HOTEL CHAIN GROWTH AND THE DEVELOPMENT PROCESS

INTRODUCTION

The conventional wisdom about hotel development is grounded in single venues. The process is designed to reduce risk for capital providers by giving assurance that once developed the venue will be able to attract sufficient demand with a cost structure that will produce the target returns.

As I write this analysis, February 2003, the performance of hotels, particularly in major cities is as weak as it has been since the early 1990's when similar twin depressants prevailed – the first Gulf War and economic recession in multiple countries. Thereafter, hotel chains in the US grew room stock by 50% adding almost one million rooms. During the same period in the UK hotel chains grew by almost 60%. It is opportune, in the midst of the current market downturn, to consider the medium to long-term prospects for the hotel industry in Europe and also to consider how far the development process is keeping up with the progress.

THE EVOLVING STRUCTURE OF THE HOTEL INDUSTRY

GLOBAL OVERVIEW

The only barely credible estimate of the total hotel room stock in the world is provided by the World Tourism Organisation, which estimates 15 million rooms. At Otus & Co we calculate that 4.7 million rooms are affiliated to hotel chains in an uneven pattern as table 1 shows:

Table 1: The Structure of the Global Hotel Industry 2002

Country Region	Total Rooms m	Chain Rooms m	Concentration %	Citizens Per Room	Citizens Per Chain Room
USA	4.27	2.98	70%	67	95
European Union	3.67	0.96	26%	102	393
10 New EU States	0.39	0.06	15%	187	1213
Rest of Europe	0.65	0.06	9%	350	4030
Rest of world	6.02	0.60	10%	887	8900
Total	**15.00**	**4.65**	**31%**	**400**	**1290**

Source: Otus & Co, IHRII and WTO

ECONOMIC STRUCTURES

The global imbalance in the structure of the hotel industry is a function of the imbalance in the structure of economies. We classify economies into five types: experience, market service, citizenship service, industrial and subsistence. The classification is based on a range of measures including GDP per citizen from agriculture, GDP per citizen from industry and GDP per citizen from services; the percentage of GDP from agriculture, the percentage of GDP from manufacturing, and the percentage of GDP from services; the percentage of male employment in agriculture, manufacturing and services; the percentage of female employment in agriculture, manufacturing and services. The structures of the European economies at the end of 2001 were as follows (table 2):

Table 2: European Economic Structures 2001

	Experience Economies	Market Service Economies	Citizenship Service Economies	Industrial Economies	Subsistence Economies
GDP/Citizen Agriculture $	586	582	512	362	185
GDP/Citizen Industry $	8,232	8,583	7,579	1,185	134
GDP/Citizen Services $	19,587	19,894	10,788	1,832	214
Services as % of GDP/Citizen	**69.0%**	**68.5%**	**57.1%**	**54.2%**	**40.2%**
% GDP Agriculture	2	2	3	10	35
% GDP Industry	29	30	40	37	25
% GDP Services	69	68	57	53	40
% of GDP in Services	**69.0%**	**68.0%**	**57.0%**	**53.0%**	**40.0%**
% Males in Agriculture	4	8	8	25	49
% Males in Industry	31	36	37	30	23
% Males in Services	56	56	48	40	27
% of Male Employment in Services	**61.5%**	**56.0%**	**51.6%**	**42.1%**	**27.3%**
% Females in Agriculture	1	3	5	24	47
% Females in Industry	12	19	16	18	16
% Females in Services	80	75	69	51	35
% of Female Employment in Services	**86.0%**	**77.3%**	**76.7%**	**54.8%**	**35.7%**
European Economies	UK	Denmark	Austria	Belarus	Albania
		France	Belgium	Bulgaria	Armenia
		Netherlands	Finland	Croatia	Bosnia
		Norway	Germany	Cyprus	Georgia
		Sweden	Ireland	Czech	Moldova
		Switzerland	Italy	Estonia	
			Luxembourg	Greece	
			Spain	Hungary	
				Latvia	
				Lithuania	
				Macedonia	
				Malta	
				Poland	
				Portugal	
				Romania	
				Russia	
				Slovakia	
Source: United Nations National Accounts				Slovenia	

Presently, there are only three experience economies in the world: USA, Canada and UK, which rate highest in each of these measures while subsistence economies rate lowest.

