Sunny Times, But Clouds On Horizon

Looking around the world, with only a few exceptions, it appears the hotel industry is doing very well. Global travel is up, particularly from some of the emerging markets such as India and China. The general feeling at most of the hotel investment conferences around the world is one of restrained euphoria. While this recent upswing in revenue and profitability may warm the hearts of owners, operators and investors, I am a little concerned about some long-term trends that might be adverse to the future of the industry. Let me describe a few.

Brand Consolidation

Over the last 15 years many of the brands have been consolidated under one company. Westin and Sheraton are part of Starwood; Ritz-Carlton and Ramada have merged with Marriott International; and Embassy Suites and Doubletree now operate under the Hilton flag. Consolidation produces economies of scale for the brand and huge conflicts for the hotel owner. Every time a hotel either opens in a market or changes flags to one of the major hotel brands, the potential for adverse competitive impact emerges. How would you feel if you own a Sheraton and Starwood decides to open a Westin across the street from you?

Many chains will justify their brand expansion by first commissioning a consultant to assess the adverse impact, but those of us in the research business know these studies are highly subjective and probably inaccurate. The only way owners will be protected from brand over-expansion is to negotiate an exclusive territory prior to acquiring a brand. There might be several defined territories for each brand within a company with numerous brands.

Amenity Creep

The hotel industry has always embraced what is termed "amenity creep." This is the unbridled desire of owners and operators to constantly add new amenities to remain competitive with other similar hotels in the surrounding market. Free breakfast, Internet, spas, flat panel televisions, new beds, curved shower bars and designer soaps are examples of amenities that did not exist 25 years ago, but are here today because one hotel in a market decided to them and every other hotel followed.

It should be remembered that most hotel amenities quickly become hotel necessities. Before creating a new amenity that currently does not exist within your market, do a cost-benefit study and competitive analysis to determine whether the expense is worth the cost and whether your competitors will follow quickly and eliminate your competitive advantage. ▶

Labor Issues

When the hotel industry does well hotel employees want more money and benefits. In the United States hoteliers are bracing for major labor unrest as the unions are organizing their workers for a major showdown. Unlike many industries, hotels have huge capital investments in land and buildings producing tremendous fixed costs. The resulting lower operating margin makes it difficult to generate profits unless all costs are held in control. Yes, in good times, hotels can be cash machines, but in bad times the negative operating leverage goes against the owner. The ideal solution is for hotel employees to reap the benefits when times are good, but they should also be willing to either reduce their compensation or be more flexible with their work rules when times are tough.

Condo-Hotel Rip-Offs

One of the best new ideas to sweep the lodging industry is combining a residential component with a hotel. The resulting synergies of offering hotel services to the residential apartments and having residential apartments available as hotel room overflow benefits both the hotel and residential owner. Unfortunately, the term describing this form of mixed-use development has become a "condo-hotel." It is unfortunate because the "condo-hotel" term is also used to describe a marketing scheme where individual hotel rooms are sold to buyers who are primarily looking for a vehicle to provide a return on their invested capital.

While the developers of these projects do not market their condos as "investments" because to do so in the United States requires all types of governmental registrations, there are very few good reasons why someone would want to own a hotel room in a location they have little desire to occupy. The main problem with this type of "condo-hotel" is that the prices these units are sold for often exceed their economic value. For example, if a hotel is going to operate at an average rate of US$150, then the rule of thumb is that this hotel is worth about US$150,000 per room. If the condo developer actually sold this hotel room at US$150,000, then the buyer would be getting a fair deal.

Unfortunately, many unscrupulous developers are marking up the individual condo selling prices 50% to 100% so the buyers have no chance to making an adequate return. I recommend the brands carefully evaluate the economics behind these types of condo-hotels before issuing either a franchise or taking on a management contract. I predict these are litigations waiting to happen.

While there are clouds on the horizon, I do not foresee a violent storm across the hotel industry. Although these concerns can adversely impact future hotel profitability and have resulting ramifications on hotel values, most can be mitigated through simple adjustments to how we do business. I would like to hear from my readers if there are any other major concerns that you might have about the future of the hotel industry. Drop me an e-mail at srushmore@hvsinternational.com, and I will include them in future columns. ♦

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