner of an off-season studio apartment at an undesirable location from exchanging that unit for a three-bedroom oceanfront suite unit in Florida during Christmas week (Callaghan, Dave).

According to David Callaghan of II, the highest exchange values are associated with weeks that are from resorts in prime locations (high demand and limited supply), that are for usages during peak demand periods, and that are deposited with exchange companies well in advance of the use period. After meeting these basic criteria, additional value can be created by resort size, resort rating and amenities, and affiliation with a name brand. However, if the week does not meet the first three basic criteria, it will probably have reduced exchange value even if the other factors are present.

2.6 Sales and Marketing

The biggest deterrent to successful timeshare developments are the high sales and marketing costs. As previously noted, these costs are the most of any development budget and represent between forty percent and fifty-five percent on average of the interval purchase price. Since timeshare is an unsought good and buyers are widely dispersed, there is a high cost to generating demand and bringing prospective owners to the product (Curran, Bill). According to industry insiders, the key to the timeshare business is effective lead generation and sales. A "lead" is a prospective owner that is attracted to the project and participates in a tour of the project. Despite these high costs, a successful development can support them and still make a substantial profit, not including financing profit, which will be discussed in further detail in chapter 2.8.

Marketing Techniques

Timeshare is relatively complicated to the uninformed consumer and still suffers from a negative perception. To interest people in attending a sales presentation, the sales program usually includes financial incentives. The incentives typically include items such as gift certificates or discounts on accommodations. Therefore, in order to sell the product, developers uses a number of high cost strategies to target consumers. Some of the more prevalent methods include the following (Minoug, Jack):

Box Programs: Boxes are placed in high traffic locations and offer a prize typically from a sweepstakes drawing in exchange for a name, address, and telephone number. Box programs are inexpensive, but do not accurately target consumers and lead to a low percentage of closings.

Direct Mail: This method generates a predictable amount of leads, but its cost effectiveness varies with the quality of the mailing list, collateralized material, and incentives offered in the mailing which generates a response.

Telemarketing: "Cold calling" is a primary method of generating leads, as well as follow up calls on other sources of marketing.

Mini-Vacations: A mini-vacation is a short vacation offered to consumers at a very low cost. It is designed to let potential owners experience the resort property and its amenities. A low key sales effort is also part of this strategy. This method is a very successful lead generation technique, but it is limited to available inventory at participating resorts.

Off-Premises Contact (OPC): OPC employees locate at high traffic areas and offer incentives to potential buyers if they agree to tour a given resort. OPC is a cost effective approach and can be successful, but it requires intensive management and its image can be construed as negative by the public.

Affinity Marketing: A timeshare developer forms a strategic marketing relationship with another branded company or organization and then targets prospective owners at events or at partner locations. For example, Bluegreen Vacation Club Ownership has a marketing program with NASCAR that targets the middle income segment. Bluegreen representatives operate booths at NASCAR events as well as advertise on collateralized material to attract customers. This method can be effective, but it is typically expensive and works best with larger timeshare developers that can spread costs among multiple projects.

Database Marketing: This method involves sorting through databases and segmenting highly correlated prospects through thousands of entries. Major credit card companies such as Visa or American Express may sell a list of members who have purchased golf club memberships in the past year to a developer who is building a golf oriented timeshare project. A lot of companies sell database lists, but they are relatively expensive compared to other methods. However, "targeted" cold calling does have a higher response rate than regular cold calling.

Referrals: Asking satisfied customers to refer their friends, typically in exchange for some form of consideration or gift, is inexpensive and yields a high closing rate.

Reloads: Reloading is selling intervals to existing timeshare owners. This method is extremely effective since the prospective buyer is informed and is satisfied with the product.

Internet: The Internet and other high-tech marketing does not now but will eventually play a large roll in timeshare marketing efforts. The internet allows for targeted and expressly tailored electronic media to be sent to prospects with the required demographic characteristics. As the internet becomes more of an everyday tool, it will become an effective way of generating qualified leads (Brown, William).

The timeshare industry, through exhaustive surveys and review of member characteristics, has refined the best prospects that are most likely to purchase timeshare intervals. As demonstrated in chapter 2.2, an abundance of demographic data exists that helps target marketing efforts and ultimately reduce these costs.

Lead Generation

According to Bill Curran, typical closing rates for the industry average about ten percent, which can fluctuate depending on the season and attractiveness of the product. Closing rates among companies are similar because timeshare typically requires the same amount of time involved in educating prospective buyers. The rescission rate for the industry on average is about twenty percent, which is attributed to buyers having second thoughts after signing a contract at the sales presentation. The above figures relate to qualified prospects who state an interest in the project. The actual lead generation process for a generic development is much more exhaustive. An example is the best way to demonstrate this. Suppose a sales and marketing team contacts 10,000 people, either through direct mail, telemarketing, or a combination of the two and achieves a ten percent response rate. Of the one-hundred interested people, ten percent buy an interval. Since rescission for the industry is approximately twenty percent, the actual confirmed sales are eight. If the project has one hundred units and sells fifty-one intervals per unit (5,100 total intervals), then the sales and marketing team must contact 6,375,000 families/individuals to sell out the project.

Typical sales practices today, in an attempt to limit rescissions and better the image of timeshare, are more relationship driven and do not involve hard sales tactics (Curran, Bill). Sales and marketing teams focus on providing customers with information, encouragement, and making them comfortable with the concept of vacation ownership, rather than pushing and over promising. Branded companies who have their reputation and other business lines at stake are especially sensitive to this (Minor, Steve). There are still some unsavory industry practices today that bring down the image of timeshare, but these instances are rare.

Resale

Resales occur when a non-developer owner of a timeshare week sells his or her week to another party. Sellers include private individuals, brokers that carry timeshares in an inventory, and resorts or homeowner associations that have acquired timeshare units at their resort (ARDA, etal).

Resale value of timeshare intervals is only a fraction of the price originally paid to the developer (Headrick, Christina). On average, fifty percent or more of a developer's sales price represents the cost of the developer's sales and marketing program. A private individual can not do the same things a developer does to stimulate demand for their week. Also, there are almost no financing sources for the resale market. Because there are many more people trying to resell their timeshares than there are people looking to buy them, the resale market is generally a buyer's market. As a rough guide, resale prices more closely reflect the cost of the unit absent the sales and marketing program, or roughly fifty percent of the new sales price (ARDA, etal). Because there is no central clearinghouse for resale prices, one cannot estimate a resale price based on past sales.

Resale prices for a few timeshare units have held above this level; these are usually top quality resorts in locations with high demand and limited supply, such as Disney and Marriott

properties (Grissius, Tim). In many cases, these resorts also operate repurchase programs to maintain higher resale values. Conversely, some timeshare units are essentially worthless.

