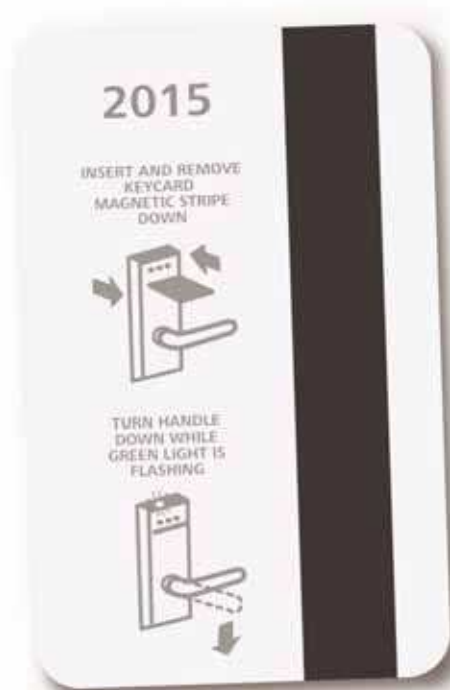


Hospitality 2015 Game changers or spectators?



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Foreword

Welcome to Hospitality 2015!

Following the success of Hospitality 2010, published almost five years ago and the feedback we received from you, we wanted to see if our predictions were accurate, and explore once again the trends which we believe will shape the hotel industry in the future.

Once again Deloitte dedicated a team of professionals who have spent the past year creating a vision supported by research, analysis and structured interviews with industry leaders.

We are pleased to report that our predictions back in 2010 were on point. The value of brand to the consumer, the growth of emerging markets, the importance of consumer-facing technology and the sourcing, development and retention of human capital have led to success and differentiation in the marketplace.

As we look to 2015, we have extended our focus to sustainability, exogenous events and cycles, and have reached out to our industry experts in the sectors which make up the wider travel experience to ensure that we do not lose sight of the impact on our industry from those sectors' success or failure.

The combination of global economic uncertainty and the resultant impact on the consumer means that, as an industry, action is needed to respond to the new world order. More than ever before, the consumer will be value-conscious irrespective of segment. Simply put, the opportunity is to be a game changer or a spectator. Which will you be?

We hope you find this executive summary from the full report useful and we look forward to any feedback you may have, and the opportunity to discuss our recommendations and findings with you in more detail. The full report is available online at www.deloitte.co.uk/hospitality2015. Finally I and the rest of the tourism, hospitality and leisure editorial team below, would like to conclude by thanking all those who contributed to the report.

We hope you enjoy reading this report.



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Executive summary

The next five years will herald the era of a consumer-led brand focus for the hospitality industry. Consumers are changing faster than ever before in both attitude and behaviours.

Engaging the new consumer

The hospitality industry, traditionally more focused on the physical product, is waking up to a consumer who is demanding consistent delivery of the brand promise and, in the upscale to luxury segments, the experiential dimension will define a successful brand as much as the finer points of product design.

By the end of 2009, consumer demand had largely stabilised and occupancy rates are starting to recover in 2010. We expect that 2011 will show a stronger, sustained recovery. Despite this optimistic outlook, as economic conditions continue to remain uncertain and governments face an uphill battle to pay off their huge deficits, value-conscious consumers will remain a key feature in the post-recessionary landscape across all segments of the market.

Which way now?

As consumer demand recovers it will be reshaped by two key demographic trends. In established markets such as the UK and US, the rise of the affluent, time-rich and travel-hungry Baby Boomer generation – aged from 45 to 64 – will evolve and grow. By 2015 in the US alone, boomers are expected to control 60 per cent of the nation's wealth, and accounting for 40 per cent of spending.¹ With more time for leisure as they approach retirement, spending can be expected to be more focused around travel.

In emerging markets such as India and China however, there will be a significant rise of the middle classes, generating an increase in demand for both business and leisure travel. Gross Domestic Product (GDP) per capita in China is forecast to more than double between 2010 and 2015 providing the population with greater disposable income to spend on hospitality, while India is forecast to have 50 million outbound tourists by the end of the decade. Each is a potentially huge feeder market.²

While much of the development until recently has focused on the upscale and luxury market, the greatest potential in these markets lies in the growth of branded mid-market and budget product aimed primarily at the domestic traveller.

Indeed the Indian Government has identified a shortage of 150,000 hotel rooms, with most of the under-supply in the budget sector.³ Understanding the desires and motivations of the Chinese and Indian traveller will be fundamental to success in these markets.

While the growth in these emerging markets is significant, this should not distract from the absolute size of the mature markets. It is forecast that the share of global tourism GDP will shift by less than five per cent from mature hospitality markets to emerging markets by 2015.⁴

The name of the game

Faced with these new patterns of consumer behaviour, the most successful brands in 2015 will be those that are able to most efficiently engage with consumers and clearly differentiate their offering from their competitors. Delivering their brand experience consistently and at a transparent price point will be vital to success.

At the upper-end of the market, brand will be the core driver of growth as markets become saturated. In the mid-market and budget-end of the market where differentiation is harder to achieve however, brands must focus on implementing consistently simpler but more compelling brand promises, and combine value with experience to entice consumers. Here, the benefit of loyalty programme will continue to be a key differentiator for the consumer.

The new 'Lifestyle' brands will be an increasing force in the market, continuing their growth in both number and scale to 2015. Their ability to achieve a strong revenue per available room (revPAR) often with relatively low conversion costs, will appeal to operators and owners alike.

Key to the brand promise is the talent delivering it. However average staff turnover in the industry is still at 31 per cent.⁵ With staff costs accounting for 45 per cent of operating expenses and the strong correlation between staff retention and guest satisfaction, operators need to consider how best to recruit, reward and retain talent to ensure consistent guest satisfaction.⁶

The world online

There are currently more than 1.5 billion people around the globe with access to the internet. With this forecast to increase by around 50 per cent by 2015, operators need to embrace the world online and ensure they deliver their brand through multiple (and ever-changing) channels.⁷

The social media frenzy has taken the world by storm the last few years. By 2015 this will become truly integrated in the travel and hospitality decision-making process, representing both threats and opportunities for the industry. The transparency of social media can highlight any inconsistencies between the brand pledge and its execution across geographic boundaries. Websites such as TripAdvisor are often the new customers first point of call. Whilst this represents a real challenge for brand owners, it also offers unparalleled opportunities for consumer feedback and opens new channels of communication between the brand and its customers.

As social media websites expand and access to the internet and online distribution channels becomes more accessible, a new breed of confident, empowered and savvy travellers is emerging. Gone are the days when everyone walks into a high-street travel agent and flicks through brochures to book their flights and hotel as a package in one transaction. Savvy consumers are now 'unbundling' the whole booking experience, self-booking directly with suppliers or through new channels such as network carrier websites. In recent years, online consumers have also become increasingly value-conscious, with the internet providing unlimited scope for price comparison and greater transparency of the guest experience on a global scale.

The use of technology is also changing and this needs to be addressed throughout the consumer's journey. Mobile technology will increasingly be at the heart of the consumer-brand interaction and offers a plethora of opportunities for customisation, communication, promotion and loyalty. However, the overall spend on technology in the sector still lags behind other sectors.

A numbers game

It is no surprise that the trend towards choosing value-for-money products has accelerated during the recession as discretionary leisure and business travel budgets have been cut. The luxury hotel market and associated industries such as gaming and premium air travel have been hit particularly hard. On the flip side, low cost air travel and products with clear value-for-money appeal such as all-inclusive cruises or resort-based holidays have remained relatively resilient.



While growth in the luxury market is expected to recover, the drivers and shape of this market will inevitably have been changed by the extended recession. Luxury hotel brands may become more dependent on a core wealthy clientele who are relatively immune to economic volatility and we are likely to see a shift away from the conspicuous consumption of the late-1990s. Continued scrutiny of corporate travel budgets and the need for large off-site meetings also seems likely to be here for some time.

Consumers are increasingly environmentally aware, which will present further challenges for the industry. By 2015, regulatory, economic and stakeholder pressures are likely to create a virtuous circle that will begin to shape new expectations amongst both leisure and business consumers. Few will be prepared to pay a premium for green hotels but values-plus-value is likely to become a growing consumer mantra.

Alongside these known challenges and risks, the industry also has to manage the impact of the unknown. Economic uncertainty, volatile oil prices, fluctuating exchange rates and variable demand present ongoing challenges to owners, operators and investors alike. Events such as terrorism, pandemics and natural disasters result in sudden shifts in demand. While these are impossible to predict, they need to be expected and planned for.

The game-changer's agenda

To be ahead of the game in 2015 and beyond, companies who are able to understand and meet the needs of these new consumers will be the true game-changers. To be one of them, companies need to ensure that they are able to respond creatively to new consumer behaviours and trends.

So, what are the new rules of the game?

The consumer

- **Global budget hotel brands will emerge as operators re-focus emerging market strategies on shortages in that segment.** Game changers will move quickly to take advantage of faster economic growth prospects and supply shortages in emerging markets, exploiting the potential for domestic travel whilst building international brand recognition amongst outbound tourists.
- **A 'game-changing' approach to loyalty programmes will be seen across all segments.** Many upscale guests prefer recognition to reward, and a direct emotional appeal and the need to feel 'special' can drive loyalty. However, the focus of guests in the mid-market and budget segments will remain on value and rewards offered. Operators may need to get use to price promiscuity.
- **Understand different generational needs and values.** The boomers are a key segment and should be targeted with 'experiential' life-enhancing products, designed to appeal to their 'forever young' attitudes.
- **Consider 'Lifestyle' brand opportunities.** If done well this segment can deliver a strong return on investment. However, the challenge is to keep Lifestyle brands current and relevant.
- **Embrace rather than resist the influence of social media.** Engage consumers in a dialogue that builds awareness and community, increases web traffic and search rankings, and draws in potential new guests.
- **Develop a multi-channel approach with increasing use of mobile smart phone technology.** Developing this capacity will enable hoteliers to create a greater degree of loyalty, by ensuring their services fit the quick response needs of today's 'on-the-move' consumer.