In subsistence economies the bulk of economic activity is in agricultural and extractive industries and only a minute proportion of the indigenous population are a market for hotels. This is the reason why the small hotel industry in developing countries relies on foreign visitors for its demand. In the industrial economies consumer spending is higher than in subsistence economies and it is concentrated on consumer durables, which with other basic manufactured goods form key elements of the economic output. Leisure activities in industrial economies are more heavily focussed in the home and consumer spending on hotels is relatively limited. Factory production in which higher productivity is achieved through larger size and fewer workers generates limited demand for hotels and that comes mainly from sales and marketing executives. When industrial economies reach a high degree of efficiency the GDP is produced by fewer citizens and manufacturing is progressively transferred to lower cost economies. The emerging economic problems include rising unemployment and a workforce trained in redundant skills. In mature industrial economies a material proportion of the citizens own a range of white goods and brown goods, furnishings, apparel, cars and houses that were acquired during the phase of industrial expansion when the availability of consumer credit also grew. The availability of credit makes the replacement of goods relatively automatic, but a factor in the slowing growth of mature industrial economies is the diminishing marginal returns from the ownership of consumer goods. Once they have been acquired the rate of growth in demand declines to the level of replacement of redundant items.

The solution to the declining contribution of manufacturing to GDP, the rising unemployment and the redundant skills is found in the emergence and growth of the service sector. In the first instance citizenship services, which are controlled predominantly by the state, expand. A service such as health grows from curative to preventative health, tertiary education expands and social services develop into areas such as senior citizen communities. On their own the growth of citizenship services is insufficient to reduce unemployment and simultaneously to grow GDP. They also provide little more business demand for hotels than the manufacturing industry. At this same stage of economic development market services are typically small, fragmented, but growing businesses.

It is only when an economy develops larger and more concentrated market services that it is able to reduce unemployment materially and to grow GDP, because we do not yet know the limits to the growth potential of market services. Ownership of consumer goods such as cars produces gratification each time they are used. In contrast, when a market service such as a holiday, a hotel stay or a meal in a restaurant has been experienced all that remains to provide gratification is the memory. The only way to experience further gratification is to buy again. This inherent growth is reinforced by the conspicuous feature of service consumption and in the case of hospitality, travel and transport the association of consumption with enjoyment. Thus, the growth potential in market services is determined more by factors such as life style and time availability than by diminishing marginal returns.

As the market service economy develops so do the critical relationships at work, which change from the worker/machine relations of the manufacturing and extractive industries to worker/worker and worker/customer relationships in service industries. Work becomes more mental than manual, more social and cleaner. Gender equality becomes the norm and the number of dual career families increases. The distinction between work and leisure becomes less dichotomised and leisure activities outside of the home become a prime growth market. The number of meals eaten outside of the home, the number and frequency of holidays taken, the frequency of visits to gaming venues, sports venues, cinemas and theatres all begin a stepped growth in the market service economy and produce changes in life style.

Service firms are also different from manufacturing firms. They are far more diverse in their functions and they are far more geographically dispersed. As a result they provide the highest level of business travellers to hotels drawn from across the full range of executive functions.

The most developed stage of an economy is the experience economy in which market services become the prime contributor to GDP and to employment. Market service firms in industries such as financial services, communications and media grow to become among the largest and most consolidated in an economy. The hotel industry in experience economies is not only more concentrated, but also larger due to the higher frequency of both business and leisure demand. The industry has national representation throughout all market levels and all configurations of hotel facilities. It is not only the hotel industry that grows, but also all of hospitality, travel and transport, which collectively become a significant contributor to GDP. Spending on hospitality moves from being a periodic luxury to being a central feature of life style and standard of living. Apartments in New York and London with minimum or occasionally no kitchen facilities are in demand, since the occupants eat most of their meals in restaurants. Such a practice would be inconceivable at any other stage of economic development.