The lack of resale value is a big problem in the industry and needs to be addressed in order to stimulate more demand. The absence of financing for resales will make it difficult to fix this problem. When considering the purchase of a timeshare property, one might want to search for an appropriate resale property before committing to a new development.

2.7 Legal

Ownership Structures: Deeded Interest and Right to Use

The majority of developments convey a deeded interest of the interval to the buyer. Most deeded programs divide ownership of each unit into specific week increments, and as a buyer, you actually purchase a fractional ownership of the unit for a particular week (McMichals, Elisabeth). The deed is recorded with the local governmental agency (such as a County Recorder or Assessor) as with regular residential purchases. A deeded property offers the highest degree of ownership security since the buyer is a part owner of the property; if the property manager becomes defunct, one will still own his or her share of the property. With a deeded property the owners of the intervals collectively own the resort. When the resort is first opened, the developer owns the weeks and, hence, controls the project. As the developer sells timeshare intervals, the developer's ownership level declines, and control of the property usually transfers to the owners.

The right-to-use program is the second most common form of ownership. Because many foreign countries either prohibit or severely limit foreign ownership of real estate, a right-to-use program may be the only way to successfully develop a timeshare project internationally. Another major reason for this ownership method is if the developer does not own the land underneath the development. In a right-to-use program, the buyer receives the right to use the unit for a specified number of years. At the end of that period, the usage rights revert to the property owner (McMichals, Elisabeth). Usually one can sell, donate, or bequeath a right-to-use contract, but the expiration date will remain the same.

In a right-to-use program, the developer typically controls the property even after all of the intervals are sold and usually retains the right to sell or transfer the property, including the timeshare program, to a third party. The developer may also be able to unilaterally change aspects of the timeshare program, increase annual fees, or impose special assessments. Owners of right-to-use intervals may have little or no ability to prevent or influence such actions by the developer or operator and may have little or no ability to force changes in property management and operations (McMichals, Elisabeth). In addition, if the resort closes or the operator becomes defunct, one might lose their right-to-use without receiving any compensation. Since the price of a right-to-use unit declines sharply as the expiration dates approaches, some right-to-use units can be purchased very inexpensively on the resale market.

Homeowners Association

As part of the process of establishing a timeshare project, the developer creates a set of legal documents describing the operation of the resort and the timeshare program. These documents are generally referred to as the "Program Documents" (McMichals, Elisabeth). For a deeded property, the program documents are usually in the form of Codes, Covenants and Restrictions (CCR) that attach to the ownership of each timeshare interval and are binding on all owners at the property (including subsequent purchasers). For a right-to-use property, the right-to-use contract will either contain the program documents or will incorporate them by reference.

In a deeded property and some right to use properties, a Homeowners Association (HOA) is created and has overall responsibility for managing the property in accordance with the program documents, including setting annual fees and levying special assessments. As an interval owner in the resort, one automatically becomes a member of the HOA and has the right to cast a vote in all matters requiring a vote of owners, including electing a Board of Directors to govern the association. The Board of Directors will usually hire a resort management company to operate the resort. Often, the resort manager is the developer (McMichals, Elisabeth).

State Legislation

Timeshare legislation is governed on the state level. Most state laws were enacted to protect consumers as a response to earlier unsavory industry practices. ARDA has established a code of ethics that is loosely followed by the industry. All timeshare projects must be registered and approved with almost every state that it intends to be sold. Forty of the fifty-two states require this. In California, this process takes up to one year. This adds another layer of complexity and time to the development process. Most timeshare purchase contracts contain a rescission (or "cooling off") period, during which a buyer may unilaterally cancel the contract and receive all proceeds back. Typical rescission periods are seven to fifteen days (ARDA etal).

Some state laws are extremely unfriendly to timesharing and may make any developments quite difficult (McMichals, Elisabeth). For example, in Louisiana, the 1985 timeshare act makes new timeshare development nearly impossible. It requires that developers place $1,000 in escrow for every interval that is intended to be sold, and the state holds such funds for one year after sell out of the entire project. In addition, a state chartered bank is required to be the escrow agent for the developer, a reluctant task.

On a national level, the most influential bill that, if passed, will negatively effect the timeshare industry is the organization of a possible national do-not-call registry (Schlaifer, Alan). The Federal Trade Commission (FTC) has proposed major changes to its telemarketing sales rule (enacted in 1995), which will create a national registry that prohibits telemarketers from contacting any person that does not wish to receive solicitations. This could have major ramifications to the timeshare industry since a large portion of total sales involve some component of telemarketing. The FTC's "Do Not Call" (DNC) proposal has many hurdles to pass before it is enacted and given the size and importance of the telemarketing industry, it is widely believed that the proposal will be watered down if it is passed. It is speculated that the DNC proposal may go to the commission for approval by mid 2003.

2.8 Finance and Economics

Developer

Timeshare development is an incredibly profitable business which generates profits ranging between three to five times normal profits from a regular real estate sale. These ranges are influenced by a multitude of factors, but primarily financing and sales and marketing expenses. Most industry insiders refer to making money from timeshare in three ways: development profit, financing profit, and operating profit (Burlingame, John). As a rule of thumb, profits average sixty percent from development, thirty percent from financing, and ten percent from operations.

Development profit is the primary source of revenue for most developers. It is generated from selling timeshare intervals. A simple example comparing a timeshare sale of a typical resort property in Orlando, Florida, to an ordinary condominium sale for the same property type illustrates this (Burlingame, John). Assume for simplicity that a timeshare unit is sold for an average purchase price of $13,000 per interval for fifty-two intervals in a year. Average construction cost are thirty percent of the sales price, sales and marketing costs are forty-five percent, general and administrative costs are five percent, and operating profit is twenty percent.

Item	Amount
Average purchase price of $13,000 for 52 intervals	$676,000
Construction cost – 35% of sale price	$236,600
Sales and marketing – 40% of sale price	$270,400
General and administrative – 5% of sale price	$33,800
Operating profit – 20% of sale price	**$135,200**

Now assume a traditional real estate sale for the same property. Assume an average purchase price of $350,000 per unit. Average construction costs are the same as the above example. Sales and marketing costs are nine percent of the sale price, general and administrative expense is five percent, and operating profit is 18.4%.

Item	Amount
Average purchase price of $350,000 per unit	$350,000
Construction cost – 68% of sale price	$236,600
Sales and marketing – 9% of sale price	$31,500
General and administrative – 5% of sale price	$17,500
Operating profit – 18.4% of sale price	**$64,400**

The above example shows an operating profit of $135,200 for the timeshare development, more than two times the $64,000 profit generated in a traditional sale

The majority of timeshare buyers finance their purchases. There are virtually no financing options for consumers other than financing through the developer. Because most banks and financial institutions steer away from financing individual timeshare purchases due to its complexity, bad reputation, and lack of residual sale value (Thiesen, Don). According to ARDA, approximately eighty-five percent of all purchasers pay a deposit between ten and twenty percent of the purchase price and finance the remainder over a five to ten year period with seven being the average. Typical fixed consumer interest rates on developer loans range between twelve and fifteen percent. Financing profit is substantial depending on the spread between the developers cost of funds and the interest rate charged to the buyer. All timeshare companies, both public and private, book the full value of the sale up front despite the fact that the majority of timeshare sales are financed (Grissius, Tim).

