

# **The Economic Ascent of the Hotel Business**

**Paul Slattery**

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# Preface

There are three gaps that this book seeks to narrow. First, the ideal combination for corporate executives in hotel chains is to have both a conceptual understanding of a business discipline and a conceptual knowledge of the hotel business. However, hotel chains frequently populate their corporate structures with executives drawn from the disciplines of accounting, marketing, finance and the other general business disciplines, but without a conceptual understanding of the hotel business. Once they have taken-up their position in a hotel chain their emerging understanding of the hotel business is only experiential and this can limit the effectiveness of their creativity. This book is designed to narrow that gap by providing a systematic analysis of high level strategic issues that confront the hotel business.

Second, most of the advisors to the hotel business: investment bankers, equity analysts, lenders, equity investors, management consultants, real estate agents, lawyers, accountants, developers, architects, construction companies, the media and a host of others have been sent to work on hotel projects, they have not chosen to work on them. As a result, there is a very high turnover of advisors involved in the hotel business. Only a few are sufficiently attracted to remain committed to it for a significant part of their careers, but even these stalwarts only have a piecemeal rather than a conceptual understanding of the hotel business, which constrains their interpretation of the challenges and can limit the effectiveness of their advice. This book is designed to narrow that gap and to help advisors gain a more comprehensive understanding of the dynamics of the hotel business.

Third, undergraduate and postgraduate degrees in hospitality management throughout the world pay too little attention to the understanding of the economic development of the hotel business, to the dynamics of economies, the hotel demand that they generate and the hotel supply needs that follow. Given that hotel chains dominate hotel development it is of concern that most graduates in hospitality management enter the business with inadequate understanding of hotel chains, their drivers, strategies and structures. This book is designed to narrow that gap and help academics and graduates to comprehend and get excited about one of the most dynamic and growing businesses in the world.

## Acknowledgements

The hospitality business has been the thread that has bound my three different careers as an academic, as an equity analyst and as an investment banker. Throughout, there have been countless colleagues, clients, corporate executives, competitors and students, most of whom are unaware that they sparked ideas, demanded solutions, inspired me and punctured the crazier ideas that I have had about the hospitality business. The 16 years to 1987 at the University of Huddersfield was a period of broad creativity with colleagues and friends such as Rita Carmouche, Keith Johnson, David Litteljohn, Ray Pine, Angela Roper and George Wilson, all of whom have left distinguished marks on the development of hospitality management in the academic world. We were very young academics charged with developing a degree in Hotel and Catering Administration and in pursuing research in hospitality management. It was at this time that my commitment to the analysis of hotel chains and to the creation of the hotel supply database was established.

At Kleinwort Benson Securities from 1987 to 1998 Simon Johnson and Greg Feehely were two graduates in hospitality management who crafted very successful careers in the investment community and worked with me when I first developed the idea that economic structure was a critical influence on the size, shape and performance of the hotel business.

Since 1998 my immediate colleagues in corporate finance at Kleinwort Benson and my close colleagues at Otus: Simon Read, Andrew Boshoff and Ian Gamse stretch my thinking because their talents are both wide and deep. It is with these colleagues and friends that I have been able to extend the wider strategic analysis of hotel chains and the hotel business.

As I was completing this book I received the news that Greg Dillon had died. Greg was one of the great statesmen of the hotel business who served as Vice Chairman Emeritus of Hilton Hotels Corporation after his retirement from the main board. His involvement with Hilton stretched from the acquisition of Statler Hotels in 1954, which was at the time the largest ever hotel chain transaction. He was responsible for the development of Hilton from the 1960s and was one of the executives who understood and drove the economic ascent of the hotel business in the US and elsewhere. Greg was also a great friend, a grand host and an inspiration.

Thanks also to Tim and Sally at Goodfellow Publishing, who have always been thoughtful and helpful.

My preoccupation with the hotel business is exceeded by my preoccupation with my family who have provided so many highs, a sprinkling of lows and a few scares. Libby has shared my whole adult life, wonderfully. Stephen and Natalia and the Ms – Martin, Millie and Markus – know that the time I spend thinking about, reading about, talking about and writing about the hotel business is secondary to my love for them.

Paul Slattery

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## About Otus

Otus focuses on three sectors: Hospitality, Travel and Transport. Otus directors and partners are sector experts and experienced bankers with long experience in the strategic analysis of the hospitality, travel and transport businesses and an unrivalled record of advising on key transactions of all sizes, national and international in hospitality, travel and transport.