THE STRUCTURE OF THE HOTEL INDUSTRY IN EUROPE

The pattern of concentration in the hotel industry reflects the structure of the economies. Experience economies have the highest hotel concentration, while subsistence economies have the lowest. The contrast in the structure of the hotel industry in the economies in Europe can be seen in table 3:

Table 3: European Hotel Supply 2002

Experience	Total	Chain	Unaffil	Chain
	Rooms	Rooms	Rooms	Share %
Country	2002	2002	2002	2002
United Kingdom	379,890	196,320	183,570	52%
Experience	**379,890**	**196,320**	**183,570**	**52%**

Market Services	Total	Chain	Unaffil	Chain
	Rooms	Rooms	Rooms	Share %
Country	2002	2003	2002	2002
Denmark	39,350	10,950	28,400	28%
France	592,330	214,380	377,960	36%
Netherlands	77,070	22,300	54,770	29%
Sweden	95,920	27,850	68,070	29%
Market Services	**804,670**	**275,480**	**529,200**	**34%**

Citizenship Service	Total	Chain	Unaffil	Chain
	Rooms	Rooms	Rooms	Share %
Country	2002	2002	2002	2002
Austria	91,350	14,980	76,370	16%
Belgium	61,330	16,360	44,960	27%
Finland	54,600	21,320	33,280	39%
Germany	609,000	145,360	463,640	24%
Ireland	50,550	11,850	38,700	23%
Italy	707,000	43,540	663,460	6%
Luxemburg	7,550	1,720	5,830	23%
Spain	597,320	197,600	399,720	33%
Citizenship Service	**2,178,700**	**452,730**	**1,725,960**	**21%**

Industrial	Total	Chain	Unaffil	Chain
	Rooms	Rooms	Rooms	Share %
Country	2002	2002	2002	2002
Greece	204,000	15,030	188,970	7%
Portugal	97,310	15,770	81,540	16%
European Industrial	**301,310**	**30,800**	**270,510**	**10%**

Total E.U.	**3,664,570**	**955,330**	**2,709,240**	**26%**
10 New Member States	**389,860**	**59,840**	**330,020**	**15%**
Rest of Europe	**645,130**	**56,230**	**588,900**	**9%**
European Totals	**4,699,560**	**1,071,400**	**3,628,160**	**23%**

Sources: WTO, IHRII, Otus &Co

The UK scores higher in the structural measures than any other European economy, it is an experience economy and at 52% has the highest level of hotel concentration in the region. Denmark, France, Netherlands and Sweden come closest in structure to the UK economy. They are market service economies and collectively have 34% hotel concentration. The economies of Austria, Belgium, Finland, Germany, Ireland, Italy, Luxemburg and Spain score lower on the structural measures. They are citizenship service economies and collectively have 21% hotel concentration. Greece and Portugal have the lowest structural scores in the European Union, are industrial economies and have only 10% hotel concentration. The proposed 10 new EU member states are mainly from Eastern Europe, are industrial economies, have a smaller hotel industry and a concentration of 15%. The other non-EU states, with the exceptions of Norway and Switzerland, which are market service economies, are industrial and subsistence economies with the smallest hotel industry in Europe. The concentration of the non-EU states is only 9%.

The very low levels of hotel concentration in Greece and Italy is the result of the lack of interest by most chains in the seasonal beach holiday markets that dominate these countries and the low levels of domestic business demand for hotels. These economies are also characterised by a low ratio of citizens to total hotel rooms due to the preponderance of small, part-time, quasi-domestic and seasonal hotels that also are a feature of these countries.

The history of the pan Atlantic hotel industry over the past 30 years has been dominated by the emergence and growth of hotel chains, yet the chains still have a long way to go to develop a national presence across all of the European countries. It has been easier for them to grow in their home country and only multi-brand chains such as Accor, Hilton, Marriott International and Six Continents have developed a mass presence in more than one country.

In Europe there are 370 hotel brands accounting for 1.1million hotel rooms. Only one brand, Accor’s Ibis has more than 50,000 rooms giving it a little more than 1% market share, while there are 180 brands that together share less than 2% of the rooms and have an average of only 460 rooms per brand. There are too many brands with too few rooms so that most hotel brands in Europe are too small to develop an effective brand infrastructure. Only the largest multi-brand chains have the size to make a loyalty programme effective. The marketing and sales structure, the investment in distribution IT and yield management systems are limited by the cash flow generated by the hotels and media spend is out of the question for most of the brands. Consequently, the cost to the smaller brands to capture demand is too high and the returns generated are invariably too low to excite the capital markets.