The final profit center for timeshare is in operations or management. Most timeshare developers act as the property manager until sellout at which time the home owners association takes control of the project. The HOA often will contract with the developer to manage the property. Typical management fees are a fixed percentage of the projects operating budget, typically ten percent (Minoug, Jack). Additional operating revenues are earned from food service and other amenities that act as profit centers. As will be discussed in chapter three, hotel properties are often located on the same grounds as timeshares which allows for management/operating efficiencies as well as the cross utilization of restaurants, golf courses, and other services.

Hypothecation and Syndication

Timesharing for the average developer is a cash negative business with heavy outflows during construction and sell out, and profit taken out toward the end of the projects (Simon, Jon, Fisher, Tom). A developer must sell far many more intervals for a project than a regular condominium development to generate positive cash flow. Typical down payments average ten percent of the purchase price, but developers incur roughly fifty percent of the unit sale price in sales and marketing costs at the time of the sale. Unless they have deep pockets, developers must sell the receivables or borrow against future sales in order to bridge the gap. Most developers remedy this by a process called hypothecation.

When a developer hypothecates his receivables, he pledges the receivable as collateral to a bank or other institution or lender in exchange for a percentage of the face amount of the note (Thiesen, Don). The bank loans the money to the developer, typically $0.90 on the dollar, at a certain interest rate and the developer in turns loans the money out to the purchaser at a higher interest rate. At the time of this thesis, average hypothecation loans to developers were at ten percent with consumer loans at fourteen percent. The developer guarantees the notes or "paper" until they are paid off. Since there is a large spread between the developers cost of funds and the cost to consumers, a seven year note might be paid off in four and a half years, at which time the receivable is transferred back to the developer. Average default rates on receivables vary widely depending on which source one talks to, but defaults range between twelve and twenty percent

depending on the target market (Hooker, John). The developer is required to do all of the credit checks on the purchasers, with most developers providing financing for almost anyone. Developer profits can be gravely affected as the incidence of defaults increase and he has to re-sell intervals in order to make up the shortfall to the lender (Minoug, Jack).

A typical sell out for an average one-hundred unit complex built in phases is approximately five years, so developers may have to wait many years until they start to make a profit from the development. The above process is fairly typical for independent and midsize developers. They strive to keep some of the receivables in house to increase their probability. Typically, the same bank or institution that finances the acquisition or renovation of the project provides the hypothecation loan since without it, the project would not have the funds to sell the rest of the intervals. Depending on the development and target audience, timeshare purchasers pay larger down payments or pay the entire amount without financing. For example, only forty-five percent of Marriott's timeshare purchases are financed (Hooker, John).

Most large developers and branded hotel companies do not have to hypothecate their receivables in order to bridge the cash shortfall of their projects. They have the financial capacity to warehouse their own receivables and gain massive returns from the large spread in capital costs. A trend in the past five years that has become hugely popular and profitable is syndicating the receivables. This process is similar to the corporate mortgage backed securities market (CMBS), where based on prioritizing cash flows and ratings by the rating agencies, the receivables are tranched and sold to institutions or conduits (Hooker, John). The costs of the rating agencies and investment banks are substantial, so only issues over $50 million are practical and are only applicable to the largest timeshare developers. This will be discussed in greater detail in chapter 3.3.

Consumer

Timeshare purchases are difficult to justify purely on a financial basis. Even without a detailed example, this conclusion is intuitive based on two reasons: fifty percent of the purchase prices is attributed to sales and marketing cost on average, and resale values are up to fifty percent lower than purchase prices (Weisz, Stephen).

One could argue that the price is inflated compared to a traditional vacation home since fifty percent of the purchase price goes toward paying sales and marketing costs for the timeshare interval compared to five to ten percent of the owned home. However, a traditional vacation home is far too expensive for most consumers and does nor provide them with the same flexibility or carefree ownership that timesharing does.

As discussed in chapter 2.6, timeshare resale values are typically half of the original purchase price due to the lack of an established secondary market, consumer financing, and high sales and marketing costs. There are some instances where timeshare intervals have appreciated over their original purchase price. This was the case at a Ritz Carlton development in Bachelors Gulch, Colorado. This ski oriented project had high demand due to its slope side location as well as lack of competing products due to a stiff permitting process and lack of developable land. The development sold out prior to completion and the high demand and lack of supply has yielded

price appreciation of approximately twenty percent (Weisz, Stephen). However, industry insiders agree that this case is not typical and that the vast majority of timeshare intervals sell for less than the original purchase price for the above reasons.

A simple example illustrates the economics of timeshare from the consumer perspective and allows for a comparison to traditional rental properties (Curran, Bill). For simplicity, we will look at the lost opportunity cost sunk into the purchase as well as annual fees connected to ownership. We will assume a seven percent before tax return on the purchase price if it was invested in a traditional investment portfolio. Consider the following timeshare purchase: purchase price of $13,000, annual maintenance fees of $500, exchange company membership at $120 per year, unit exchanged every other year with an exchange fee of $120 per exchange, after tax return on investment income of seven percent.

Item	Amount
Opportunity cost associated with purchase price, 7% of $13,000	$910
Annual fees	$500
Exchange company membership	$120
Exchange fees, $120 every other year	$60
Estimated Total Annual Cost:	**$1,590**

Using this approach, we can compare the $1,590 estimated total annual cost with the cost of renting similar accommodations in the area of the resort, as well as accommodations in other areas in which one would like to vacation. The above example assumes an outright purchase of the timeshare, whereas most timeshares are financed at typical interest rates between twelve and fourteen percent. If we assume that we pay as a deposit ten percent of the $13,000 purchase price and finance the remainder over seven years at 14%, then using an eight percent discount rate we can calculate a present value of $15,400. This increases the opportunity cost of annual ownership to $1,708.

Comparing the above example to renting a condominium at a similar resort, one finds that the costs are comparable on an annual basis. Renting a two bedroom condominium during a desirable time period can easily approach $1,700. However, renting has some profound advantages. Renting involves a one time fee with no future obligations to vacation at the same property, especially if cash is tight. In addition, renting does not require a capital commitment up front nor does it require additional maintenance fees and interest payments as the property ages. Conversely, renting does not offer the same non-monetary advantages that timeshare ownership offers.