Otus Corporate Finance offers advice on a full range of corporate finance activities including: mergers and acquisitions, disposals, joint ventures, MBOs/MBIs and financing transactions.

Otus & Co provides independent, high level and innovative strategic advice drawing on a range of proprietary data and analytical tools.

For the hotel business we own and operate the Otus Hotel Brand Database, the most sophisticated hotel brand supply database covering all of Europe, the Middle East, Africa and Asia. We provide systematic analysis of hotel brand supply with consistent classification of hotel market levels, hotel configurations and hotel locations each economy.

We track developments in economic structure for each economy and economic policies to assess their implications for the hotel business. We also track the volume of domestic business demand, domestic leisure demand, foreign business demand and foreign leisure demand into hotels.

We use these resources to advise on portfolio and performance strategies of hotel brands to enable main boards to make more secure decisions about the medium to long-term directions of companies.

Our clients include international and national hotel companies, online travel agencies and capital providers in Europe, North America and elsewhere.



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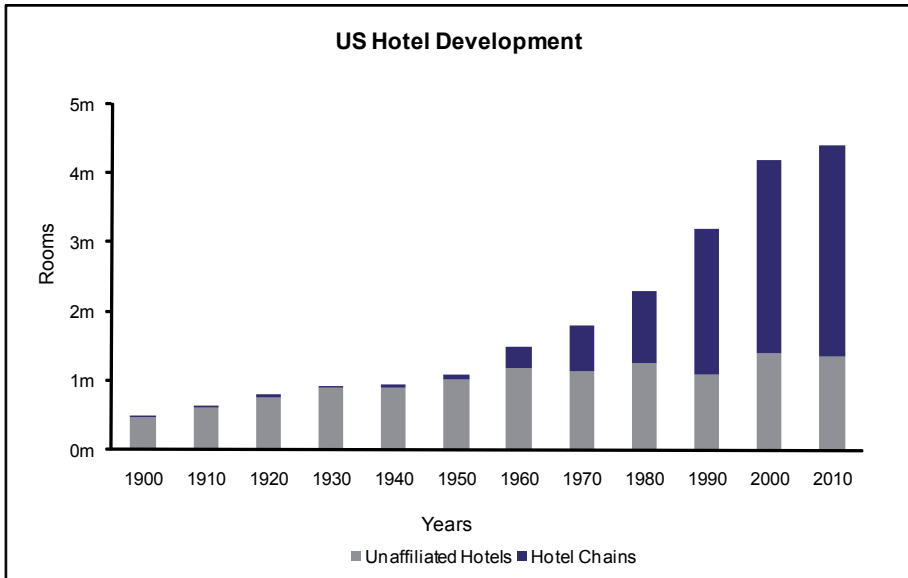
## Introduction

This book is about the hotel business and the economic contexts in which it has evolved. The central thesis is that the size, structure and growth of the hotel business in a country are functions of the prevailing economic structure. Thus, fundamental to comprehending the economic ascent of the hotel business is an understanding of the structural development of the economies in which hotels operate and which provide the fertility for hotel demand and supply to grow. The book draws on contemporary data and events to chart the historic development of economies and of the hotel business to illustrate patterns in this fundamental relationship. The book also focuses on the economic conditions that produced hotel chains of different sizes, structures and growth patterns and it seeks to provide a more comprehensive basis on which future developments in hotel demand, supply and performance can be contemplated.