The position is no better when it comes to brand length. There are only 17 brands with more than 100 hotels in Europe and none with more than 1,000 hotels while there are 182 brands, each with less than 10 hotels. The short brands are unable to provide national or even regional coverage and are thus handicapped in their ability to compete in the wholesale markets. The problems for short chains are similar to those for unaffiliated hotels. The vicious circle is that, to compensate for the lack of brand infrastructure, unaffiliated hotels and those in short chains are too frequently over-specified for the market level at which they compete. The resulting higher investment invariably makes the target returns even harder to achieve.

DEMAND GROWTH AND SHARE OF NEW HOTEL ROOMS

The continental European economies are at a crucial stage because their structural developments are likely to shift the classifications of several of the economies over the next decade or so. The precise timing of such shifts cannot be pinpointed precisely, but we project that the structural developments in the economies will produce a stepped growth in hotel demand across Europe by end 2011 and that this will be accompanied by a marked growth in hotel concentration.

Over the next decade we expect at least some of the market service economies in the EU: Denmark, France, Netherlands and Sweden to progress to become full-blown experience economies. This will boost their domestic growth in hotel demand and in hotel concentration. We see the citizenship service economies: Austria, Belgium, Finland, Germany, Ireland, Italy, Luxemburg and Spain progressing and several becoming market service economies. We also project that the secular change in hotel demand in these countries over the medium to long term will be accompanied by significant growth in the size and concentration of their hotel industries. We anticipate that the Greek and Portuguese economies will also develop, but that the reliance on foreign holidaymakers will remain paramount and they will continue to have relatively low levels of hotel concentration. The 10 states due to join the EU in 2004 will probably produce accelerating economic growth as a result over the period and their hotel industry will grow and concentrate from their currently low levels. The progress in the remaining industrial and subsistence economies will be positive, but the hotel industry will remain small and concentration will remain relatively low.

In parallel to the structural analysis of demand growth in the European economies, the World Travel and Tourism Council **2**, which provides the most comprehensive and systematic medium to long-term forecasts for world tourism growth, projects that by 2012 business travel in the EU will grow by 96% and leisure travel by 93% from current levels.

The first two issues about the medium to long-term projection of hotel supply in Europe are how many new rooms will be developed and how many of the new rooms will be affiliated to chains. If the demand growth inherent in the structural developments in the European economies and in the WTTC projections is achieved then within the next 10 years around 675,000 new hotel rooms, a compound average growth rate (CAGR) of 1.5%, will need to be added to stock if there is to be any hope of supply keeping up with demand. Of this total we anticipate that more than 500,000 will be added in the current member states of the EU.

In the US we anticipate a slower rate of growth adding circa 475,000 new rooms, a CAGR of 1.2% over the period, even though it is already an experience economy and has already achieved much of the domestic growth in demand and in hotel concentration. Our estimate assumes that the US will continue to bulldoze obsolete hotels and that in the medium to long term the main growth in demand in the US hotel market will be derived from foreign visitors. The UK is closer to the US in terms of its economic structure than it is currently to the continental economies; however, we project a CAGR in room supply of less than 1% due to the reluctance to demolish obsolete hotels. This reluctance is not only a significant factor in the slower growth in new room stock, but also a drag on the rate of further growth in hotel concentration, since most obsolete hotels are unaffiliated and of little or no interest to the chains.

The second issue in the medium to long-term projection of hotel supply in Europe relates to the share of new rooms that will be affiliated to hotel chains. The two main drivers of the expansion of hotel brands across the whole market spectrum are demand and capital access. Fortunately, the industry is at a stage when the medium to long-term growth of both is accelerating. Holiday Inn Express, the mid-market limited feature brand was introduced in 1993 and has developed 1,300 hotels, that is, one hotel opened every 3 days for 10 years. All but circa 100 of these hotels are in North America. The explanation has little to do with the paucity of demand for the brand in other parts of the world, but it has a lot to do with the availability of capital in North America for hotel investment and the ease with which franchisees and other hotel owners have access to it.

Travel Inn, an economy lodging brand in the UK, developed at a rate of a hotel every 10 days for several years during the 1990's. Whitbread, which owns the brand, funded most of the hotels while no more than a handful of the hotels are franchised and none are held on management contracts. Unlike the situation in North America the capital markets in the UK and the continent insufficiently understand and are insufficiently committed to the hotel business to provide more capital and Whitbread with its own resources has been unable to keep up its earlier pace of development of the brand.