Industry insiders concur that based purely as an investment, the return is marginal. According to Stephen Weisz, " In the timeshare business, you're not selling real estate primarily as an investment opportunity, you're selling a product that people can enjoy...timeshare enables the public to obtain better quality vacations for less costs in the long run." However, timeshare is not just based as an investment, but is based on many non-monetary factors such as: greater flexibility than associated with renting; consideration that owning a timeshare forces you to take

vacations that you might otherwise defer; the certainty of knowing that one will be able to stay at a resort that one likes since the interval is owned; larger and fully furnished accommodations; and other vacation exchange opportunities such as cruises. As mentioned earlier, ones ability to exchange their interval depends on the value of their interval, therefor, one typically needs to purchase a top resort during a desirable season in order to achieve the greatest range of exchange options (Curran, Bill).

Since there is less than two percent penetration rate in the United States, perhaps the economics need to become more compelling to be accepted by a greater percentage of the public.

3. Brands and Independents

3.1 Introduction

As demonstrated in chapter two, timeshare is a complex process with many disciplines and moving pieces that need to function together in order to make it work effectively. The industry has evolved to meet consumer demand of flexibility and physical product offerings to fit all ranges of consumer tastes and expectations. Timeshare has emerged from its early beginnings of dominance by small independent entrepreneurs and developers to becoming an important driver in the lodging industry, accounting for approximately ten percent of the leading hoteliers revenue such as Starwood, Marriott, and Hilton (Fuller, Jack).

Now part of the mainstream, the demonstrated profitability and complementary nature of timeshare to the major brands only solidifies their desire to grow and take control of the industry. The brands want to capture as much of the consumers lodging business as possible (Rowe, Megan). According to ARDA, of the 400,000 or so intervals valued at $4.5 billion sold in the United States in 2001, approximately twenty-five percent were sold by brands and seventy-five by independent developers. However, according to a report by Thomas Weisel Partners, sixty-five percent of total revenue or approximately $3 billion in sales were generated by the four dominant brands in timeshare: Centedent, Hilton, Starwood, and Marriott. This shows that although independents are selling more intervals, the brands are generating more revenue from their products due to higher prices and greater margins. The thesis author has determined that there are five key areas, all pivotal to timeshare, which will demonstrate the success and competitive advantages of brands over independents. Chapter three will explore these five areas with a focus on the advantages that brands have over independents, making comparisons between the two where appropriate in order to support the argument.

3.2 Brand Awareness and Credibility

Most industry insiders attribute the success of timeshare in the past ten years due to the entrance of the large branded leisure companies that have entered the market. Consumers today value the brands that they have come accustomed to and the promise of quality and reliability that comes with it. Consumers look at brands as a way to make safe choices, especially those skeptical of timesharing's early negative image (Weisz, Stephen). Overall, they would rather choose a brand name rather than a less well known product. For the same reason, brands are unwilling to risk their hard earned brand equity on marginal products or sales practices that could lower their brand perception and reputation. Timeshare represents a new revenue stream that allows the company to further leverage existing brand equity and profitability.

According to Stephen Wiesz, president of Marriott Vacation Resorts International (MVRI), both brand recognition and the Marriott reputation are pivotal to instilling confidence in the company's staying power and ability to fulfill its commitment of providing quality service and successful timeshare developments.

Hyatt has grown slowly compared to some of the other brands who entered the industry in the mid 1990's. At the time of this writing, Hyatt had only seven locations with three more

locations in the design/construction phase. Hyatt has chosen high barrier locations and quality developments because they deem their brand and reputation the most important to their long term success. Also, Hilton is a private company so unlike its public counterparts, it does not have to drive earnings to satisfy industry analysts and shareholders (Burlingame, John).

Four Seasons decided to get into the timeshare industry due to the high recognition of their brand name and the premium it could charge for its product and the perceived value of quality and service that it is known for. Four Seasons has seen the lines blur between their residential product and timeshare products and believe that they van better service for the consumer and drive profits by servicing both (Marsan, Joan).

The quality of construction by the brands has raised the bar for the entire industry. Independent developers average twenty percent for construction costs as a percentage of sales price, while brands product construction costs run at an average of thirty-five percent. This is attributed to the fact that brands answer to higher standards than the average developer and choose high barrier locations. Brands maintain higher margins than industry averages despite their higher product costs by getting a premium of up to twenty percent for their intervals and achieving vast savings on sales and marketing costs (Weitz, Stephen).

Brands have not only benefited themselves, but raise the tide for the entire industry, including independents. Having big names in the industry marketing and developing the timeshare products helps validate the concept to consumers (Malley, Mike). Some independents have been in business long enough and provide a quality product, that even though they are not a national brand, they become an accepted "brand" in their own market. Many independents have been successful and will continue to be successful by targeting specific regions and by building their names through sophisticated marketing techniques (Nash, Craig). Independents have also come together to form their own regional brands and vacation clubs such as Pacific Monarch Resorts and Royal Resorts in order to combat the national brands. This strategy allows independents to convey the value added benefit of having multiple resorts in its "club" while creating credibility and legitimacy to consumers.

Another trend that is in its infancy in the timeshare world is franchising. For example, the Carlson Companies, owner of the Radisson brand among others, has partnered with an independent timeshare developer to provide marketing support and timeshare developments using the Radisson brand name (Burns, Rick). Franchising is a tricky proposition in timesharing because brands need to be assured that brand standards and sales and marketing practices are in line with their existing lodging strategy. Most large branded companies have no desire to franchise their products for the above reason and will continue to grow organically or through acquisitions (Weisz, Stephen).

There will always be a place for niche or "boutique" independent developers in timeshare since high barriers to entry as well as size of projects make certain developments unappealing to the brands, yet still appealing to consumers. However, independents will face major challenges in executing their sales goals due to the volume and name recognition that brands have brought to the marketplace.

Hybrid Products

Once viewed as cannibalizing hotel guests, locating timeshare developments alongside traditional hotels or resorts has become common practice. One benefit of combining hotels and resorts is the opportunity to leverage the hotels existing amenity base (Nash, Craig). Hospitality brands view locating hotels and timeshare products together as complementarily rather than a competitively. In many ways, there are physical, functional, and economic advantages to locating the two property types together (Grissius, Tim). From a design and amenity standpoint, there is a greater base of owners and hotel guests that generate more revenue and thus can support more elaborate designs and amenity packages that contribute to consumer satisfaction as well as the salability of the timeshare units. Expensive golf courses and multiple pools and spas can be supported and used by both hotel guests and consumers that would otherwise be economically unfeasible if supported by only timeshare or hotels. There are also great staffing and facility synergies by combining the two, especially since timeshare check ins typically take place on one or two days a week. Timesharing typically runs at high occupancy year round and provides a stable base of customers for restaurants and other resort amenities which are typically located within the hotel complex and suffer during the off seasons (Rishell, Paul). In addition, timeshare owners have already prepaid for their vacation, making it more likely for them to spend money on entertainment and restaurant facilities.

