

Redefining a Mature Hotel Sector

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Successful hotel investing may require different posturing in the early years of the new millennium. Investment in the hotel real estate sector may still be a positive experience for the diligent, but it certainly will not be the high yield mecca that it has been for the last few years.

Both public and private sector companies may have to revisit and redefine their existing assets to achieve growth. A matured hotel real estate sector may have activated barriers, which will continue to limit high yield acquisition or development opportunities.

Mid-90s transaction activity thrived in an atmosphere of a rebounding economy with the availability of under producing assets, under served market segments, and ravenous acquisition appetites of public and private investment funds. A flip and strategy benefited many investors. Now, investment requires long term vision based on a trend of steady rather than rampant growth in revenues and related profit.

Trends in reported 1999 REVPAR growth of 2% to 3% might be perceived as a slow down, but it should be recognized as normalization in a mature industry. General demand growth has stabilized, occupancy buoyed by a heated economy has peaked in those markets which have either resisted or dodged overbuilding (for now!), and average daily rate (ADR) is trending closer to CPI after several years of furious increases.

Slipping revenue growth coupled with ongoing operational expense increases will begin to reduce profitability growth. This will make the hotel real estate sector unattractive to some and challenge some public and private investors with a major commitments to hotel real estate.

All is not doom and gloom, however, as hotel assets should experience continued and gradual long-term earnings growth, as opposed to a devastating cyclical downturn. Achievement of minimal steady growth will necessitate constant attention to management, product positioning, and other operational opportunities. Expansion of individual hotel market share might require even grand, if not radical efforts.

Traditional strategic investment goals will drive individual acquisition or development decisions with basic issues split between location, product, competitive dynamics, barriers to entry, investment return thresholds, holding periods, and an exit strategy. Future success, however, will demand a greater

understanding of customer needs, trends, and social triggers.

Hotel assets seem to be trending towards becoming commodity products. Physical structures are minimally distinguishable and interchangeable, loyalty is bought with frequent user rewards, and customers are enticed by price/value.

Between five and ten years ago new product entries plowed into under developed niche segments and harvested growth opportunities. Today, most markets are overgrown with multiple properties in each niche. Hotel units have similar cosmetics, hospitality products, and services, which have both clogged the individual market segments and limited differentiation.

It might be assumed that this insinuation applies primarily to the economy and mid-market sectors of Fairfield, Comfort, Courtyard, Hampton, Hilton Garden, etc., when in reality the recipe for the luxury hotel may also have been counterfeited. Where once there was only one or at best two great luxury products in any major market, now several may exist. As brands like Four Seasons, Peninsula, Ritz Carlton, St. Regis (Luxury Collection), and Inter-Continental pursue their grand global growth global plans, this formerly exclusive segment may also be moving towards commodity status as well.

Although fine and highly respected organizations, many brand name hotel companies with literally hundreds of critically massed units have moved away from being distinctive customer experiences to predictable packaged products. While franchise companies have focused their efforts to create brand standards and product consistency for physical plants, services, and amenities, the "magical" or "distinctive experience" has been removed and replaced with a predictable commodity.

McDonald's, Burger King, Pizza Hut, and KFC have proven that there is nothing seriously wrong with this direction. Selling these commodity products, however, often leads down a tactical trail of low price leadership in tandem with the fastest food or best French fry experience. Customer loyalty can be significantly contaminated by financial incentives. This works in the fast food commodity sector because volume can be increased through price incentives, and it is rarely governed by capacity.

In the hotel sector, commodity positioning and the emphasis on price leadership may become an anchor on limiting industry revenue growth, as individual hotel units are governed by nightly capacity and ultimately run out of product to sell. Loss of guestroom revenue due to competitive pricing can not always be off set by volume.

The alternative may be the Starbucks model, where the "experience" of purchasing activity may be as important as the product itself. Selling the

customer experience takes the emphasis off of pricing pressure to place a higher value on the product transaction. Customers have to like the coffee, but they also remember the experience associated with the transaction. This orientation builds both product reputation and loyalty. Residually, it broadens the opportunity for increased revenue and profit growth, as customers are willing to pay the difference for the associated benefits.

The archetype is defined in the hotel sector with creative product developments, which strike a visceral chord with customers. Current successful examples of differentiated products focus upon technology, wellness, fashion, or whimsy. As a new generation of hotel guests demand lifestyle versus commodity products, earnings growth may be stimulated through addressing customer preferences and enhancing their experiences.

Hotel investors may come to a fork in the road and be forced to choose between the directions of commodity versus differentiated products. Both options can be beneficial. Established commodity products conjure trends of predictable and steady (low yield?) stability, while the alternative portends higher risk, but potentially greater rewards. Regardless of objective, the navigation will require long term vision to replace quick hit maneuvers.