- **Enhance in-room technologies as consumer expectations continue to be raised across all segments.** As the budget/economy segment incorporates features once considered the preserve solely of the luxury hotel, the upscale guest will seek further innovation not available in the mass market. However, technology for its own sake and 'gimmicks' can prove costly and damaging to the brand. Ultimately, the customer will determine what the hotel room of the future will look like. Hoteliers should try and keep it simple to use.

The business

- **Invest in talent management.** Engage employees with the brand and deliver consistent standards of customer service across global portfolios. Develop innovative talent programmes and re-design operating models to effectively execute the talent strategy.
- **Develop an environmentally responsible brand and embed a 360-degree view of sustainability within the business model.** Price, quality, brand and convenience will continue to drive consumer spending, but sustainability will increasingly be part of the decision-making process.
- **Develop better integrated IT systems and shared services.** Upgrade or replace creaking core legacy systems; upgrade to 'self-healing' technology.
- **Develop and invest in research and development (R&D).** The industry needs to adopt more of an R&D focus to have a chance of staying ahead of their consumer's needs and desires.
- **Invest in reinforcing data security.** Ensure that the organisation has taken all the necessary safeguards to protect guests and the reputation of the brand.
- **Yield management tools will be developed and extended to improve cost management.** Review costs and free-up working capital through improvements in operational efficiency. Implement cost management systems driven by Artificial Intelligence-based technology.
- **Minimise the shocks of unpredictable events.** Best practice in a crisis includes organisational re-structuring, business continuity planning, flexible pricing, loyalty and customer care. Reconfigure each crisis as an opportunity to reinforce brand values and enhance the consumer relationship. Prepare for the Black Swan.⁸

The hospitality industry

The value of brand to the consumer, the growth in emerging markets, the importance of consumer-facing technology and the sourcing, development and retention of human capital have helped shape the hospitality industry over the past five years. These, along with the growing importance of the sustainability agenda and exogenous events and cycles are the key trends that will define success in the market place in 2015. Our report explores in detail these key trends, which impact both the hospitality industry, as well as the other sectors which make up the wider travel experience.



Emerging markets

Time for a shift of emphasis



Over the past five years, most brands have focused their emerging market expansion plans on the upscale and luxury sectors, targeting international business and leisure travellers.

Key findings

- By 2015, China and India will each have absolute year-on-year tourism growth equal to or greater than the UK, France or Japan.
- Penetration of the domestic travel markets in China and India will yield the greatest long-term returns for international brands.
- Local brands still dominate emerging market mid-market and budget sectors.
- Across India the government has identified a shortage of around 150,000 rooms, with most of the under-supply occurring in the budget sector.
- Both China and India are at risk of an over-supply of luxury hotels in key tourism cities, at least in the short term.

There is now a risk of over-supply of upscale product. Many brands have failed to cater for the significant number of domestic travellers within highly populated emerging markets.

The emphasis needs to shift towards mid-market and budget product, catering for the growing middle classes. In Hospitality 2010 we highlighted an increasing demand for mid-market and limited service product. The recession has made this need even more acute, and supply is lagging behind demand. In times of financial turmoil, catering for the more budget conscious traveller has a stabilising effect and counteracts falling occupancy and revPAR at the upper end of the market.

**“Half of humanity is middle class ...
That middle class needs hotels.”**

Frits van Paasschen, President and Chief Executive Officer, Starwood Hotels & Resorts Worldwide, Inc¹

China and India to dominate emerging markets

Travel and hospitality industries are expanding rapidly in a number of emerging economies across the globe. Countries with a forecasted average annual industry growth rate from 2009 to 2015 of five per cent or more include the BRIC nations – Brazil, Russia, India and China² – and certain countries in South East Asia, the Gulf States, North Africa and the West African coastline. This compares to forecasted growth rates of around two to three per cent in more mature markets (the US, UK, France and Japan). However, with the key exceptions of China and India, these emerging markets are unlikely to become truly significant on a global scale, despite their hospitality industries showing rapid relative growth.

By 2015, China and India will each have absolute year-on-year industry growth comparable to or greater than the UK, France or Japan. By 2019, Chinese absolute industry growth is forecast to exceed that of the US.³

Emerging markets present hospitality groups with significant opportunities but they also offer unique challenges. This is particularly the case in India, where hospitality is lagging behind the Chinese market which opened up earlier and presents fewer hurdles for new entrants. Despite this, many brands that have already begun their expansion into China are now assessing 'where next' and are reinforcing their long-term commitment to the Indian market.

Over-supply at the top

Western leisure travellers are seeking out more exotic and far-flung holiday destinations, travelling to destinations that were once only on the backpack trail. By the end of 2010, China will have surpassed Spain and the US to become the second most popular international tourism destination in the world, behind France.⁴

“International brands have shown increasing commitment to expand in India, but most are reluctant to spend their own money (albeit for some good reasons), and are having difficulty in finding the right local partners.”

P R Srinivas, Industry Lead, Tourism, Hospitality & Leisure, Deloitte India

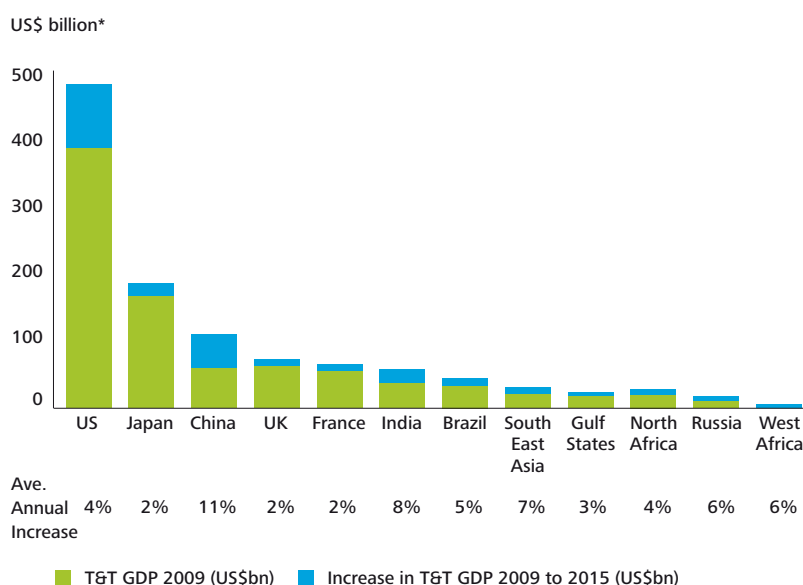
“It is the domestic traveller who is the key driver of sustainable hospitality growth in many of the largest hospitality markets.”

Jean-Claude Baumgarten, President & Chief Executive Officer, World Travel & Tourism Council

Most international hospitality groups have launched expansion programmes into the key emerging markets, not only to cater for western tourists and business travellers, but also to build brand recognition and loyalty among the local populace who are expected to be one of the largest groups of outbound tourists across the globe. The most significant expansion programmes are in China and India with all of the major operators taking their signature brands into these countries.

To date, these programmes have largely concentrated on establishing upper-midscale to luxury hotels in destination resorts and Tier I cities such as Mumbai and Beijing. However even the most ambitious expansion programmes can be counted in the tens, rather than hundreds, of hotels.

Figure 1. Forecast Travel & Tourism industry (T&T) growth from 2009 to 2015 in key mature markets and emerging markets



*US\$billions, expressed at 2000 prices and exchange rates (excludes the effect of price changes)
Source: World Travel and Tourism Council, Tourism impact data, March 2010

As international hospitality groups vie for market share at the top end, cities with established tourism markets such as Shanghai and Beijing are at risk of an over-supply of luxury hotels. With even mid-market brands taking advantage of low construction and employment costs to 'trade up' to five star facilities and levels of service, there is a growing lack of product differentiation.

Domestic market potential

The steady increase in demand from western travellers is supporting the hospitality industry in emerging markets, however it is not the key driver. By focusing their strategies on the business and international leisure travellers, hospitality groups are ignoring the largest market segment: the domestic traveller.

Chinese and Indian domestic traveller numbers far exceed their international arrivals: India has over 563 million domestic travellers,⁵ compared to inbound arrivals of five million;⁶ in China there are 1.9 billion domestic travellers⁷ compared to inbound arrivals of 52 million.⁸

These domestic travellers are the most important factor in the expansion of the emerging hospitality markets. The increase in their numbers and spending power is being driven by the strength of underlying economic development and prosperity in China and India. One effect of this is a rise in business travel; whilst the US business travel market is expected to stagnate over the next five years, growing at 0.3 per cent per year, China's business travel spending will grow 6.5 per cent annually to 2013.⁹ More importantly, economic development coupled with a rapidly growing population results in the proliferation of the 'middle classes'.¹⁰ In China, rising disposable income amongst the local populace has led to a greater appetite for travel, with the greatest impact being felt in domestic and inter-regional tourism markets.

However, this rising disposable income is relative and far from equivalent to a traditional western perception of a 'middle class' income. Middle classes in the emerging markets need to be offered competitively priced hospitality, tempting them away from the unbranded guesthouses that currently have the lion's share of the market.

Their growing desire to adopt more westernised standards of living – and holidaying – offers significant potential for the domestic and inter-regional tourism markets. Premier Inn, the UK budget hotel operator which has begun a modest expansion into India, expects their clientele base in India to be 9:1 in favour of domestic travellers.¹¹

Local brands dominate lower-end product in emerging markets

Local brands dominate hotel development in the lower-midscale and budget sectors and are expanding more aggressively into Tier II and Tier III cities, such as Nanjing and Zhenzhou in China or Chennai and Surat in India. Whilst margins may be tighter, given the scale of the domestic markets the opportunity for lucrative returns cannot be ignored.

One of the most significant impacts of the recession for the hospitality industry in India and China has been a marked shift away from the luxury sector as cost-conscious international leisure travellers have tightened their belts and businesses have cut back on long-haul travel and downgraded their executive travel options. It has yet to be seen whether the long-term impact of this will be a rebasing of prices at the upper end of the market, a more permanent structural shift towards the lower end of the market or merely a short term impact. However, coupled with the surge in domestic travel due to the growing middle classes in emerging markets, this is fuelling demand for lower-midscale, budget and even ultra-budget hotels.