Another huge benefit of locating hotels and timesharing together are huge cross marketing and lead generation opportunities, which will be discussed in chapter 3.4.

3.3 Finance and Economics

Chapter 2.8 introduced the three main profit centers from timesharing: development, financing, and operations. It is appropriate to discuss each profit center regarding the advantages that brands have over independents.

Development

The advantages that brands have over smaller, less capitalized independents is obvious: cheaper access to funds, higher leverage levels, the ability to raise public debt or equity, and bulk purchasing power. Marriott Vacation Club International (MVCI) is an excellent example of this. MVCI is a$1 billion dollar company with over $100 million in annual revenues. It could easily operate on its own, but it would have a cost of capital of approximately ten percent rather than its current cost of funds of seven percent. As part of Marriott International, MVCI can easily get financing from the public markets on the strength of Marriott International's balance sheet, fund its development projects internally, and use high leverage ratios (Grissius, Tim). MVCI is able to leverage off of the bulk purchasing power of Marriott International to acquire construction materials and unit case goods at very favorable prices. Starwood and Hilton's timeshare division share the same competitive advantage as MVCI. Due to high brand value and quality conscious developments, brands have been able to charge up to a twenty percent premium for their intervals over less known independent projects.

Independents, on the other hand, have a very difficult time accessing capital for their projects. On the main street level, there are only two large commercial banks that lend money to timeshare developers, Textron Financial and Heller Financial (bought by General Electric). Finova bank was a capital source until its bankruptcy last year. Historically, regional and local banks have been hesitant to get into timeshare lending due to its complexity and bad reputation. In today's market place, independents ability to obtain project financing is based on five factors: equity, experience, location, balance sheet, and size (Thiesen, Don).

Independents are required to put up a large portion of equity in the deal, typically twenty-five percent or more. Timeshare developers must demonstrate a successful track record in timeshare, especially regarding sales and marketing. Most novice timeshare developers are locked out of the market unless they affiliate with a qualified sales and marketing company that will coordinate the sales effort for the project. This is problematic since sales and marketing cost have the strong possibility of killing the project if the projected sell out occurs slower than forecasted. The development must be in a desirable location with barriers to entry as well as a "driver" such as a ski resort or tourist destination in close proximity. Ultimately, the developer will guarantee the loan to the institution, so the strength of his balance sheet is important. Typical financing is also full recourse debt. Most developers also finance their receivables with the same bank and the developer guarantees the hypothecating notes until they are paid off. Due to the risks associated in timeshare financing, banks will only lend up to ten to fifteen million in today's market, requiring independent developers to find multiple financing sources (Thiesen, Don).

Despite all of the above requirements, independents do find financing for good projects with a lot of hard work and knocking on a lot of doors, but the interest rates and required terms are hefty (Curran, Bill). Typical developer financing averages above ten percent with lots of additional fees and net worth requirements for the lead developer.

Financing

The main competitive advantages of brands over independents are their greater spreads in consumer financing and their ability to shed risk and raise capital through syndicating receivables.

As mentioned earlier, the majority of timeshare purchases are financed by the developer of the project. Financing profit is based on the spread between the developer's cost of funds and the interest rate charged to the buyer. At the time of this writing, cost of funds for the brands were averaging seven percent and ten to eleven percent for independents (Hooker, John). Typical consumer loans average fourteen percent interest rates and seven-year terms. Brands are playing with a seven hundred basis point spread versus the independents three hundred. This varies based on the size of the down payment and the amount of the loan (Thiesen, Don). Purchasers of high-end fractionals, which are greater than one week intervals, with an average price of $250,000 pay much lower interest rates.

As discussed in chapter 2.8, most independent developers must hypothecate their receivables in order to bridge the cash shortfall from the sales and marketing costs recognized at the time of the sale. These developers also must guarantee the receivable until it is fully paid off and only profit from the financing portion during the last few years of the life of the notes. Brands have a key advantage since they are well capitalized; they have the option to warehouse the loans and benefit from huge spreads in their cost of funds, or syndicate the notes on Wall Street. Securitization allows the brands to shed risk associated with receivables by syndicating them with limited guarantees, and raise funds early in the lifecycle of the timeshare development that can be used for constructing the later phases of the development or new timeshare projects (Grissius, Tim).

Since 1992, there have been approximately forty timeshare securitization deals. Expansion of timesharing, along with timeshare collateral being fairly attractive versus other real estate asset-backed securities, is helping to lead to further securitization in the industry (Musero, Frank). Average deals range from $100 to $200 million and thus lock the small players out. An example of a typical securitization deal is one done by Starwood in June 2001. The syndication raised $200 million in proceeds backed by an underlying pool of receivables with a principal balance of $225 million. The offering featured four classes or tranches, each with fixed rate coupons, and an average life of approximately three years.

According to John Hooker, vice president of capital markets for Marriott, the securitization of MVCI receivables is a profitable business that generates double-digit returns using leverage. Marriott warehouses receivables from its various timeshare projects until it gains a critical mass for securitization. It then has the securities rated and tranched by Moodys or Standard and Poors. Marriott international guarantees certain portions of the debt in the given tranche to provide additional security to buyers and to ensure the largest portion of the receivables are rated investment grade. As with traditional CMBS, the better the rating, the lower the interest rates. In other real estate securities, cash flows are stripped from the receivables and are paid in a waterfall or sequentially to the highest rated tranche and downward. Marriott acts as the servicer on all of its deals and receives any residual values. Typical defaults on the receivables average ten to twelve percent on Marriott's deals, although lower grade receivables can average up to twenty percent. The higher the default rate, the higher the interest rate demanded by investors. Mainly, conduits and commercial banks purchase timeshare asset backed securities.

Independents have a higher cost of outside funds and a lower degree of flexibility due to their heaver reliance on lenders for acquisition and receivable financing. Independents also must be liable for all payments and cover any defaults on the receivables.

Operations

Brands do not have a competitive advantage over the independents in operations. Management fees are fairly standard at ten percent of the projects operating budget for both independent and brand management companies. Management fees are generated from the maintenance fees paid by interval owners. Rising maintenance fees have been a problem in the industry since the costs of maintaining heavily used timeshare projects with multiple amenities

have become more expensive (Weisz, Stephen). It is common to have maintenance fees low at the onset of ownership, often supplemented by the developer, only to have the fees rise over time. Sometimes, there are one-time assessments for large capital items such as a new roof.

Brands do have a competitive advantage over independents by driving timeshare guests to other profit centers within their resort developments (Marsan, Joan). By locating timeshare projects in a larger resort structure, brands are able to achieve greater profits at their golf courses, spas, restaurants, and other amenities. Also, timeshare has a high year round utilization and drive revenue even in the off season.

