We predominantly franchise our brands and manage hotels on behalf of third-party hotel owners. As an asset-light business, we focus on growing our fee revenues and fee margins, with limited requirements for capital. This enables us to grow our business whilst generating high returns on invested capital.

Whether we franchise or manage hotels is largely determined by market maturity, owner preference and, in certain cases, the particular brand. For instance, in more developed markets such as the US and Europe, over 90% of IHG hotels are franchised. These hotels tend to be limited service. By contrast, in emerging markets such as Greater China over 80% of IHG hotels are managed by IHG, where we look after the day-to-day running of the hotel on behalf of the owner. These hotels tend to be full service.

Over time, we expect the Chinese market to move towards a franchised model. We successfully launched the first tailored franchised offer for Holiday Inn Express® in 2016, and have since extended this to include Holiday Inn® and Crowne Plaza®.

Since launch, we have signed over 200 franchise hotels in Greater China, which attract full franchise fees.

Our asset-light business model means that we do not generally employ colleagues in franchised hotels, nor do we control their day-to-day operations, policies or procedures. That being said, IHG and our franchised hotels are committed to delivering a consistent brand experience, conducting business responsibly and delivering our purpose of providing True Hospitality for everyone. See page 28 for more information.

**IHG owner proposition**

We focus on ensuring our brand portfolio, loyalty proposition, systems and expertise provide a rich and distinctive offer that stands out to consumers and is attractive to owners.

To keep our brands relevant to guests and evolving trends, we commit to developing our established brands with new designs, service enhancements and operational support that drive demand and returns, and keeps True Hospitality at the heart of our offer.

**How we generate revenue**

- **Franchised hotels**
  We receive a fixed percentage of rooms revenue following a guest staying at a hotel. This is our fee revenue.

- **Owned, leased & managed lease hotels**
  For hotels which we own or lease, we record the entire revenue and profit of the hotel in our financial statements. Our owned, leased and managed lease hotels have reduced from over 180 hotels 18 years ago, to 26 hotels at 31 December 2019.

**Managed hotels**

From our managed hotels, we generate revenue through a fixed percentage of the total hotel revenue and a proportion of each hotel’s profit.

**Revenue from reportable segments**

Our revenue is directly linked to the revenue generated by the hotels in our system.

- **Franchised**
  614,974 rooms

- **Managed**
  262,253 rooms

- **Central**
  Revenue is principally technology fee income see page 72

  - **Owned, leased and managed lease**
    6,336 rooms

*Excludes System Fund results, hotel cost reimbursements and exceptional items.

**How we deliver value**

- **Franchised hotels**
  We deliver value to our hotel owners through the cultivation of hotel brands, economies of scale, access to shared systems and resources, and centralised marketing activity to drive hotel guest bookings.

- **Managed hotels and owned, leased and managed lease hotels**
  As well as the benefits we deliver through our franchise model, we drive value to our managed hotel owners, and owned, leased and managed lease hotels, by optimising the performance of these hotels.

**Other stakeholders**

As part of our purpose to provide True Hospitality for everyone we believe it is important that we deliver value to all our stakeholders. Whether it is our workforce, hotel owners, guests, suppliers, shareholders or society, we want to create a positive impact on them and the world around us. See pages 24 to 40 for more information.
IHG revenue from reportable segments and the System Fund

**System Fund**

IHG manages a System Fund on behalf of our third-party hotel owners, who pay contributions into it. This includes a marketing and reservation assessment and a loyalty assessment.

The System Fund also receives proceeds from the sale of IHG Rewards Club points under third-party co-branding arrangements.

The System Fund is managed by IHG for the benefit of hotels within the IHG system and is run at no profit or loss over the long-term. In 2019, IHG recognised $1.4 billion of System Fund revenue.

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**Total Gross Revenue**

2019: $27.9 billion. This comprises:

- **Franchised hotels =** total rooms revenue
- **Managed hotels =** total hotels revenue
- **Owned, leased and managed lease hotels =** total hotels revenue

(Only owned, leased and managed lease hotel revenue is directly attributed to IHG.)

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**Fees to IHG in relation to the licensing of our brands and, if applicable, hotel management services.**

- Franchise fees = RevPAR x rooms x royalty rate.
- Management fees = fee % of total hotels revenue plus % of profit.
- Central revenue (principally technology fee income – see page 72).
- All revenue from owned, leased and managed lease hotels.

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**Assessments and contributions are collected by IHG for specific use within the System Fund.**

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**IHG revenue from reportable segments**

2019: $2.1 billion

Revenue attributable to IHG comprises:

- Fee business revenue from reportable segments: in 2019, 72% of our revenue came from franchise and management fees, and central revenues:
  - Franchise fees = RevPAR x rooms x royalty rate.
  - Management fees = fee % of total hotels revenue plus % of profit.
  - Central revenue (principally technology fee income – see page 72).
- All revenue from owned, leased and managed lease hotels.