Some international brands already have a presence in the mid-market and budget sectors; the main players in China are InterContinental Hotels Group's (IHG) Holiday Inn Hotels & Resorts and Holiday Inn Express, Accor's ibis hotels and Wyndham Hotel Group's Super 8. However these international mid-market and budget brands pale into insignificance in comparison with the local Chinese budget brands. Home Inns Hotels, Jin Jiang Hotels, Green Tree Inns and 7 Days Inn each have between 300-500 hotels currently, with expansion plans in the hundreds of hotels.

In contrast, even domestic budget brands remain relatively undeveloped in India. The Sarovar Group and Indian Hotels have launched their own budget brands, Homitel and Ginger, with plans to have eight hotels¹² and 30 hotels¹³ open by the end of 2010 respectively. Budget hotel group Tune Hotels.com has announced plans to build a presence in India of around 70 hotels within the next seven years.¹⁴

There remains significant capacity for branded product in emerging markets, particularly at the lower-end. Across the BRIC countries, the number of branded rooms increased from 29 per cent of total rooms in 2004 to 35 per cent at the end of 2009 and is projected to rise to 44 per cent if current pipeline projects are included.¹⁵ This remains significantly behind the US and UK markets, where branded rooms are forecasted to make up 68 per cent and 60 per cent of the total supply respectively.

Future supply shortages

Looking to the future, the Chinese market continues to grow at a faster rate than its room supply, despite the surge of rooms that became available in anticipation of the 2008 Olympic Games. However, the impact of investment decisions made during the economic downturn in 2008 and 2009 is likely to limit supply growth in 2010 and beyond. This may lead to a shortfall of supply in future years, particularly in the mid-market to budget sectors, as the market continues to expand.

India's pipeline has proved more resilient than the global average, partly due to development in anticipation of the 2010 Commonwealth Games. As a result of this resilience, there is a risk that elements of the Indian hotel market may move into over-supply, at least in the short term. The majority of the current Indian pipeline relates to upscale and luxury product in Tier I – and to some extent Tier II – cities. Industry analysts are already starting to question the economic viability of incremental top end hotels in core cities such as Delhi, Mumbai and Bangalore,¹⁶ until demand ultimately catches up with supply in the medium term.

Nevertheless, across India as a whole, India's tourism secretary has referred to a shortage of around 150,000 rooms¹⁷ and a serious under-supply of rooms of an adequate standard even in Tier I cities. The majority of that shortage is in the budget, economy and mid-market sectors which currently have limited pipelines.

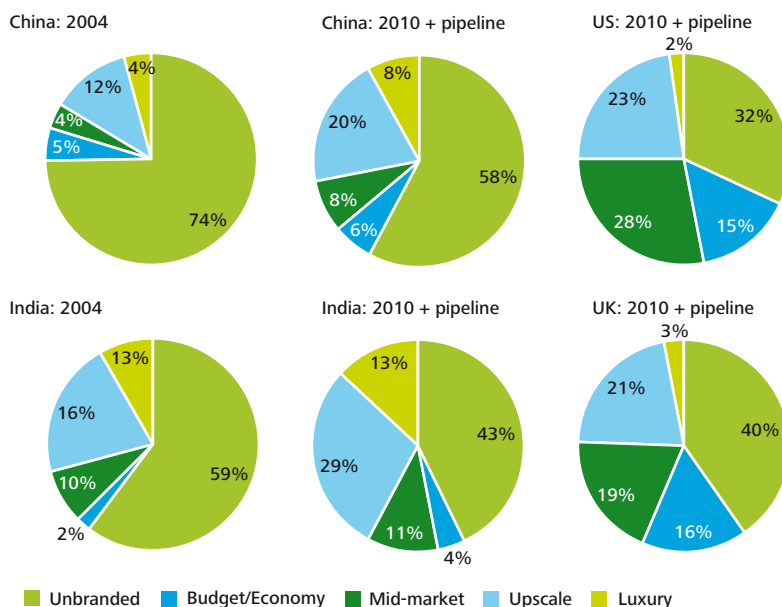
Barriers to entry

Local infrastructure

The development and upgrade of infrastructure within emerging markets has long proved an obstacle to the development of country-wide tourism, with a potential impact on both the international inbound market and the domestic market. The importance of adequate infrastructure is finally being recognised and most governments are now implementing plans to develop key transportation links, including air and road.

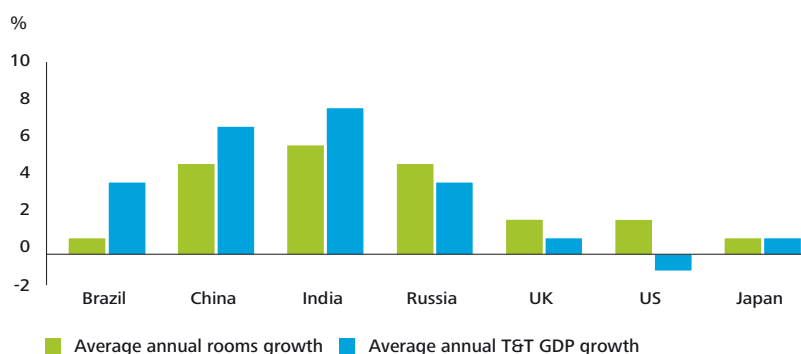
China is already known for its impressive infrastructure, in which a further US\$2.7 trillion is expected to be invested over the coming decade.¹⁸ Although poor infrastructure has historically been a major issue in India, the government is now promoting infrastructure development as one of its priorities. India has only around 60 airports currently capable of handling commercial air passengers but the country has a target to more than double the number of major international and regional hubs by 2020.¹⁹ Current estimates are that infrastructure investment of almost US\$1.7 trillion will be required in the ten years to 2020.²⁰

Figure 2. Percentage of branded rooms across China and India from 2004 to current day (including pipeline)



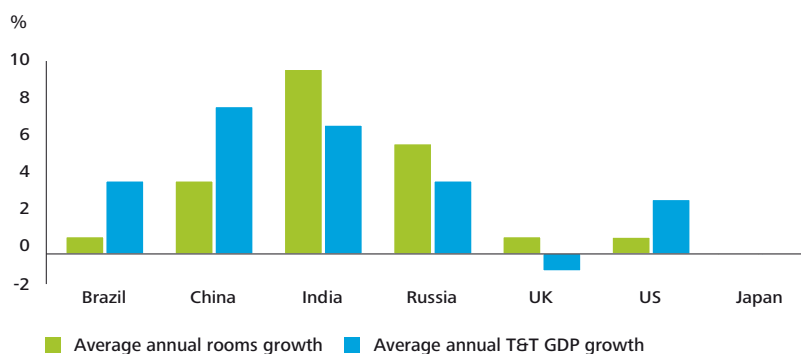
Source: World Travel and Tourism Council, Tourism impact data, March 2010; STR Global data, February 2010

Figure 3. Rooms growth compared to T&T industry growth from 2005-2010



Source: World Travel and Tourism Council, Tourism impact data, March 2010; STR Global data, February 2010

Figure 4. Rooms growth compared to T&T industry growth from 2010-2012



Source: World Travel and Tourism Council, Tourism impact data, March 2010; STR Global data, February 2010

Table 1. Current infrastructure statistics in China, India, the US and UK

	China	India	US	UK
Area of country (km ²)	9,600,000	3,300,000	9,800,000	200,000
Population	1.338bn	1.157bn	307m	61m
Airports ²¹	195	76	419	41
Road network, total (km)	3,600,000	3,300,000	6,500,000	400,000
Road network, expressway (km)	54,000	200	75,000	4,000
Railways (km)	78,000	64,000	226,000	16,000
Internet users	298m	81m	231m	49m
Telephone – main lines in use	366m	37m	150m	33m
Telephones – mobile cellular	634m	545m	270m	76m

Source: US Central Intelligence Agency, World Fact book, extracted March 2010

Partnerships

To date few international brands have been willing to put their own cash on the table in emerging markets, preferring to enter into lower risk management or franchise arrangements. Coupled with this exchange controls and restrictions on foreign ownership of assets, and a lack of suitable local partners with sufficient experience and economic resilience continues to be a major hurdle.

This is especially the case in India where Accor and Hilton Worldwide have both seen their respective joint ventures stall. Perhaps as a result of these experiences, Marriott International has relationships with several different developers and investors in India. Marriott's Area Vice President – India, Malaysia, Maldives and Pakistan, Rajeev Menon, has suggested that a country of such size and diversity as India does not lend itself naturally to a single master franchisor or joint venture partner.²²

Local workforce

Another key consideration is the availability of an adequately skilled workforce, particularly in Tier II and Tier III cities. One solution is to train prospective employees in dedicated local industry training schools, or even in established hotels in developed markets, before they take up local management roles. Both IHG and Accor have opened dedicated training academies in China²³ and Accor plans to do the same in India.²⁴

Customised product

Although differences may exist between established and emerging hospitality markets and some degree of local customisation of product is generally required, there is little evidence of international brands having to significantly modify the build or finish of local developments in either China or India.

However food and beverage offerings are highly customised and the range of services provided is often tailored to meet local market expectations. In India, even the most cost-conscious business traveller generally expects a full service offering, and even mid-market product like Courtyard by Marriott offers restaurants, room service and meeting spaces.

Red tape and real estate

Drawn-out planning approval processes and bureaucracy remain significant obstacles but governments are beginning to cut red tape. The Indian Government has become more flexible in the run up to the 2010 Commonwealth Games, due to a shortage of mid-market rooms available for the event and has introduced tax breaks for companies developing properties in this sector.

In India real estate is expensive and prices are rising, impacting the viability of projects offering an acceptable return on investment, particularly in the mid-market to budget sectors. Despite lobbying from the industry, the Indian Government has yet to show signs of support such as land banks reserved for hotel development.

Political instability

In emerging markets political instability can lead to increased volatility in hospitality. For example, the Mumbai terrorist attacks in late November 2008 had a significant impact on Indian tourism. In December 2008, demand was down 45 per cent compared with December 2007 and took around four months to recover.²⁵

International events

International events, on the other hand, can have a positive impact in raising the profile of emerging markets for international travellers, as well as encouraging rapid investment in new hotels to support visitors to the events and raising brand awareness locally and internationally. All of the BRIC economies are hosting such events: China staged the 2008 Olympic Games and will host Expo 2010 this year, India is hosting the 2010 Commonwealth Games, Brazil will host the 2014 FIFA World Cup and the 2016 Olympic Games and Paralympics, and Russia will stage the 2014 Winter Olympics.