For the past decade in the US and UK circa 95% of capital invested in new rooms has been in hotels affiliated to chains. Currently in continental Europe no more than 45% of the capital invested in new hotel rooms per year finds its way to affiliated hotels and this has inflicted a higher risk on the capital provision to hotels in this region compared with the US and the UK. As a result continental Europe has too many small new hotels built in the wrong places with idiosyncratic facilities owned and managed by amateurs.

The first initiative in the effort to solve this problem is for capital providers to reduce the investment in new unaffiliated hotel rooms. This is the single most important development that is necessary to improve the structure and performance of the hotel industry and to reduce the risk attached to hotel capital.

The time it will take for continental Europe to reach the current situation in the US and the UK depends on the commitment of lenders and other capital providers to make the change, but the decision making structure in continental banks is a constraint on the speed with which the change can be made. Our current working assumption is that, within 10 years, 67% of capital provided for new hotel rooms will be chain affiliated, up from 45% at present. On this basis circa 450,000 of the new rooms will be affiliated to chains over the period and that circa 220,000 new unaffiliated rooms also will have found capital. This implies only a 6% growth in unaffiliated rooms compared to a projected 40% growth in chain rooms.

CAPITAL AVAILABILITY AND HOTEL MIGRATION

The next issues in estimating the medium to long-term growth in the European hotel industry are how much capital will be provided to acquire existing unaffiliated hotels and how much capital will be provided for independent hoteliers to acquire single hotel assets from hotel chains. In Europe, at an average development cost of circa €100,000 per room the total capital needed for the projected new rooms over the next 10 years will be in the region of €70 billion. The provision of this capital is not assured. However, the most efficient way to meet the demand growth is through hotel chains rather than unaffiliated hotels and this is also the lowest risk basis on which the capital can be provided. On our estimates the 220,000 new unaffiliated rooms will require capital of around €20 billion. Although this is a significant reduction in the rate of growth it is still a material amount of capital and we expect more than 85% of it to be concentrated on the citizenship service, industrial and subsistence economies where unaffiliated rooms will grow by 7% over the period. We anticipate that the experience and market service economies will be quicker to reduce the capital available to build new unaffiliated hotels and we project that such capital will grow by only 4% over the period amounting to around €3 billion. The lower the capital invested in unaffiliated hotels the better the performance of the industry and the higher the returns to capital providers.

The question of the capital available for unaffiliated hoteliers to acquire single hotel assets, either from other unaffiliated hoteliers or to buy redundant hotels from chains is problematic. Bankers in Europe have sustained the unaffiliated segment by providing capital for such acquisitions. The UK experience is notable. Most of the hotels that change hands are old, with fewer than 50 rooms, are mid-market or lower, full feature or basic hotels in tertiary or quaternary locations. Many in country and coastal resorts have heavily seasonal demand while those in other areas face strong competition from the chains. By definition these hotels have no brand infrastructure, invariably they are owned and managed by amateurs and they experience the highest levels of bankruptcy and liquidation in the industry by far. The more this practice continues the longer the hotel industry will be under-demolished and the higher the risk attached to hotel debt. The problem will be resolved only by cutting-off of capital. The solution is in the hands of the banks.

The second issue in estimating the changes over the period is the extent to which there will be a migration from existing unaffiliated hotels to chains. The limits on this process include the low propensity of unaffiliated hotel owners to award management contracts or franchises on their hotels to hotel chains and the low rate of single hotel acquisitions by the chains. We expect a relaxation in the current entrenched positions on these issues and have estimated that these processes will migrate almost 100,000 rooms, less than 3% of the current unaffiliated stock, to the chains over the period.

THE EUROPEAN HOTEL INDUSTRY 2011

Our net projections Europe-wide are that hotel chains, through growing share of new build rooms and migration of existing rooms from unaffiliated to chains and after accounting for the disposal of redundant hotels to the unaffiliated market will grow room stock by 50% to 1.62 million and that unaffiliated rooms will grow by 4% to 3.76 million rooms. The outcome of the projected developments is that by 2011 hotel concentration in the region will grow from 23% to 30%.