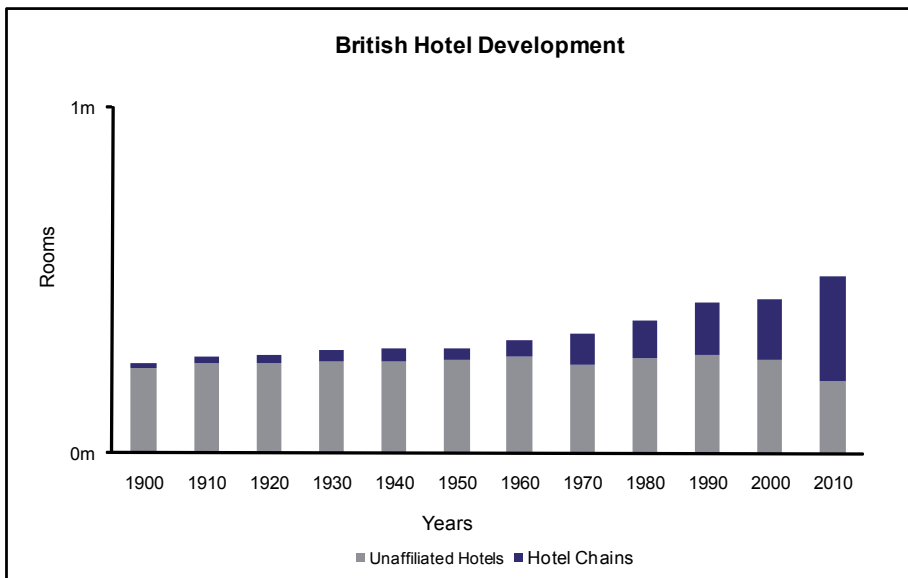
The economic ascent of the hotel business has not been uniform because the development of economic structures has not been uniform. Europe and North America are the centre of the hotel universe, so that, with a combined population of around 700 million and with around 10 million hotel rooms, they have a supply ratio of 14 hotel rooms per 1,000 citizens. The rest of the world accounts for a population of around 6 billion with 6 million hotel rooms, a supply ratio of one hotel room per 1,000 citizens. The fundamental question is: what is it about the economies of Europe and North America that generate a much higher volume of hotel supply, and by implication hotel demand, than the rest of the world? Those economies from Africa, parts of Asia, parts of South America and parts of Eastern Europe that are grounded in agriculture and basic manufacturing generate the lowest volume of demand for hotels, have the lowest supply of hotel rooms and throughout history the economic ascent of their hotel businesses has been minor. At the other end of the continuum of economic structure, the most advanced economies such as the US and Britain, have progressed to be driven more by service businesses. They generate the highest volumes of hotel demand and need the highest volumes of hotel room supply per citizen to accommodate them. It is in these countries that the economic ascent of the hotel business has been greatest. Thus, identifying the historical development of the economic structure of these countries and the parallel development of their hotel businesses is necessary to make sense of the different size, shape and prospects of their hotel businesses.

In the most advanced economies the hotel business has existed and grown throughout their economic history and has been dominated by two major trends. First, the provision of hotel facilities and services has developed from small inns, which were an extension of the home of the innkeeper, with primitive communal sleeping and eating facilities for handfuls of travellers at any time to modern mammoths such as Wynn Las Vegas, opened in 2005 with a development cost of \$2.7 billion in 2,716 rooms and suites, an 111,000 square-foot casino, 22 restaurants and bars, an 18-hole golf course, approximately 223,000 square feet of meeting space, an on-site Ferrari and Maserati dealership and approximately 76,000 square feet of retail space.

Second, from the middle of the 19th century in Britain, hotel chains emerged. They developed gingerly during the next 100 years, but the emergence of chains and therefore the growth in concentration of the hotel business was a feature of the second half of the 20th century, most notably in the US and Britain as Figures 1 and 2 illustrate.



**Figure 1:** US hotel development. Source: Otus & Co Advisory Ltd



**Figure 2:** British hotel development. Source: Otus & Co Advisory Ltd

The experience of the US and Britain is that hotel chains come to prominence when the development in economic structure is driven most by the growth of service businesses. Of the two countries, the US has by far the larger hotel room stock, because it is the larger economy with a larger and faster growing population and the larger physical size, but also, crucially, because throughout the 20th century the structural development of the US economy progressed at a faster rate than Britain's. At the start of the 20th century both economies were grounded in manufacturing and their hotel businesses were closer than they have been since. In 1900, the US, already the world's largest economy, had 500,000 hotel rooms and a supply ratio of 6.6 hotel rooms per 1,000 citizens, while Britain had 270,000 rooms and a supply ratio of 7.1, higher than the US. Britain started the 20th century with a higher level of concentration in the hotel business than the US due to the vertical integration of railway companies and of brewers, which accounted for most of the hotel chains. However, throughout the 20th century, the US economy progressed more speedily to be driven by service businesses and the country had a political philosophy of small government, which facilitated faster structural development of the economy.

In contrast, Britain took longer to make the transition to service businesses and did so with a political philosophy of big government, which slowed the structural development of its economy. The progressive growth in total hotel room supply and in hotel chain supply in both countries reflected the divergence in their economic structures. By 2008, the US hotel business had grown to 4.7 million hotel rooms, a supply ratio of 15.5 hotel rooms per 1000 citizens and hotel chains accounted for 69% of total room stock. In contrast, British hotel room stock had grown to 510,000 rooms, a supply ratio of 8.4 hotel rooms per 1000 citizens and a concentration of only 57%.