However, such events tend to have a localised beneficial impact on the hospitality industry which may be short-lived. In August 2008, the Beijing hotel market hit a record high during the Olympic Games, before falling to record lows from September. Luxury hotels in particular boomed then plummeted, with occupancy rates falling from 95-100 per cent to 30-40 per cent.²⁶

Conclusion and recommendations

The continued economic growth of emerging market economies, together with growing middle classes that have sufficient disposable income to travel, are driving an increase in both business and domestic leisure travel. These factors, and the greater resilience of these economies against the impact of the recession, have highlighted their growing dominance on the world stage and their potential scale as hospitality markets of the future.

China and India will continue to be the key emerging hospitality markets. We expect penetration of their domestic travel markets – both business and leisure – to ultimately yield the greatest long-term returns and provide a counter-balance to the more volatile international travel market. Over-supply at the upscale end of the market, caused largely by the impact of the recession, should reduce over time as demand creeps back up. However, there is little sign of the supply gap at the budget end of the market closing in the short to medium term, particularly in India.

Hospitality groups should review their global expansion plans and consider:

- Committing greater resources to the Chinese and Indian markets;
- Broadening the brands exported to those markets, to increase presence in the budget-midscale, economy, budget and even ultra-budget segments;
- Developing stable, long-term relationships with committed local partners;
- Lobbying governments and authorities in these areas to remove or reduce barriers to entry; and
- Introducing tailored solutions to recruit, train and retain the necessary skilled workforce.

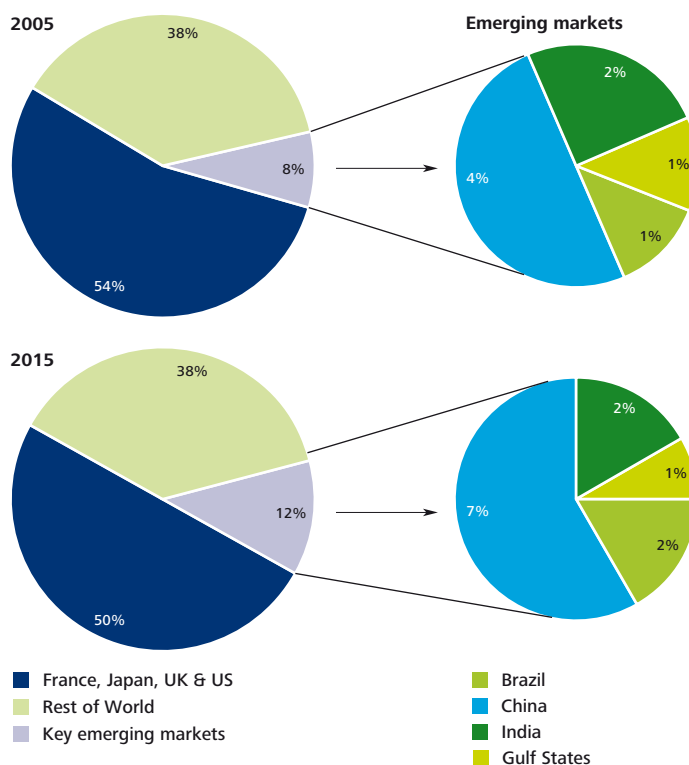
Comparative size

Relative industry growth rates in mature markets may be lower than in emerging markets, but this should not detract from the forecast absolute size and growth in the mature markets. In fact, over the ten year period from 2005 to 2015, it is forecast that the proportionate share of global tourism GDP will shift by less than five per cent from mature hospitality markets to emerging markets.

The emerging markets will still be playing a game of 'catch-up' for the coming decades before they are in a position to rival the mature markets in terms of sheer scale. The total value of the Chinese tourism industry is forecasted to grow by US\$52 billion to reach a total value of US\$113 billion by 2015. In comparison, the US industry is predicted to grow by US\$99 billion over the same period reaching a total value of US\$495 billion by 2015. It is not until 2019 that China's absolute year-on-year growth is forecast to exceed that of the US and China will start closing the gap in terms of industry size.²⁷

Although mature markets continue to grow, they present a very competitive environment in which it can be difficult to increase market share. Hospitality groups willing to invest in the right market segments in India and China are in a strong position to use their global capabilities to gain a greater proportionate market share than would be possible in the mature markets.

Figure 5. Proportionate share of Worldwide T&T Industry GDP in 2005 and 2015 (forecast)



Source: World Travel and Tourism Council, Tourism impact data, March 2010



Spotlight on the Gulf States

Supply of upscale and luxury hotels and resorts in the Gulf States has continued to increase at a significant rate even during the recession, accounting for 62 per cent of the current pipeline (75,000 rooms).²⁸ However growth in visitor numbers has slowed in Dubai. The Dubai Government set a target of 15 million annual visitors by 2010, but more recent forecasts estimate 10 million visitors. With the emergence of new destinations such as Abu Dhabi and Qatar, the Gulf States will continue to see rapid development to 2015, although this is likely to be at a slower pace than in the past five years. Whilst still 'emerging', they will mature in due course but will never have the domestic market to rival China and India in terms of sheer scale of opportunity.

Even the Gulf States are seeing an increasing demand for budget product. The Dubai based firm Layia Hospitality is setting up a new low cost hotel brand called Day & Night Hotels, with plans for 15 properties across the Middle East. The largest UK budget chain Premier Inn also has plans to expand in the region. The Gulf States also provide the greatest evidence of product localisation, with alcohol-free hotels and women-only floors.

Spotlight on Russia

Russia was ranked as one of the top 40 tourist destinations worldwide in 2009 (in terms of human, cultural, and natural resources).²⁹ The country certainly has potential for hotel development: Moscow has a population of over 12 million and only 6,000 western standard hotel rooms.

This compares to 100,000 and 90,000 rooms in Paris and London respectively.³⁰ However, Russia was ranked only 127 out of 133 in terms of Government tourism policy. The country is renowned for complex hotel development laws, which generally necessitate local partners or allies to help steer projects through the bureaucracy. There are signs that the approach may be changing, and the Russian Government has recently created a number of 'special tourist economic zones' which will provide lower taxes and other benefits to companies.³¹ Despite all of these positive indicators, the market will not be large enough in the foreseeable future to rival the existing mature markets, or the emerging markets of China and India.



Spotlight on Brazil

Brazil continues to lag behind other emerging markets, with a forecast annualised growth rate of around five per cent. International tourist arrivals have largely stagnated over the past 10 years, at around five million annual visitors. As a result, many cities suffer from an over-supply of upscale and luxury hotels. The domestic market, although potentially as large as the mature markets, has been affected by the impact of the US dollar exchange rate, which strongly benefits dollarised products. As a result the domestic market has increasingly sought value for money abroad.

Demographic drivers of change

Targeting the boomers and emerging middle classes



In 2015 and beyond there will be two key demographic drivers of change in the industry, creating new patterns of travel demand in the west and important new source markets in the east.

Key findings

- By 2015 US Baby Boomers are forecast to own 60 per cent of the nation's wealth and account for 40 per cent of spending.
- The key to attracting boomers is appealing to their 'forever young' attitude and desire for experiential travel.
- Chinese GDP per head is forecast to more than double between 2010 and 2015. Personal and business travel is expected to grow 73 per cent in the same period.
- India is forecast to have 50 million outbound tourists by 2020.

The ageing of the Baby Boomer generation – aged from 45 to 64 – and their gradual transition into retirement will shape new forms of travel and open new opportunities catering for a relatively affluent and time-rich generation. The emerging middle classes of China and India will also create ripples of change far into the future as their travel patterns evolve from domestic to regional and then international.

In Hospitality 2010, we examined how attitudes and lifestyles differed between generational segments and the impact these differences were having on travel patterns. The 'one size fits all' approach to business had become redundant. Five years later, and the industry has become more advanced in the way it relates to consumers.

Market segmentation by generational characteristics has become a catalyst for a smarter approach to business with multiple benefits. For example, Visit Britain's marketing strategy for 2010-2013 identifies the Generation Y – under 30 years old – as a target market. Through the contemporary and quirky 'Dynamic Britain' campaign, the tourism agency plans to attract these visitors several times during their lives and aims to change popular brand perceptions of the UK.

Segmentation is also influencing innovation in product development, branding, sales strategies and operations. Wyndham Hotel Group is strengthening its brand positioning to attract Generation X – aged from 30 to 44. The company has introduced Generation X friendly functional design and technology including single serving coffeemakers, Mp3 player clock radios with 'WynTunes' playlists and educational video game systems in family suites. The 'Be Well' tag line is used to align the brand with wellness, a value highly regarded by Generation X, and the 'The Fields and Sun' healthy breakfast programme is also aligned with this theme, providing consistent messaging to its target audience.

Boomers to have most impact

Four generations dominate the population structure in most developed countries. Between now and 2015, all of these segments will travel more and will provide significant opportunity for the industry.

Table 2. Generational segment ages

Generational segments	Age	
	2010	2015
Mature	>65	>70
Baby Boomer	45 – 64	51 – 69
Generation X	30 – 44	37 – 50
Generation Y	<30	<36

Source: Deloitte Research, 2009

Mature – over 65 years old – consumers will be looking for price deals and 'freebies' to limit their spending. Generation X is becoming the driving force in family travel and is entering into its peak earning years. The discerning Generation Y is proving to be brand loyal when its expectations are exceeded and this generation is driving the adventure travel trend.

These segments will remain important but we expect the boomers to have the greatest impact on the industry. Between 1995 and 2008, the number of inbound visitors to Britain aged over 55 increased by 92 per cent, compared to 41 per cent growth for tourists under the age of 55.¹

The boomer generation spans those born over an 18 year period – between 1946 and 1964 – and the older part of this segment is only just reaching retirement age. The boomers will therefore be a source market for the global tourism industry for several decades and will have most impact when the latter part of the group retires around 2024.