3.4 Sales and Marketing

Many developers, both big and small, have said that the key to the timeshare business lies in sales and marketing and lead generation. Ones ability to sell the project in the allotted time frame at the set price structure determines the profitability of the project. Sales and marketing costs typically are the biggest component of the total sales cost, ranging between twenty-five percent and sixty percent. Brands are at the lower end of the cost of sales with independents at the higher end. Since timeshare is a sought after good being marketed to a wide audience, these costs can quickly eat away at the profits. Sales and marketing is a huge quality control issue and thus most large companies and brands keep this in house.

The main competitive advantages that brands have over independents in this area are their ability, through cross marketing techniques and leveraging off of brand equity and membership clubs, to generate qualified leads and sales substantially cheaper than independents. Brands have at their disposal more targeted sales approaches that produce a higher penetration rates than other traditional methods such as cold calling or direct mail (Burlingame, John). The overlap of brands' existing sales and marketing efforts makes reaching prospective buyers less expensive. Also, since the brands have a large pipeline of projects and active developments, they are able to keep their sales staff in house, dedicated and more efficient.

Brand hotel customers are primary targets for vacation ownership products. Sales desks, information packets, monetary gifts in the form of membership points, and advertising on hotel television stations are effective ways of marketing timeshare. When a brand builds timeshare as part of or near one of its hotels, the proximate location as well as shared use of amenities facilitates effective marketing. Hotel guests stay at the resort and if they enjoy their vacation experience, it is easier for them to buy a vacation ownership product. Other cross-marketing partnerships with airlines, cruises, rental car agencies, and credit card companies can be effectively used to target probable timeshare buyers. These relationships are coveted in the industry and are only available at the highest scale to the largest branded lodging companies (Brennan, Kate).

Many of the brands, including Marriott, Hyatt, and Hilton, have linked their membership rewards programs to their timeshare programs (Burlingame, John). Membership rewards programs allow members to earn points for each night's stay at a brand hotel which can be redeemed for stays at any of their other brand hotels in the world. By linking this program with their points based vacation club or timeshare product, the brands have made timeshare owners

customers for life. Members earn points that can be used toward upgrades, additional services, or fees toward their timeshare owned product by staying in branded hotels during business or vacation trips. Brands can also use their huge database of hotel members to effectively target prospective timeshare buyers based on their stays at various hotels and resorts (Powell, Laura). Marriott's membership rewards program is the largest in the world with over fourteen million members. This development is a key competitive advantage that the brands have over independents that makes branded timeshare more attractive than independent products.

At Marriott, approximately forty percent of total sales are generated from existing Marriott timeshare owners. At the time of this writing, Marriott was the second largest timeshare company in the world with fifty-two active resorts and over 210,000 vacation owners world-wide. "Bigger is better" since a larger ownership base means more sales to existing owners, which is far cheaper than selling to new, uneducated buyers (Weisz, Stephen). Marriott also offers its vacation club member's huge referral fess, in the form of points, for successful referrals that buy Marriot timeshare intervals.

As mentioned earlier, congress is mulling over a new telecommunications bill that will allow consumers to choose whether or not they want to be contacted by telemarketing companies or solicitors. This will have huge implications for the timeshare industry since virtually all sales approaches involve some form of telecommunications. The bill, however, does not apply to solicitations to consumers that companies have a prior relationship with. This bodes well for the largest players with a existing membership databases and name recognition. As telemarketing legislation becomes more relevant, brands will have a huge advantage over others since their brand equity and database of millions of hotel guests will allow them to contact potential timeshare buyers (Curran, Bill).

Segmentation

A true signal that the timeshare marketing has become sophisticated is the tendency to design and market timeshare products based on specific price points and services. Creating value by "segmenting" the timeshare market place with different product offerings at certain prices depending on location, size, and quality has become a common practice in the industry (Baumann, Michael). For example, Bluegreen Corporation and Shell Vacations have established their marketing niche by targeting middle-income customers who desire a high price to value ratio. Marriott is the master of segmentation in the timeshare industry with four products that are targeted toward four distinct markets. By affective marketing as described above as well as targeted product offerings, Marriot is able to keep sales and marketing costs well below forty percent of the sales price on average.

Marriott's strategy is to stratify the market by product demand from different consumer groups and then design and sell products to cater to specific needs (Weitz, Stephen). Marriott first got into the timeshare industry with one product, Marriott Vacation Club International (MVCI) in 1984. Since 1984, MVCI has grown from one resort to fifty-two locations in North America, Asia, Europe, and the Middle East. The core MVCI product was at the upper end of the price range for timeshare intervals due to their superior quality, amenities, and locations. Because many prospective timeshare buyers could not afford MVCI, Horizons By Marriott

Vacation Club (HMVC) was created to target the middle market. The middle market segment is the largest timeshare owner by buyer type. The Horizon timeshare units are twenty-five percent smaller than the MVCI units, of lesser quality, and in second tier locations. There are currently three Horizon properties (Vacation Industry Review).

The third Marriott timeshare product, the Ritz Carlton Club, was developed as a luxury-tier real estate product combining the benefits of second home ownership with the personalized service and amenities that are the hallmarks of The Ritz Carlton Hotel Company. It is a private club offering luxury accommodations in exclusive enclaves around the world (Rishell, Tim). There are currently three properties in the club located in St. Thomas, U.S.V.I., Colorado, and Florida. The newest Marriott timeshare offering, the Marriott Grand Residence Club, is a fractional ownership product combining the advantages of second home ownership with the service and amenities of a fine resort. Intervals for this product will be one month long and there is currently one property located in Lake Tahoe, California, under development.

Independents

Although independents do not enjoy the same resources or tools available to the brands, there are effective ways for them to target consumers and market their timeshare products. As with any development, picking a great location with high barriers to entry and limited competition is a strong recipe for success. Independents have also been successful with targeted affinity marketing with strategic partners, as described in chapter 2.6. (Minoug, Jack).

There will always be a market for niche locations with high barriers to entry. Independents can take advantage of their local knowledge and reputation to get projects permitted and developed that are otherwise unappealing to branded companies that do not have the patience to deal with local politics. This strategy drives sales and marketing costs lower since consumers will seek this project instead of the traditional heavy marketing strategy. Pre-selling before the development is built is also possible.

Urban locations with strong tourist traffic patterns are also very successful timeshare projects. Urban projects allow the timeshare property to support itself through heavy hotel revenue while intervals are being marketed and sold. In fact, these projects typically do not employ dedicated sales people but have the concierge and reception desk double as the sales and marketing arm. This strategy produces much slower timeshare sales, but at a fraction of the price. These savings in sales and marketing costs are past on to consumers in the form of lower interval prices. Overall, profitability is unaffected because the project remains profitable due to heavy hotel revenue and high margins due to lower marketing costs (Curran, Bill).