Hotel chains have also grown internationally. At the end of 2008, global hotel chains such as Hilton Hotels Corporation, Intercontinental Hotels Group, Marriott International and Wyndham Worldwide each accounted for around half a million rooms. However, hotel chains are still at the early stages of their global growth and demand and supply are accelerating as the structural balance of more economies progresses. Although it has taken all of economic history to develop the first hotel chains with half a million rooms, the rate and pattern of growth in hotel chains means that if these chains maintain their recent growth, they will reach a million rooms each by 2020. Yet, the growth of hotel chains is not only about the global majors. At the end of 2008, in the 52 countries of Europe, there were 700 hotel brands operating portfolios of more than four hotels, accounting for a total of 14,000 hotels with 1.7 million rooms. Otus projects that in the 10 years to 2018 they will need to add a further one million rooms to stay in touch with demand growth that is the result of developments in the structures of the European economies.

The hotel business and its sisters in travel and tourism are now of too great an economic significance for the dynamics of demand and supply to be only casually understood. However, the hotel business has been lured into a reliance on a narrow range of short-term and general macroeconomic metrics such as changes

in total GDP, changes in interest rates and movements in currency exchange rates. Sadly, the analysis gets no deeper than the superficial assumption that rises in GDP, reductions in interest rates and reduction in currency exchange rates are positive for the hotel business and movements in the opposite directions are negative. At the micro level the depth of analysis is not much more than a dependence on short-term hotel operational measures such as historic revenue per available room (RevPAR) and tracking of future pipelines of hotel construction. These macro and micro output indicators are necessary tools, but without a more comprehensive understanding of inputs into economies, the drivers of hotel demand and supply, and the economic context in which the outputs occur, they are insufficient to make real sense of developments. Thus, it is no accident that too frequently, hotels have delivered sub-optimal returns on invested capital, because their development strategies and marketing strategies have not been grounded in effective analysis. Along with greater economic significance comes greater responsibility to investors and other stakeholders in the hotel business. An understanding of the structural development of economies enables us to identify more effective ways to measure the hotel demand and hotel supply needs of economies and enables us to plan investments more effectively. This book is about these big economic and investment issues. It presents a consistent understanding of the dynamics of economic structures as well as the patterns and volumes of hotel demand and supply that they generate and the development of hotel chains that follows.

There are three purposes to this book. First, to demonstrate that the Otus approach to the strategic development of the hotel business is an advance from the conventional approach. Second, to argue that the structural balance of economies are in the process of shifting to segments that yield higher demands into hotels. Third that if the structural balance of economies move as anticipated, then the global hotel business will enter a golden age.

The book tracks six stages in the economic ascent of the hotel business.

**Chapter 1, Economic structure:** The building blocks of economic structure are introduced and used to explain how economies develop.

**Chapters 2 and 3, Historic primary economies and the emergence of the hotel business until 1850:** The economic structures of the historic agricultural economies and the Industrial Revolution are reviewed. The economic development of the hotel business during these periods is tracked and the ways in which the patterns of hotel demand and supply were influenced by the prevailing economic structures are illustrated.

**Chapters 3, 4 and 5, Historic secondary economies and the emergence of hotel chains: 1850 to 1945:** The segmentation of hotels is shown to have paralleled the economic and social structures as they evolved in industrial economies. The severe impact on the hotel demand and supply of world wars, ideological shifts and the Great Depression are tracked and the emergence of hotel chains is explained.

**Chapters 6 and 7, The emergence of the service business economy and the growth of hotel chains: 1945 to 1960:** The transition of the US to a service business economy is examined, as is the fast growth in hotel demand and supply that it engendered. The meteoric growth of US hotel chains and innovations in the structure of hotel chains that set the patterns for the rest of the century are explored. This is contrasted with the struggles of the European economies to recover from World War II and the sluggish progress of their hotel businesses.

**Chapters 8 and 9, The establishment of the service business economy and the acceleration of hotel chains: 1960 to 1980:** The growth in the significance of service businesses in the US is traced and compared with the growth in the volume and diversity of hotel demand and the growth in the significance of hotel chains. The slower development in the structural balance of the European economies is charted and its impact on the growth in the size and structure of their hotel business is examined.

**Chapters 10, 11, 12 and 13, The expansion of the service business economy and the dominance of hotel chains beyond 1980:** The most dramatic growth of the hotel business occurs within service business economies because they produce the widest diversity, volume and frequency of hotel demand and this has been matched by the greatest significance and diversity of hotel brands.

The book draws on data from the Otus Hotel Brands database and its precursor that I started at the University of Huddersfield in the early 1980s and expanded at Kleinwort Benson Ltd until the end of the millennium, to illuminate the dynamics of the economic ascent of the hotel business.