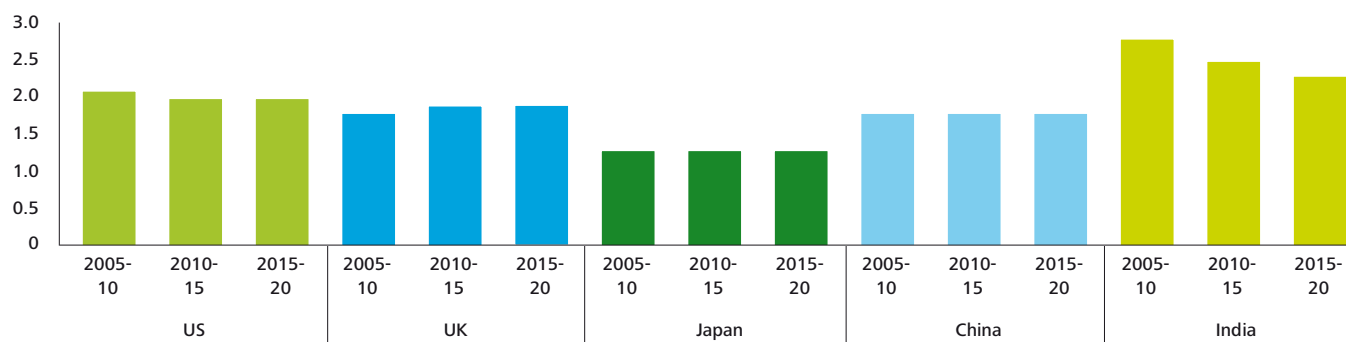
The ageing population is a global phenomenon with almost all nations experiencing growth in the number of older residents. However, most developed nations have higher percentages of older people than do the majority of developing countries.² This is largely because fertility rates in the developed world have fallen persistently below the replacement rate of 2.1 live births per woman since the 1970s. As Figure 6 indicates, all selected countries apart from India and the US currently have fertility rates below the replacement rate. Looking ahead to 2015, US fertility rates are expected to fall to 2.0, leaving India as the only country to have fertility rates above the replacement rate until 2020 at least.

As the proportion of older people increases they are also living longer, a trend which should continue until at least 2020 (Figure 7). US life expectancy is projected to grow from 79.2 years of age in 2010 to 80.5 by 2020 and similar growth is expected across most of the developed world. The expanding boomer population can be expected to enjoy longer periods of retirement than previous generations.

Boomers will also have more disposable income than previous retired generations. By 2015 US boomers are forecast to own almost 60 per cent of the nation's wealth and account for 40 per cent of spending.³ In short, boomers will have significant amounts of time and money at their disposal. For many, travel is a high priority and is likely to top their list of desired retirement activities.

Figure 6. Fertility rates and forecasts for selected countries

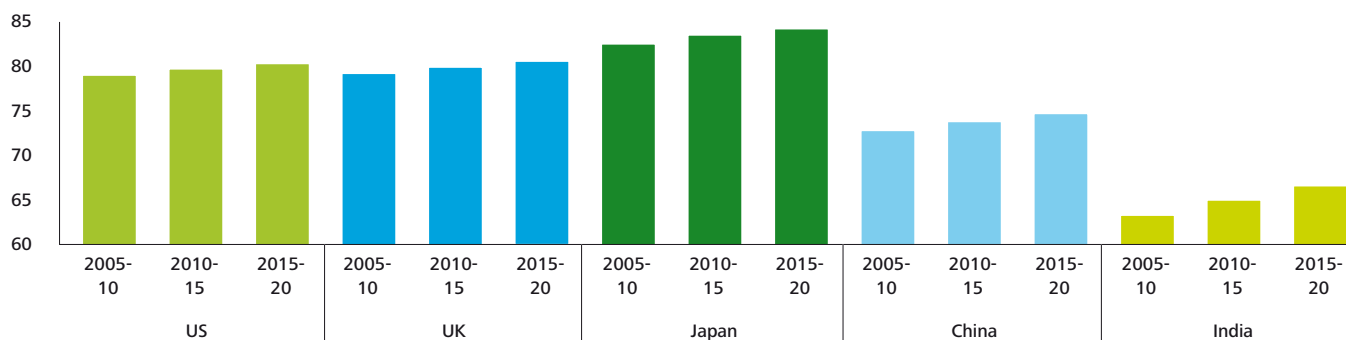
Live births per woman



Source: United Nations Population Database (revised in 2008)

Figure 7. Life expectancy and forecasts for selected countries

Age



Source: United Nations Population Database (revised in 2008)

Most boomers entered the workforce between 1964 and 1984. The introduction of the Boeing 747 in 1968 opened up the world for this generation, making air travel more accessible, affordable and important. For the next two decades overseas travel was no longer seen as an unaffordable luxury. With the introduction of the low cost carrier business model in the 1990s, the cost of travel declined further and both leisure and business travel were re-defined as a necessity for many people.

For Generation X and Y, travel has become increasingly seen not only as a necessity, but even as a right. Boomers have witnessed their children living jet-set lifestyles, taking extended holidays and gap years in far-off places while they have been more restricted to shorter holidays, business trips and less adventurous destinations. For many, retirement will offer the chance to spread their wings further.

Understanding the boomer mindset

Despite the growth of travel and hospitality companies specifically targeted at the boomer generation, the market is far from flooded and the scale of opportunity is large.

The key to unlocking the boomer generation is understanding and appealing to its 'forever young' attitude. Boomers are reluctant to consider themselves as senior citizens and are adopting travel habits previously associated with younger generations. Experiential travel is an important dimension. Retired boomers have more time to explore their interests and passions.

'Voluntourism', hobby-based or educational travel such as painting holidays or archaeological digs will appeal to this demographic. Boomers are also more experienced, confident travellers than the older generations of the past and will be searching for 'off the beaten track', authentic and adventurous travel experiences.

Best practice in marketing will address these youthful attitudes but also acknowledge the distinct interests and needs of the boomer generation, rather than grouping boomers with marketing campaigns aimed at younger audiences.

Advance of the east

While the rise of the boomers in the established markets will be a key driver of international tourism to 2015 and beyond, the axis of global travel growth is also tilting towards the growing middle classes in the emerging markets. Frits van Paasschen, President and Chief Executive Officer of Starwood Hotels & Resorts Worldwide, Inc, expects to see a 'rise in the rest of the world', implying that the US may no longer be the dominant leader in travel spending.

Since 2000 the average annual growth rate of outbound departures from China has been over 20 per cent, and since 2004 the equivalent rate for India has been over 16 per cent. Establishing a presence in these markets now will not only allow hospitality groups to exploit these high growth domestic markets, but will also build brand recognition and loyalty amongst the international travellers of the future.⁴

History often repeats itself and the rise of China and India is no exception to that rule. These two countries produced around 45 per cent of the world's wealth two centuries ago (30 per cent by China and 15 per cent by India).⁵ Looking ahead over the next few decades, wealth is expected to shift once more from West to East. China is on course to become the largest economy in the world by 2025, overtaking the US, with India moving ahead of Japan into third position.⁶

Cruise industry: Preparing for the boomers

The cruise industry, a traditional favourite of older travellers, has been preparing itself for the rise in boomer travel over the last decade by increasing the size of its fleets. According to the UK travel association ABTA, 16 new ships will be launched in 2010. The industry has also been extending routes and aligning service offerings to boomer interests such as healthy eating and wine tasting courses.

Saga, a UK travel operator for the over-50s, is also targeting the boomer bulge. Its website contains unique features that acknowledge the needs and values of 'silver surfers' such as value for money and pricing transparency. For example, if the cost of a holiday is reduced once it has been confirmed, Saga will automatically pass the value of the saving onto early bookers who may have booked at a higher price. The website also includes a font size adjustment tool, demonstrating that the company is aware of the needs of older travellers.

Emerging economies are leading the way out of the global recession with the Economist Intelligence Unit (EIU) forecasting GDP growth of 9.3 per cent in China and 7.3 per cent in India during 2010. As shown in Table 3, these high growth rates should continue until at least 2020, whilst more developed countries such as the US, the UK and Japan see much lower rates of growth.

China and India are by far the two largest populations in the world and, fuelled by the economic strength of these countries, their respective middle classes are expanding and increasing the amount of disposable income they have available for international travel.

Table 3. GDP percentage growth 2008-2020

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
China	9.6	8.7	9.9	8.1	8.0	8.3	8.0	7.4	6.9	6.4	5.9	5.6	5.3
India	5.1	6.8	7.7	8.0	8.3	8.0	8.0	7.4	7.0	6.6	6.4	6.1	6.0
Japan	-1.2	-5.2	1.7	1.1	1.2	1.0	0.9	0.8	0.7	0.6	0.6	0.6	0.6
United Kingdom	0.5	-4.9	0.8	1.1	1.3	1.6	1.5	1.5	1.5	1.5	1.5	1.6	1.7
United States	0.4	-2.4	3.3	1.8	2.0	2.2	2.3	2.5	2.7	2.8	2.9	2.9	2.9

Source: Economist Intelligence Unit, 20 May 2010

As well as new tourism source markets, the large emerging market populations are also providing important new labour resources. The Chinese labour force is set to peak at 831 million in 2016,⁷ providing a source of talent for the growing Chinese tourism industry. The workforce in India, speaking a high level of English, will also provide a source of talent for the global tourism industry for decades to come.

The Chinese traveller – lure of the western brand

As shown in Table 5, China is seeing huge growth in GDP per head, forecast to more than double between 2010 and 2015, fuelling growth in disposable income and interest in travel.

Despite this growth, per capita GDP still lags well behind the developed world, making domestic travel a more attractive and affordable option in the short term. This is reflected in the difference between domestic and outbound tourism figures. The outbound market consisted of 47.5 million tourists in 2009, up 3.6 per cent over the previous year. However, domestic figures were much higher with 1.9 billion tourists, up 11 per cent over the previous year.⁸

The outbound travel sector is still very much in its infancy, having only developed over the last five years. Its potential, however, is huge, demonstrated by the forecasted 15 per cent growth in outbound tourism in 2010 and, to a much greater degree, by the 1.9 billion domestic tourists who could take international trips in the future.