Affinity marketing with strategic partners has also proven to be effective for independents to market their projects. Affiliating with local businesses and services is a strong way to generate consumer interest at reasonable costs. For example, Westgate Resorts of Florida is involved in a marketing project with the Florida Marlins and Peachtree Resorts operates information kiosks at four local malls (ARDA, etal).

Despite the fact that brands are more effective and efficient at sales and marketing, their close rate is virtually the same as the independents. The industry as a whole has an average closing rate of approximately ten percent, not including rescissions. This is attributed to the fact that consumer awareness of timeshare is low and they must be educated about the industry in order to buy. Once prospective buyers take a tour and listen to a sales presentation at a given project, the playing field is equal between brands and independents (Curran, Bill).

3.5 Liquidity and Flexibility

Vacation Clubs

Most brands like Marriott have organized their timeshare efforts in the form of vacation clubs which offer members the greatest value and flexibility compared to independent developments. Vacation clubs pursue the long term strategy of servicing their customers through multiple, geographically diversified resorts managed by one entity which allow members to exchange intervals and other leisure services within their own system. Vacation clubs strive to achieve high member satisfaction and create a feeling of exclusivity and sophistication. Vacation clubs perceive buying a club membership as an entire vacation experience rather than just a lodging facility (Disick, David, Van Der Ploeg, George).

Branded vacation clubs offer members their own portfolios of timeshare properties, world-wide branded hotels, exchange opportunities through RCI or II, as well as the most flexible system for using their intervals. The extreme flexibility is due to the use of a point based system or currency to purchase or exchange intervals and other services (Burlingame, John, Weisz, Stephen).

For example, the Hilton Grand Vacation Club (HGVC) is a point based system. Club members purchase a deeded interest in a property that has an equivalent point value. The point based reservation and exchange system enables members to select alternative ways to exercise their ownership allowing for maximum flexibility. Members can choose to use their points to receive maximum value and flexibility by vacationing during less desirable weeks, staying in smaller units than originally purchased, or taking shorter vacations. The points system allows Hilton to sell less than a one week interval, making timesharing more affordable for younger audiences. Conversely, additional points can be purchased to add a couple of days onto a vacation (www.hgvc.com).

HGVC members can exchange points in three ways. Members may use points to vacation at any of their twenty-six resorts, composed of five Hilton Grand Vacation Clubs and twenty-one affiliated Hilton resorts. Exchanging through the vacation club is free to members and offers them the greatest exchange value. Members may also convert their HGVC points to Hilton Honors Points and redeem them for stays of any length at Hilton Hotels, airline tickets, cruises, car rentals, casino chips, etc. Hilton Honors points are awarded to members of Hilton's Hiltons rewards program when they stay at Hilton hotels or use partner services. The final way for members to exchange points in through RCI's network of over 3,300 resort destinations

around the world. RCI charges a fee for their exchange services and offers the least value for points compared to the HGVC internal system (www.hgvc.com).

As was discussed earlier, the downside to points is that as they are used or monetized, processing and selling expenses decrease their value. Also, as newer resorts are built, points needed to purchase intervals are increased, costing more money to vacation (Minor, Steve). Disney, Marriott's, and Starwood's Vacation clubs are similar to Hilton's.

It is interesting to note that all branded vacation clubs still affiliate with either RCI or II despite their own large internal portfolio of properties. The main reason for this is that all vacation clubs lack the distribution and balance needed to satisfy members exchange choices and demands (Grissius, Tim). For example, the majority of MVCI's fifty-two resorts are located in warm climate areas with only two ski oriented locations. On its own, MVCI can not satisfy demand of their 210,000 members who might want a ski-oriented vacation in a given year. By affiliating with II and its thousand of affiliated resorts, MVCI members have a far greater chance of exchanging their interval for a ski vacation. It should be noted that up until July 2002, MVCI was a minority owner of II. Affiliating with either RCI or II is an important marketing feature for buyers.

Because most of the vacation clubs are of higher quality and represent the largest customers for both II and RCI, branded resorts receive the highest ratings, thus allowing members the highest "currency" or trading value for their exchanges. Members also receive preferential treatment over independent interval owners.

Exchange Networks

For independents, the only way for them to compete with vacation clubs are by affiliating with an exchange company, typically RCI or II, or by affiliating with other independent developers to establish their own vacation club (Curran, Bill). Consolidation among independents will be discussed in chapter 3.6.

On the surface, exchange companies level the playing field between brands and independents. Exchange companies make the concept of timesharing work by acting as a clearinghouse, processing owner's desires to exchange their intervals with other intervals around the world. The ability to exchange intervals in their projects for intervals around the world is the main marketing pitch by the independent developers. RCI and II have become brand names in the timeshare industry, partly based on the services they provide and partly based on the huge marketing budgets spent targeting developers, interval owners, and the general public.

RCI and II are huge profitable businesses. They charge a fee to developers for rating and agreeing to list their property in their network and they charge interval owners an annual membership fee ($130) which allows them to exchange their properties. Exchange companies also receive a fee for processing an exchange ($130) or receive a commission (thirty three percent of each nights rent) for renting an interval.

Exchange companies are not regulated and research has shown that independent projects and interval owners are not always treated fairly. For example, as part of its services, II is supposed to try to exchange an interval on behalf of the interval owner up to two months before the interval date. If unsuccessful, II is authorized to rent the interval to outside parties. According to Bill Curran, who is an independent developer with multiple resorts in the New England area, II has taken intervals out of the "exchange pool" that he has deposited for exchange and tried to market them months before the two month trigger date. Curran reasons that since II receives 1/3 of the rental fees if they rent the interval versus a flat $130 fee if they execute the exchange, II is motivated by the additional money.

Curran also reasons that both II and RCI rate all resorts based on a scale from A to D. The brands and newest resorts are all rated A or B, and smaller, independent developments are rated C or D. This makes it nearly impossible for a D rated property to be exchanged for an A or B rated property. Thus, the claims that independent sales and marketing teams give to prospective buyers that they can exchange their interval for anywhere in the world is not necessarily true. Curran also states that both RCI and II give preferential treatment to the large brands since they produce the most revenue for the companies.

Another independent development that has gained prominence in the industry as a way to combat the brands is the development of a "points based system" controlled and monitored by the exchange company RCI. Up until this development, independents were locked out of the points market since the points concept does not really work with a single or few resorts. The RCI points system allows independent interval owners to convert their intervals into points and then use this currency to purchase leisure related services such as airline tickets or car rentals as well as take more flexible, shorter vacations (McCown, Nance). The RCI point system has gained critical acclaim by independent and small developers and has translated into additional sales (ARDA, etal). As of April 2002, there were 150,000 RCI points members and 400 participating resorts (www.rci.com).

