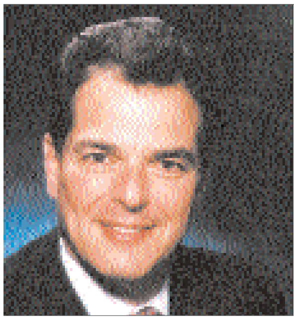

By Rick Swig

Sector Remains in the Game Despite Reaching Strike Three

FOR THE THIRD YEAR IN A ROW, CONDITIONS ARE not normal in the hotel sector. Three strikes would mean you are out, but despite war, disease and continued economic instability, the hotel game goes on, although it's weakened.

According to recent Smith Travel Research data, the hotel business segment is producing revenues at 1999 levels with a combination of more supply and lower occupancies. Gross operating profit thresholds resemble 1996 dollar levels with net income results below 35% of gross revenue, which is the lowest percentage since 1993.

The news is not all bad, however. Occupancies are now beginning to improve compared with last year and a poor first half of 2003. Americans invoked their right to travel during the summer and headed to more local and regional destinations with travel patterns and demand offering little predictability or consistency. The other good news is that the development pipeline continues to slow. There is reason to believe that oversupply in some markets will be absorbed within the next several years before too many new hotels arrive on the landscape to dilute demand.

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Room-rate pricing and distribution channel utilization are the hottest topics this year. If operators compare their historic ratio of travel agent commission payments versus demand with their current levels, they can see that the electronic channels are sweeping into prominence. Any hotel operation without an implemented e-commerce plan is not competing effectively in today's market.

The failure to create profit can be attributed to increased expense for labor, energy and property and worker's compensation insurance. However, the root of the inability to sustain profit is operators' failure to manage pricing. Discounting has not created increased demand, but rather the deterioration of profit, value, brand positioning and the long-term relationship between hotel operators and customers.

A recent Cornell University study took the position that discounted guest rooms do not stimulate travel, but simply yield less revenue from those customers who are traveling anyway. Regardless of the distribution channel, customers have found it easier to buy lower rates on hotel rooms that they were planning to buy anyway.

The perceived beneficiaries, and simultaneously the victims, of this unfortunate strategy are the customers who are now able to move up a notch in brand quality without paying more. This is really a hoax for those consumers because hotel operators have scuttled service levels, deferred maintenance and postponed physical improvements as a result of lower revenues per occupied room. Customers will soon find that their favorite hotel brand products are not the same.

The victims will also be the brands, which, when they are also the operators, allow their legacy and reputation to deteriorate, as they compromise their product standards to fit into the financial straitjacket caused by discounting and revenue weakening. Furthermore, the brands have managed to lose loyal customers to discount distribution channels by not sustaining customers' attention toward traditional brand preferences. The question is, how much time is it going to take and how much is it going to cost to get them back?

Of course, hotel owners continue to suffer. In the short run, discounting strategies may have purchased market share and supported market penetration, but now the competitive nature of the market is to discount the discounts, thus further eroding rate integrity, market positioning, income potential and overall value. But thank goodness for low interest rates.

Through it all, traveler demand remains the primary challenge for the sector. There is no solid foundation in the commercial transient, leisure transient or group segments. General US corporate performance seems to be returning to profit versus loss, but the corporate traveler is still grounded, for the most part, until stronger economic trends illustrate the benefits of travel on revenue production.

Most industry experts agree that 2003 has little chance of ending with significant revenue growth over the past year. The demand fundamentals are still not in place to support a healthy hospitality industry. No amount of discounting will stimulate adequate demand for profitability. Until there is general economic improvement, hotels will not prosper. It is therefore quizzical why hotels are the focus of investment capital. ◆

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