The top ten destinations for Chinese tourists engaging in international travel for the first time are currently: Hong Kong, Macau, South Korea, Japan, Vietnam, Russia, Singapore, Australia, US and Malaysia.⁹ These are mostly within Asia but, as per capita GDP increases, we believe that Chinese travel patterns will evolve from domestic to regional and then onto long-haul.

Tourism expenditure forecasts are also rising. US leisure spend is currently the most lucrative in the world, followed by Japan, the UK, China and India. Although the top two spots are firmly set in place, the pecking order is set to change in 2012 with China's leisure travel expenditure likely to surpass that of the UK. China is expected to experience the strongest growth in both personal and business travel between 2010 and 2015, up 73.5 per cent and 73.2 per cent respectively (Table 6).

Table 4. Population projections

Population in key countries (million)				
Country	2005	2010	2015	2020
China	1,312	1,354	1,396	1,431
India	1,131	1,214	1,294	1,367
Japan	127	127	126	124
United Kingdom	60	62	64	65
United States	303	318	332	346

Source: United Nations Population Database

Table 5. GDP per head in US\$

			Percentage change 2010 vs. 2005		Percentage change 2015 vs. 2010		Percentage change 2020 vs. 2015
Country	2005	2010		2015		2020	
China	1,761	4,280	143.0	9,120	113.3	17,180	88.4
India	765	1,370	79.0	2,620	91.2	4,310	64.5
Japan	35,704	41,140	15.2	49,230	19.7	59,800	21.5
United Kingdom	37,886	35,740	-5.7	45,900	28.4	54,500	18.7
United States	42,736	48,230	12.9	57,070	18.3	76,190	33.5

Source: The Economist Intelligence Unit, 20 May 2010

Disposable income and English language skills are the two major drivers in the Chinese international outbound market. Young professionals who speak English in their late 20s, 30s and 40s are currently the most likely to travel internationally. Older Chinese generations do not tend to travel, preferring to save their limited disposable income and English is not widely spoken amongst older Chinese.

The internet is the most popular medium for Chinese consumers seeking information about travel, and the bulk of trips abroad are taken in a tour group with a translator. Chinese travellers seek value for money and cities with bargain-priced luxury brand goods have a particular pull.

The trends that currently define the Chinese outbound market will change as more middle class tourists travel abroad. We expect independent travel to become increasingly popular as more Chinese people learn to speak international languages. We also expect long-haul travel to become more prevalent, especially to Europe and the US, as levels of disposable income rise.

“Generally speaking, the Chinese tourist will fully embrace the destination, taking in shows, sights and shopping while not spending much time in their rooms. As such, they are not discriminating in terms of bed configuration or the availability of certain amenities and they place importance on good value for money.”

Ronald Chao, Partner, Tourism, Hospitality and Leisure, Deloitte China

Table 6. Amounts spent on travel and tourism within key markets

Country	Travel & Tourism activity (2000 US\$ billions)*	2005	2010	% change 2010 v 2005	2011	2012	2013	2014	2015	% change 2015 v 2010
United States	Personal	626	609	-2.7%	624	650	677	701	724	18.9%
	Business	211	194	-7.8%	199	209	220	232	242	24.4%
United Kingdom	Personal	141	128	-9.3%	130	135	139	144	149	16.4%
	Business	28	24	-13.7%	25	26	27	28	30	21.9%
Japan	Personal	279	273	-2.0%	274	282	290	298	304	11.4%
	Business	72	71	-0.6%	72	74	78	81	83	17.1%
China	Personal	74	108	44.7%	118	133	151	169	187	73.5%
	Business	26	36	38.8%	39	44	49	55	62	73.2%
India	Personal	38	54	40.5%	58	63	70	76	82	53.1%
	Business	7	9	18.3%	9	10	11	13	14	63.1%

* US\$ billion, expressed at 2000 prices and exchange rates (excludes the effect of price changes)
Source: World Travel and Tourism Council, Economic Data Tool, extracted 20 March 2010

The Indian traveller – beyond friends and family

India has the second largest population in the world, estimated at 1.2 billion.¹⁰ By 2016 its population is expected to be larger than that of the US, Europe, Russia, Australia, New Zealand, Japan and Canada combined. With fertility rates higher than the replacement rate, the country is forecast to become the most populous in the world by 2025.¹¹ GDP per head is forecast to grow by 93.9 per cent between 2010 and 2015 (Table 5). Although economic growth rates are slightly lower than in China, India has great long-term potential as an outbound tourism market.

The local population has a great appetite for travel with the greatest impact being felt in domestic and regional tourism markets. In 2008, according to the State/Union Territories Tourism Departments, 562.9 million domestic visits took place, an increase of 156 per cent from 2000.

International tourism is also increasing in popularity with the Ministry of Tourism reporting 10.8 million departures in 2008, a similar rate of increase of 146 per cent from 2000. Indians who travel for leisure within the Asia-Pacific region are more likely to stay with friends and relatives than in hotels. Popular short-haul destinations include Singapore, Dubai, Malaysia and Thailand, all of which have large expatriate Indian populations.

We believe that international travel will grow in line with increased levels of per capita GDP and disposable income and long-haul destinations such as Europe will become more popular. The World Tourism Organisation (UNWTO) predicts that India will account for 50 million outbound tourists by 2020.



India has the second largest population in the world, estimated at 1.2 billion. By 2016 its population is expected to be larger than that of the US, Europe, Russia, Australia, New Zealand, Japan and Canada combined.

As interest in travel increases, we also expect Indian leisure tourists to begin travelling to destinations for reasons other than to visit friends and relatives and therefore stay in more hotels.

To prepare for the increase in Indian tourists, hospitality operators should consider the factors that influence Indian travellers in their destination selection, as set out by UNWTO. These include: safety and security; variety of things to do and see; the overall image of the holiday destination; good tourist facilities and infrastructure; and ease of obtaining visas.

Difficulty obtaining visas is one of the main obstacles to growth in Indian outbound tourism. If the application process is convoluted then Indian travellers will be tempted to choose other destinations. Hospitality operators who want to attract Indian guests should also address vegetarian and Halaal dietary needs.

Conclusion and recommendations

The global population is evolving and the pockets of disposable income available for travel are shifting. Affluent baby boomers in the western world are moving into retirement, living longer and are hungry for travel experiences. The middle classes in emerging markets are expanding and most of the new entrants will come from China and India. Despite disposable income lagging behind the current developed world, international tourism from these two source markets will accelerate over the next few years.

Products and services should be targeted to the attitude of 'agelessness' and interest in experiential travel shown by the boomers, appealing to their sense of adventure, independent spirit and desire to explore off the beaten tourist track.

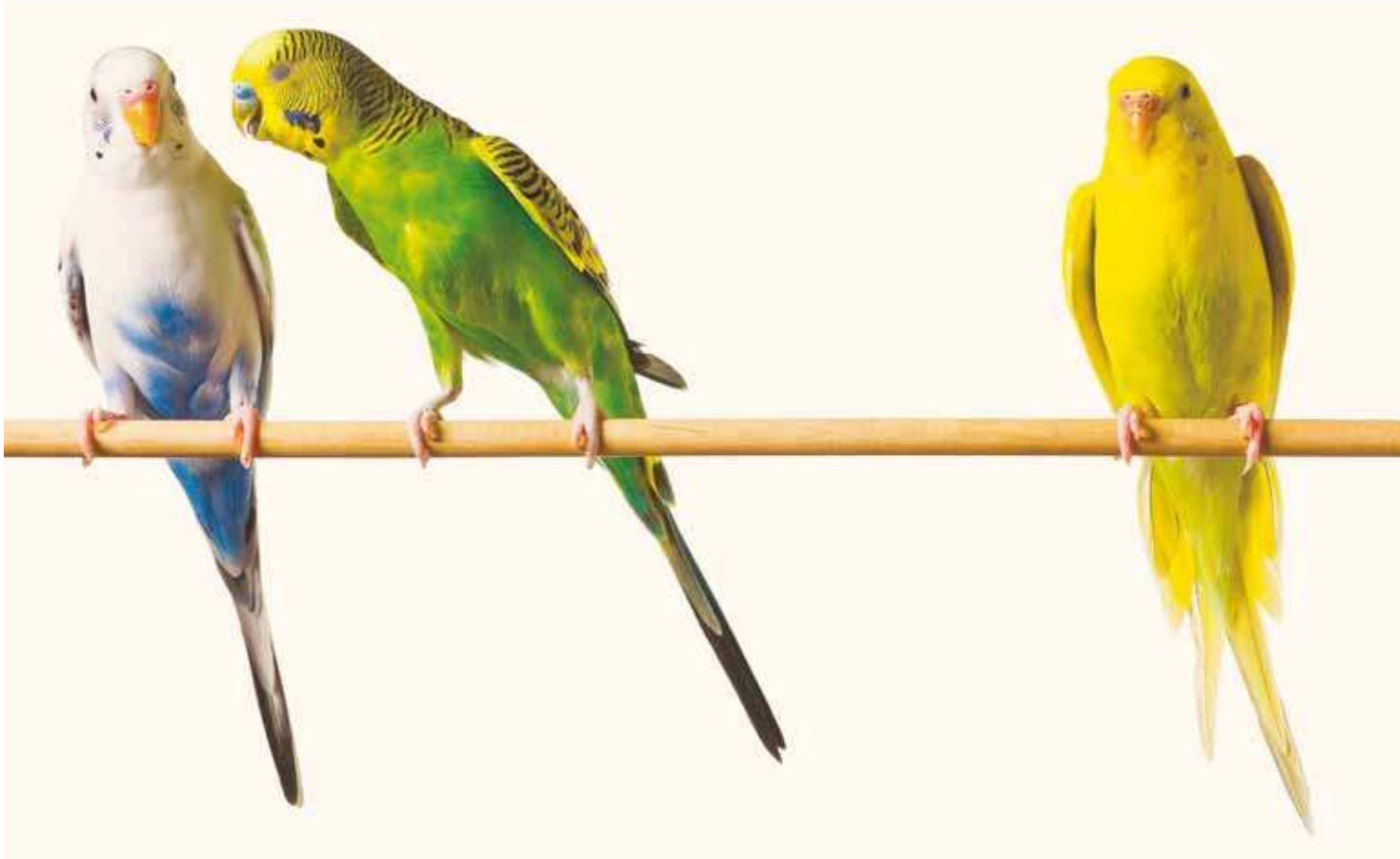
Operators should also acknowledge the distinct and diverse interests and needs of the boomer generation, and offer a wide variety of options and opportunities for self-confident boomers to self-determine and customise their travel and hospitality experiences.