In the current EU countries we expect the processes to grow chain room stock by 44% to 1.38 million while in the rest of Europe we anticipate hotel chain exposure doubling to 240,000 rooms as table 4 records:

Table 4: European Hotel Supply 2011

Experience Country	Total Rooms 2011	Chain Rooms 2011	Unaffil Rooms 2011	Chain Share % 2002
United Kingdom	408,100	223,150	184,980	55%
Experience	**408,100**	**223,150**	**184,980**	**55%**

Market Services Country	Total Rooms 2011	Chain Rooms 2011	Unaffil Rooms 2011	Chain Share % 2002
Denmark	45,000	15,330	29,660	34%
France	677,250	280,360	396,910	41%
Netherlands	88,120	30,890	57,240	35%
Sweden	109,680	38,530	71,140	35%
Market Services	**920,050**	**365,110**	**554,950**	**40%**

Citizenship Service Country	Total Rooms 2011	Chain Rooms 2011	Unaffil Rooms 2011	Chain Share % 2002
Austria	104,450	23,380	81,070	22%
Belgium	70,120	22,000	48,110	31%
Finland	59,720	24,600	35,120	41%
Germany	696,320	201,370	494,960	29%
Italy	775,530	87,610	687,920	11%
Ireland	55,780	15,200	40,580	27%
Luxemburg	7,900	1,950	5,960	25%
Spain	713,850	272,440	441,410	38%
Citizenship Service	**2,483,670**	**648,550**	**1,835,130**	**26%**

Industrial Country	Total Rooms 2011	Chain Rooms 2011	Unaffil Rooms 2011	Chain Share % 2002
Greece	246,150	39,700	206,450	16%
Portugal	116,290	27,010	89,290	23%
European Industrial	**362,440**	**66,710**	**295,740**	**18%**
E.U	**4,174,260**	**1,303,520**	**2,870,800**	**31%**
10 New States	**453,960**	**97,710**	**356,250**	**22%**
Rest of Europe	**745,350**	**120,240**	**625,100**	**16%**
Europe Total	**5,373,570**	**1,521,470**	**3,852,150**	**28%**
EU Room Migration		**74,000**	**-74,000**	
New States Room Migration		**8,520**	**-8,520**	
Rest of Europe Room Migration		**13,920**	**-13,920**	
Net Total European Rooms	**5,373,570**	**1,617,910**	**3,755,710**	**30%**

Sources: WTO, IHRII, Otus &Co

For the longer-term we project a doubling of global room stock by 2030 to 30 million rooms, a compound annual growth of 2.5%, not enough to keep pace with the long term projections for growth in world travel demand. By that date we also project that of the 30 million rooms, 15 million will be affiliated, which entails that over this period the total number of unaffiliated rooms will grow by nearly half while the number of rooms affiliated to hotel brands will grow better than 3 times. Consistent with this trend we anticipate that within ten years the first hotel chains with one million rooms will emerge.

THE DEVELOPMENT PROCESS IN HOTEL CHAINS

From the perspective of hotel development the first difference between chains and unaffiliated hotels is in the starting point. There is no standard starting point, but for unaffiliated hotels the development process typically starts with a site, which means that the city, the country and the economy in which the venue is located is determined. The formation of the concept stage of development then seeks to establish the most effective market level, hotel configuration, room configuration and size for the proposed hotel.

In contrast, hotel brands start with concept formation typically by identifying the market level and the configuration of facilities for the brand. The chains approach to hotel configuration has been to improve the financial structures of hotels mainly by increasing the proportion of turnover derived from rooms, which in turn produces higher margins and higher returns. In up market hotels such as those in the Hilton, Intercontinental and Sheraton brands this has been achieved by locating hotels in the larger cities and increasing the number of rooms per hotel. At the mid-market level this has been achieved through the creation of limited feature brands such as Holiday Inn Express and Courtyard by Marriott. At the economy lodging and budget levels the improvements have been achieved by developing brands such as Travelodge and Formula 1 as room only hotel brands.

Investment in non-room facilities in full feature hotels has been reduced progressively by limiting the number of restaurants and simplifying the logistics of restaurants. The main impact has been the reduction of non-resident demand for such hotel restaurants and the reduction in restaurant usage by hotel customers at lunch and dinner. The exception has been in the conference market, which is a captive meal market for full feature hotels and is logistically easier for the hotel to manage, since delegates invariably arrive to eat at the same time and have a set menu. The resultant higher percentage of hotel turnover derived from rooms has produced higher hotel EBITDA margins and higher returns.