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**System Fund revenues**

2019: $1.4 billion

The System Fund is not managed to a profit or loss for IHG over the longer term, but for the benefit of hotels in the IHG system, and comprises:

- Assessments and contributions paid by hotels.
- Revenue recognised on consumption of IHG Rewards Club points.

(See page 72 for more information.)

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**Profit from hotel revenues**

After operating costs of sale, our margin by business model is:

- **Fee margin**: 54.1%.
- **Owned, leased and managed lease**: 9.1%.

Not all of our costs can be allocated directly to revenue streams and these are shown as central costs.

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**Key elements of System Fund expenditure**

- Marketing and sales activity.
- IHG Rewards Club loyalty programme.
- Global distribution systems, such as our Guest Reservation System.

For examples of how we have deployed the System Fund in 2019 to support our strategic priorities, please see pages 19 to 23.

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IHG revenue from reportable segments\(^a\) and the System Fund

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\(^a\) Excludes System Fund results, hotel cost reimbursements and exceptional items.

\(^b\) Definitions for Non-GAAP measures can be found on pages 55 to 59. The reconciliation for fee margin can be found on page 216.

\(^c\) The margin for owned, leased and managed lease is calculated from the results related to owned, leased and managed lease included within reportable segments (see page 214 revenue of $573m and operating profit of $52m).
Disciplined approach to capital allocation

Our asset-light business model is highly cash generative and enables us to invest in our brands and strengthen our enterprise. We have a disciplined approach to capital allocation which ensures that the business is appropriately invested in, whilst maintaining an efficient balance sheet.

Beyond this, we look to return surplus cash to shareholders through ordinary and special dividends and share buybacks. Our objective is to maintain an investment-grade credit rating. One of the measures we use to monitor this is net debt: EBITDA and we aim for a ratio of 2.5-3.0x. This is equivalent to our previous guidance of 2.0-2.5x before the adoption of IFRS 16 ‘Leases’.

Dividend policy
The Board consistently reviews the Group’s approach to capital allocation and seeks to maintain an efficient balance sheet and investment-grade credit rating. IHG has a progressive dividend policy and an excellent track record of returning funds to shareholders through ordinary and special dividends, and share buybacks, with the ordinary dividend seeing 11% CAGR since 2003. This is in addition to special returns of funds detailed on page 242. When reviewing dividend recommendations, the Directors take into account the long-term consequences of any recommendation. The Company looks to ensure that any recommendation does not harm the long-term sustainable success of the Company and that there are sufficient distributable reserves to pay any recommended dividend.

For more details on our dividend policy and approach, see pages 4 and 73.
**Disciplined approach to capital expenditure**

Capital expenditure incurred by IHG can be summarised as follows.

<table>
<thead>
<tr>
<th>Type</th>
<th>What is it?</th>
<th>Recent examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintenance capital expenditure, key money and selective investment to access strategic growth.</td>
<td>Maintenance capital expenditure is devoted to the maintenance of our systems and corporate offices along with our owned, leased and managed lease hotels. Key money is expenditure used to access strategic opportunities, particularly in high-quality and sought-after locations when returns are financially and/or strategically attractive.</td>
<td>Examples of maintenance spend include maintenance of our offices, systems and our owned, leased and managed lease hotels. Examples of key money include investments to secure representation for our brands in prime city locations.</td>
</tr>
<tr>
<td>Recyclable investments to drive the growth of our brands and our expansion in priority markets.</td>
<td>Recyclable investments are capital used to acquire real estate or investment through joint ventures or equity capital. This expenditure is strategic to help build brand presence. We would look to divest these investments at an appropriate time and reinvest the proceeds across the business.</td>
<td>Examples of recyclable investments in prior years include our EVEN Hotels brand, where we used our capital to develop three hotel properties in the US to showcase the brand. Over time, we expect to divest our interest in these hotels.</td>
</tr>
<tr>
<td>System Fund capital investments for strategic investment to drive growth at hotel level.</td>
<td>The development of tools and systems that hotels use to drive performance. This is charged back to the System Fund over the life of the asset.</td>
<td>Recently, we rolled out our new pioneering cloud-based Guest Reservation System (GRS), one of IHG Concerto’s comprehensive set of capabilities, which we developed with Amadeus (see page 224). In addition, during the year we made a strategic investment, alongside other large hotel companies, in Groups360 to create an online sourcing and booking solution for meetings.</td>
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