Hospitality groups should see their growing presence in emerging markets as an opportunity to build brand recognition and loyalty amongst the international travellers of the future. For Chinese and Indian middle class travellers, value for money is the key and their interest in western consumer brands and fully engaging with the destination are of more importance than specific in-room products and services. Specific cultural, dietary and language requirements also need to be considered.

Hospitality operators who understand the drives and needs of these growing demographics will reap the rewards and become the future leaders in global tourism.

Brand

Differentiate to survive



Over the next five years, the importance of brand to guest choice is likely to differ widely across different segments. Social media will also present new challenges for brand consistency and open up new forms of dialogue with the consumer.

Key findings

- Brand is likely to become a more important choice factor for luxury travellers as key locations become increasingly saturated.
- By 2015, mass market Lifestyle brands will increase both in number and scale.
- Lifestyle brands will achieve strong revPAR with relatively low conversion costs.
- Social media offers opportunities to build brand awareness and community, but can highlight brand inconsistency which could be detrimental.

Brand perception is more often influenced by experience than by product. It is therefore likely to have a strong, growing influence over consumer choice at the upper end of the market and a smaller, declining role in the large mass-market, more product-driven segments.

Many of the well established brands have experienced the most rapid growth in their history over the past five years, and several have undergone multi-million dollar re-launches. New types of brand have emerged, notably the 'Lifestyle' brand, pioneered on a relatively large scale, such as 'W' hotels from Starwood. We have also seen the increasing influence of macro external factors on brand development, in particular the green movement.

However, the industry remains fragmented with a high percentage of unbranded properties in all segments. Brand should continue to play an increasing role in the short, medium and long term future, but with clear variations. This has important implications for brand owners who need to make careful investment decisions in the continuing harsh economic climate.

Within the mass market, consumers are primarily interested in the key aspects of a good stay: a comfortable bed, a clean bedroom, an adequate and functioning bathroom, basic in-room technology and basic food and beverage. This is illustrated by research conducted by Mintel in 2009 on the UK Budget Hotel sector. This research showed that price and location were the dominant factors with 74 per cent and 47 per cent of respondents citing them accordingly and brand did not receive enough responses to make the top 10. Most telling was a quote from a 25-34 year old ABC1 female – “I don’t have a favourite brand, would generally go with the cheapest.”¹ The ‘softer’ brand attributes such as decor, type of bathroom amenities and service style are often of less value to the consumer and can have less impact on hotel choice.

By contrast, at the top end of the market, consumers are drawn by the brand attributes of the hotel and feel an emotional connection with the brand that supersedes their functional requirements. In these segments, the ‘softer’ brand attributes have significant and growing value to the consumer and have a large impact on hotel choice.

Brand and the luxury traveller

Brand is likely to become a more important factor in the choice of luxury travellers as key locations become increasingly saturated with top end hotels.

Most major operators have more than one mass market brand in their portfolio but only one luxury brand. At the top end of the market, greater brand differentiation is required to entice consumers. Few operators want to risk cannibalising their own customer base by creating another competing brand.

Location is frequently cited as the main reason for selecting a hotel for both business and leisure purposes. When it comes to luxury brands, however, key gateway locations² are already reaching saturation. Of the 29 key locations we considered, there is an average of 5.6 luxury hotels in each location, with some cities having more than 10 competing luxury hotel brands.³

According to STR Global figures, the average growth in new luxury hotel developments in Europe has been flat between 2004 and 2009, and we expect this trend to continue over the next five years. North America continues to invest in a large number of luxury hotel developments, its growth more than double of its nearest competitor Asia. It has achieved this via significant growth – upwards of an average of four per cent per year between 2004-2009 – in six key cities: Atlanta, Boston, Chicago, Dallas, San Francisco and Washington DC.⁴ As the Chinese, Indian and Russian economies grow and their major cities attract more visitors, luxury hotel brands may fight for space in these markets too.

As the market becomes increasingly saturated, luxury hotels will need to differentiate themselves from their competitors even more than in the past. Brands that can offer something truly unique or compelling are likely to win market share and the ability to innovate will be crucial for success.

The websites of many top end hotel chains are currently difficult to distinguish from one another, with frequent repetition of the words ‘luxury’ and ‘experience’ and relatively similar messaging. We believe that much greater differentiation will be needed over the next five years to capture the loyalty of the luxury traveller.

“We see VENU as a natural extension of the Jumeirah brand that will enable us to expand into new markets while maintaining our core focus on operating luxury hotels. VENU is designed to deliver a compelling contemporary lifestyle experience offering ‘local soul’. This can be successfully delivered in sufficient scale to ensure a strong business proposition for owners across the globe.”

Gerald Lawless, Executive Chairman, Jumeirah Group

Sample of luxury hotel website statements

The Dorchester Collection

Vision: The ultimate hotel management company, with a passion for excellence and innovation, honouring the individuality and heritage of its iconic hotels.

Mission (for Guests): We genuinely value our guests, who long to return, knowing they are in hotels that respect the authenticity of their location, are 'the places to be' and where they receive precious and exceptional experiences, while their privacy is respected.

The Luxury Collection

Life is a collection of experiences. Let us be your guide.

Waldorf Astoria

Unrivalled experiences. Located in exclusive travel destinations, our luxury hotels offer a world of possibilities that combine local flavour with global sophistication.

Taj Hotels Resorts and Palaces

For the world's most discerning travellers seeking authentic experiences given that luxury is a way of life to which they are accustomed ... each Taj hotel reinterprets the tradition of hospitality in a refreshingly modern way to create unique experiences and lifelong memories.

Apart from differentiation, consistency remains a challenge for luxury brands. A positive experience can influence consumers to seek out the same brand when travelling to a new location; a negative experience can stop them going back to the same brand. Experience generally outweighs reputation or brand promise.

Consumers who have experienced something positive once at the top end of the market expect to find the same quality whenever and wherever in the world they stay with the same brand. Over the next five years, luxury brands will have to deliver this consistency in an ever more competitive and saturated marketplace.

Lifestyle brands and the mass market

By 2015, mass market 'Lifestyle' brands will increase both in number and in scale by providing a differentiated offering to consumers and sufficient financial returns to owners and operators.

Lifestyle brands focus on a specific experience, style or image rather than functionality. They often have basic services at a property level, tend to be smaller in scale – in terms of room number – and try to create an emotional connection with their guests.

Many of the current Lifestyle brands are positioned within the mass market. Operators have been able to introduce such brands without the risk of cannibalising their existing mass market offer, because of the highly differentiated, experiential appeal of Lifestyle hotels. The challenge these brands face is to expand their portfolios in order to gain economies of scale without damaging their boutique appeal.

Source: Deloitte Research, March 2010

Table 7. Total number of branded luxury hotels in the largest cities*

1	2	3	4	5	6	8	9	10+
Osaka	Houston	Madrid	Atlanta	Chicago	Bangkok	Mumbai	San Francisco	New York (11)
Sao Paulo	Taipei	Melbourne	Dallas	Kuala Lumpur	Boston	Washington DC	Singapore	Paris (11)
		Seoul	Moscow	Milan	Hong Kong			London (17)
		Toronto	Philadelphia	Sydney	Los Angeles			
					New Delhi			
					Tokyo			

Source: Deloitte Research, December 2009

*See Research Approach on page 27 for sample of luxury brands analysed

The past five years have seen rapid growth in the number of Lifestyle brands, as the biggest operators have entered the market and committed themselves to ambitious roll-out plans. Following its launch of the W Hotels Worldwide brand, Starwood has added Aloft Hotels and Element to its Lifestyle portfolio; IHG has launched Hotel Indigo; Marriott has introduced Edition; Hyatt Hotels Corporation has launched Andaz Hotels; whilst Hilton has suffered a false start with Denizen Hotels. Most recently Jumeirah Group have announced the forthcoming launch of its new five star lifestyle brand, VENU, targeting the traveller 'seeking a sophisticated immersion in the destination'.

Our research across 118 cities worldwide shows that only 26 per cent of them currently have a Lifestyle hotel. Within the Americas however, 78 per cent of cities already have a Lifestyle hotel, compared to nine per cent in Europe and five per cent in Asia-Pacific.

The largest Lifestyle brands are W with 26 properties, Hyatt Place Hotels with 20 properties and Hotel Indigo with 15 properties, and together these account for 76 per cent of all Lifestyle hotels. These figures compare unfavourably with the largest traditional brands which typically have around 100-200 properties across our sample cities. For example, there are 140 Marriott, 109 Sheraton Hotels & Resorts, 222 Holiday Inn Hotels & Resorts and 177 Hilton properties.⁵

However, given their relatively immature development, the Lifestyle brands compare favourably with other smaller mass market brands, which typically have around 50-100 properties. For example, there are 84 Residence Inns, 45 Four Points by Sheraton Hotels and 57 Doubletree Hotels by Hilton properties across the sample cities.



Lifestyle – business potential

Although global penetration is extremely low outside of the Americas and there are only three dominant Lifestyle brands, this pattern is consistent with the development of a relatively immature sector. The 'big three' – W, Hyatt Place, Indigo – are moving closer to the scale of some of the smaller mass market brands, an indication that they can also match their economic viability.

The Lifestyle sector has consistently outperformed the mass market in the Americas in terms of revPAR by over 25 per cent since 2003.⁶ The real difference comes in the Average Daily Rate (ADR) between the two sectors rather than occupancy, in which they are broadly similar.