However, this new development may have negative repercussions for participating resorts and developers. Since RCI controls the exchange network and point values for all intervals, it has the ability to raise the points needed for exchanges. In order to successfully exchange their interval for a higher valued interval, one would have to purchase additional points from RCI to execute the exchange. Presumably, RCI would get to keep the additional funds without sharing them with the owner of the intervals or developers (Curran, Bill).

Despite the discussion above, most new timeshare owners perceive their ability to exchange their interval through RCI or II as motivation enough to purchase timeshare interval. As mature owners try to exchange their intervals and experience some of the difficulties described above, it becomes apparent that a branded vacation club is the best option.

3.6 Consolidation

Consolidation is a natural trend for any business as it matures, especially one as complicated as timeshare. Consolidation leads to efficiencies in all areas. There are three

underlying reasons for consolidation in the vacation ownership industry besides the most obvious and compelling reason, benefits from brand recognition (Crawford-Welch, Simon McMullen, Edwin). First, in order to take advantage of the popularity and profitability of point based products, a company must offer multiple resorts in multiple locations. Second, larger companies benefit from lower costs and higher margins associated with buying power, lower marketing expenses, and the more efficient use of owner bases. The third and final reason are the vast financial advantages larger, more stable companies have over smaller independent companies, particular in the cost and access of funds.

Many timeshare companies have already been purchased and the majority of brands have either acquired or started their own timeshare companies or divisions. Rapid industry growth in the mid 1990's resulted in the establishment of eight public companies. The market capitalization for these companies grew from $370 million in 1996 to $3.4 billion in 1998. A string of disappointing earnings and failed growth expectations as well as stock market volatility caused market values and stock prices to decline sharply, closing the door for other IPO's. Of the original eight public companies, four have been acquired by brands (Fairfieled, Trendwest, and Equivest were acquired by Centedent; Vistana was acquired by Starwood), one filed for bankruptcy (Sunterra), and three are still public (Bluegreen, Mego, and Silverleaf) (Fuller, Jack).

Many large companies chose to buy their way into the industry while others chose to grow organically. Starwood entered the timeshare arena by purchasing a public company, Vistana, in early 2000 rather than growing "one resort at a time" at a much slower pace. It was easier for them to purchase the expertise and infrastructure of Vistana's management and combine it with Starwood's resources and brands to create substantial value (Dela Cruz, Tony). Through consolidation, Centedent Corporation has surpassed Marriott International as the largest timeshare company in the world. Centedent purchased Fairfield Communities and Trendwest Resorts in 2000 and 2002 respectively, representing a combined eighty-six properties with over 475,000 members. Centedent also owns RCI, the largest timeshare exchange company in the world, as well as Equivest Financial, a timeshare marketing and consulting company. Centedent's strategy is to grow these companies and their profitability through economies of scale and huge cross selling opportunities and efficiencies through its different businesses and huge owner base. Besides timeshare, Cendant owns Avis Car Rentals and Century 21 Realtors, as well as franchises the Days Inn, Howard Johnson, Knights Inn, Ramada, Super 8, Travelodge, Village Lodge, and Wingate Ins (Blank, Dennis).

MVCI chose to grow organically, utilizing Marriott Internationals core competency as probably the best large scale hotel and resort developer in the world, instead of acquiring competitors. MVCI came to this conclusion in the late 1980's after they looked at acquiring other competitors. The main weakness in these acquisition targets were inferior products, weak brands, and weak revenue streams. The only thing that Marriott would be buying was a development pipeline and membership base, which would accelerate earnings, but was not worth the acquisition price. Because of this, MVCI decided to grow internally and by 2002, was the second largest timeshare company next to Centedent (Grissius, Tim).

With the IPO market unreceptive to timeshare offerings, the independent operator will have to either affiliate with a brand or other independent operators to form a broad system of resorts or target a narrow but lucrative niche market (Crawford-Welch, Simon McMullen, Edwin,) in order to compete with the brands. For example, Consolidated Resorts, an independent developer with eleven resorts in Nevada and Hawaii, plans to group all of its properties under the Soleil Resort Flag in order to create awareness of the company's reputation for quality and services as well as to reduce sales and marketing costs (Bauman, Michael). Industry insiders believe this trend will continue.

4. Conclusion

4.1 Summary of Findings

The timeshare industry is complex with many moving parts and disciplines that must work together in order to be successful. It is the fastest growing segment in the hospitality industry with double digit growth over the past twenty years, an eighty-five percent satisfaction rate among owners, and high profitability. Timesharing's early image of deceptive practices and high-pressure sales has been replaced with an image makeover of credibility, convenience, and value. Its new found credibility is mainly due to the entrance of branded lodging companies whose brand equity and reputation for quality and reliability has substantiated the industry in the eyes of consumers. With approximately $4.5 billion in sales in the United States in 2001 and less than a two percent penetration rate, the growth potential is enormous.

This thesis, after building a framework describing and explaining the many characteristics and disciplines of the timeshare industry, concludes that brands will dominate over the smaller independent companies due to five key factors. First, consumers embrace the quality and reputation of the brands and are willing to pay a premium for it. Second, the brands have substantial financial and economic advantages over independents, particularly in their cheaper access to capital, bulk purchasing power, and ability to raise debt or equity using their parent companies' balance sheets. In addition, brands have the key advantage of shedding risk and recycling capital by syndicating timeshare receivables on Wall Street. Third, sales and marketing, arguably the key to timesharing, is more efficient and cheaper for brands due to effective cross-marketing techniques, segmentation, and leveraging off of brand equity and existing members. Fourth, brands have organized their products into vacation clubs which offer their members more liquidity and flexibility by monetizing vacation intervals into points, and by offering multiple exchange methods. Finally, most brands have already entered the timeshare industry either by consolidating with existing developers or growing organically. Consolidation leads to efficiencies in all areas, particularly in lower costs and higher margins.

The independent developer has a much harder time filling up their resorts without help from major travel industry leaders. Independents can compete with the brands through strategies by participating in vacation networks such as RCI and II, becoming niche players, or developing strategic alliances with non-hospitality outlets such as Nascar or regional department chains (Powell, Laura).

The timeshare industry looks remarkably similar to the lodging industry thirty years ago: essentially a cottage industry dominated by independent developers and operators with no critical mass. But the landscape is changing quickly with the entrance of branded companies applying the same brand management and marketing techniques that consolidated the lodging industry and resulted in eight out of every ten travelers preferring branded accommodations regardless of the purpose of their trip (Yesawich, Peter). For the brands, timesharing represents a complimentarily product with demonstrated profitability and synergy with existing operations.

END NOTES

(1) This report is based on 1,846 responses to a survey of randomly selected RCI members who purchased a timeshare located in the United States during the period between May 1999 and April 2000.

(2) Fractionals. This report is based on a survey of resorts/clubs conducted in the first quarter of 2002, and a survey of demographically qualified U.S. households conducted during the first quarter of 2001.

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