The innovations with most impact in the configuration of hotels have not come from the development of single hotels, but from the conception of hotel brands. Brands are conceived to meet the twin goals of attracting both demand and capital and thus to grow the length of the brand. The longer the hotel brand the more the corporate infrastructure is designed to capture demand for the portfolio rather than for individual hotels. The longer brands deal in wholesale markets, which are beyond the reach of unaffiliated hotels. In contrast, the conventional wisdom about hotel development has assumed demand capture to be more reliant on the inherent features of the hotel. The recent fashion for boutique hotels is the most notable example. Invariably, they are small hotels trading at the deluxe and up market levels in major and primary cities, with a high investment cost to create their style and no brand infrastructure.

When hotel brand specifications are established a rollout programme is planned within which hotel size is a function of location. For hotel brands a higher priority is attached to the rollout programme than to fretting over the unique facilities or design that might be developed on any given site. The countries, economies and cities that are target markets for the brand are then identified and the rollout programme progresses by finding sites and capital. However, for any hotel brand the brand length potential is inversely related to market level. Deluxe brands need the fewest hotels and budget hotels need the most to generate brand power.

For the rollout of hotel brands the conventional wisdom on the development process is too slow and too expensive. Hotel chains are more than the sum of their venues and have the right to insist on economies of scale in the development process, which involves reducing the time and the cost required for development. In brands this is achieved in their approach to concept formation. The rollout simply adapts the brand specifications to the conditions of each site. The faster the rollout programme the more the economies in planning and construction.

An implication of the accelerating rollout of hotel brands is not only that hotels in any brand bear a family resemblance to each other, but also that the performance of hotels within a brand is not uniform. For instance, Post House Hotels, the mid-market full feature brand with 77 hotels in the UK, was sold to Six Continents in 2001 for £810 million. Twenty percent of its rooms were in London, 23% in the primary provincial cities, 54% in the secondary and tertiary towns and cities, 3% in quaternary locations and the average size of a Post House was 158 rooms. The RevPAR range across the portfolio in 2000 was £62.63 to £16.55 and EBITDA per room ranged from £18,951 to £3,125. The value of each hotel was not uniform. On the basis of 8x EBITDA the hotels ranged in value from £155,000 per room to £25,000. Typically, the construction cost for a mid-market full feature hotel in the UK could be circa £60,000 per room, which indicates the potential gap attached to the value of existing hotels and the replacement cost of equivalent hotels. The diversity in performance and in values is not untypical in mid-market and up market chains.

Many brands, particularly those at deluxe, up market and mid-market levels grow by acquisition as well as new build. Holiday Inn, owned by Six Continents and the brand to which Post House Hotels were converted is an example. In a formal auction process for a hotel chain the limits on time and information available to potential buyers before there bids have to be submitted is controlled and in the case of hostile bids only publicly available data can be examined before the company is acquired.

The logic of hotel development practice is based on venues. When the focus is raised to the corporate level the development process has to be adapted. The conventional approach to development assumes little or no knowledge or understanding of the hotel market by the client, but as hotel brands have developed so the extent and the reliance on feasibility studies has reduced and the roll-out programme has routinised the rest of the development process. Banks and other institutions progressively are using independent feasibility studies as a validation of the decision to lend or invest in hotel projects. This process parallels the growth in the proportion of the capital available to chain hotels. The more that the development process delivers hotels and chains that produce returns on capital that meet the demands of investors as well as the demand of customers then the higher will be the level of concentration in the hotel industry. It is a critical step in the progress of the industry.

CONCLUSION

The strong prospects for the European hotel industry in the medium to long-term will propel hotel concentration to more effective levels. This requires thinking about the industry to be elevated from the level of the hotels to the level of the brands and this in turn requires the hotel development process to adapt to the rhythm of the brand rather than to be constrained by the possibilities of individual venues. Of course, there are many other challenges for the chains, such as, the access to capital, the distribution of demand through the Internet and the development of corporate executives with an effective understanding of the hotel business. The growth prospects are the fundamental driver that demands solutions to the challenges and the prize is a more concentrated, more successful and more professional hotel industry.

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