It might seem that the financial benefit of these higher rates could be diluted by higher development costs within the Lifestyle brands. These costs are necessary to create a special sense of the 'boutique' demanded of these hotels. However, discussions with one of the largest Lifestyle branded operators regarding the development of its Lifestyle brand suggest that these fears are unfounded. This operator confirms a significant revPAR increase for its Lifestyle brand above its other mass market brands, but also reports that conversion costs for its Lifestyle property are relatively low. A major factor in these lower development costs is the limited service nature of a brand that does not require, for example, multiple and expensive food and beverage outlets.

This particular operator plans to address the scale issue by opening multiple of their Lifestyle properties in the same gateway city, each having no more than 120 rooms. It has adopted a franchise model to enable rapid roll-out of the brand by appealing to owners of underperforming traditional branded properties.

Our research indicates that consumers are reacting positively to the brand positioning of Lifestyle hotels and are prepared to pay higher rates. These brands have clear potential to achieve critical scale. The next five years will see the current Lifestyle brands significantly increase their scale and see many new brands entering the market.

Social media – challenge and opportunity

The increasing use of online social media will shine a spotlight on how successfully and how consistently operators fulfil their brand promise. Proactive operators will benefit from this communications revolution; those slower to adapt may see their brands pilloried in the full glare of the online public arena.

Tools such as Facebook, TripAdvisor and Twitter play an increasingly important part in the traveller's pre-departure research. As many as one in five travellers are now using these sites prior to departure, while up to one in ten travellers are actually contributing to the sites.⁷

Social media offers enormous opportunities to build brand awareness and community, but also poses difficult challenges for the industry. The growth of social media is making it harder than ever to achieve a consistent brand message.

Wide ratings variance

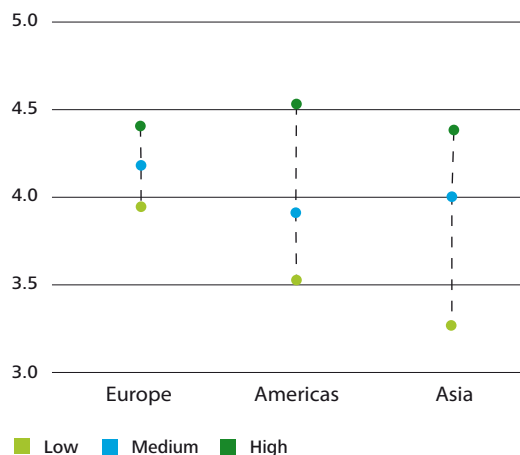
Building a strong core business based on consistent execution can be the springboard to successful geographic expansion and even product diversification. However this very expansion, and the diverse management models involved, can make the goal of consistent brand execution difficult to achieve. Social media is now exacerbating this problem, introducing far greater transparency into the consumer experience of hotels across the globe, and illuminating inconsistencies across the brand portfolio.

Research using TripAdvisor hotel ratings, based on a sample of 30 hotels around the world for one leading midscale hotel brand, showed that weighted average guest ratings varied from 3.27 to 4.53 out of five (Figure 8). This wide variance shows how social media can highlight consumer perceptions of brand inconsistency.

There appears to be little correlation between hotel scale and weighted average rating. Further research, based on a random sample of hotels in London, showed that one midscale airport hotel and two economy hotels appeared in the top ten, ahead of some upscale hotels in more recognised tourist locations (Table 8).

This suggests that social media can work in favour of midscale and budget hotels, where initial consumer expectations may be lower. Hotels that manage to exceed these expectations can sometimes surpass upscale hotels in the rankings, where initial expectations are likely to be higher.

Figure 8. Spread of hotel ratings by region for a midscale hotel brand



Source: Deloitte Research, 2009

Table 8. Top 10 hotels by grade and location in London (random sample)

Number	Grade and Location	Score out of 5
1	Upscale, city centre	4.78
2	Upscale, city centre	4.41
3	Upscale, business district	4.37
4	Midscale, airport	4.30
5	Upscale, business district	4.24
6	Economy, commercial district	4.21
7	Upscale, city centre	4.20
8	Upscale, city centre	4.16
9	Upscale, city centre	4.13
10	Economy, city centre	4.09

Source: Deloitte Research and social media sites, 2009

The power of social media was demonstrated in July 2009 by musician Dave Carroll's campaign which included a YouTube video, 'United Breaks Guitars' that has been viewed over seven million times. This extreme example of a company not meeting the customer's expected level of service should act as a warning for the industry.

“You define customer satisfaction when the guest becomes so satisfied with the brand that they become part of our sales force.”

David Kong, President and Chief Executive Officer, Best Western International



Consumers own the brand

In the past travellers often relied upon brochures or guidebooks, sometimes only to have their expectations and perceptions dashed. Now the experience of previous guests can be read in forensic – and sometimes lurid – detail.

This has led to a decline of traditional brand 'authority', with the views of fellow consumers now often regarded as more reliable than company marketing messages. In the new marketing landscape it is the consumer who owns the brand.

Inconsistent (or consistently bad) consumer experiences will inevitably dilute the integrity of the brand message and will have an impact on future brand choice and loyalty. When future brand choice is put in doubt this is no longer just a marketing issue. It becomes a problem for the board. Starwood's Sheraton brand, for example, is making strides to enhance brand consistency by removing hotels from their portfolio that do not meet their new brand standards. The brand's multi-billion dollar revitalisation effort has resulted in an all-time high for guest satisfaction scores which is translating into growth of market share.⁸

Operators have been seeking consumer feedback through traditional means for many years. Social media sites may generate reams of unsolicited opinion, but hoteliers should not ignore the potential of this highly public feedback mechanism. For example, a demonstration of swift, appropriate recompense from hotel management in the event of a problem can turn a potential PR disaster into a sign of proactive hotel management.

The practice of asking employees to add personal ratings in order to improve the standing of a hotel, on the other hand, should be firmly avoided. Consumers will see through this and any resulting negative publicity can make a potentially bad situation even worse, damaging the rest of the brand.

Whilst online social media has the power to permanently damage the brand, we believe that it can also enhance the brand by allowing hoteliers to open a dialogue with consumers and form a greater bond with them. This dialogue, if handled correctly, will lead to increased loyalty and market share. Social media drives greater transparency and puts the onus on hoteliers to fulfil their brand promise consistently. Negative experiences can be communicated quickly to a large audience but, happily, so can positive experiences. Hoteliers must look carefully at how best to harness the power of social media or lose out.

Conclusion and recommendations

The importance of brand in the luxury segment will continue to grow in an increasingly saturated marketplace. This will be reinforced by the need to respond to consumer desire for experiences rather than hard products. To be successful brands will need to differentiate themselves more clearly within the market and deliver their branded experience consistently across their portfolios.

We expect brand to play less of a role in the large mass market segment. However, the success of Lifestyle hotels demonstrates that brand can still sometimes have a significant impact within the mass market and we expect the Lifestyle brand success story to continue. This success has been built on a very brand-led, experiential approach and brand is unlikely to have the same effect within the traditional mass market where hotels are typically product and location led. This trend will pose serious challenges to the major brand owners as they seek to gain market share from their competitors, perhaps increasing the importance of other factors such as the hotel's loyalty programme on guest choice in this segment.

The growth of social media in the last five years has been staggering and will continue to grow up to 2015 and beyond. This new form of feedback is good news for consumers and offers both threats and opportunities for operators. The transparency of social media will highlight any inconsistencies in the delivery of the brand, and will provide a quick and enriching communication channel between the brand and its consumers. The most successful brands will be those that embrace and learn to harness social media rather than underestimate or fight against its influence.

*Research Approach

Our approach focused on the analysis of hotel properties in 118 cities across the globe: 45 in Europe, 4 in the Middle East and Africa, 32 in the Americas and 37 in Asia-Pacific. The selection of the cities was based on a categorisation using both travel flows and economic importance.

Our research includes data from Luxury, Mass Market and Lifestyle brands in these 118 cities, and our sample sets were as follows:

- **Luxury:** The Luxury Collection, St Regis, Wyndham Grand Collection, Waldorf Astoria Hotels & Resorts, Sofitel Luxury Hotels, Fairmont, Shangri-La, Four Seasons, Taj Hotels Resorts & Palaces, Jumeirah, Park Hyatt, Kempinski, Mandarin Oriental.
- **Mass Market:** Marriott Hotels & Resorts, Residence Inn, Courtyard, Crowne Plaza, Holiday Inn, Express by Holiday Inn, Sheraton, Four Points, Ramada, Wingate by Wyndham, Baymont Inn & Suites, Howard Johnson, Hilton, Doubletree, Hilton Garden Inn, Embassy Suites, Pullman Hotels & Resorts, Novotel, Mercure, Suitehotel, Hyatt Regency, Clarion, Quality, Cambria Suites, Radisson Hotels & Resorts, Park Plaza Hotels & Resorts, Park Inn, Scandic.
- **Lifestyle:** W Hotels, Aloft, Element, Hotel Indigo, Andaz, Hyatt Place, Hotel Missoni, NYLO, Edition, Miraval.

Location data was sourced from the websites of the above brands in December 2009, and pipeline and performance data was supplied by STR Global in January 2010.

For our research on social media we surveyed hotel reviews on TripAdvisor. For the research into consistency, 30 hotels were selected at random for one mass market hotel brand from our sample set, ten in each of the Europe, Americas and Asia-Pacific regions. Their weighted average rating score was then calculated based on the number of people rating the hotel Excellent, Very Good, Average, Poor or Terrible. The expectation management research was carried out by taking a second random sample of 30 hotels, this time in London. The top ten hotels based on weighted average rating were selected, and their location and grade ascertained. All the TripAdvisor data was taken in mid-December 2009.

We expect brand to play less of a role in the large mass market segment. However, the success of Lifestyle hotels demonstrates that brand can still sometimes have a significant impact within the mass market.

Technology

Time to play catch up



In Hospitality 2010 we concluded that technology investment in the industry was significantly lagging behind other sectors. Five years on, the picture has not improved. Technology spending has declined as a percentage of revenue and investment has often failed to deliver the efficiencies or returns that were promised.

Key findings

- Technology spend is still behind other sectors and is forecast to remain so in the coming years.
- Artificial Intelligence-based technologies will be used to forecast food and beverage demand more accurately as pressure grows for better cost control and reduced waste.
- Operators will need to replace creaking core legacy systems and new systems will use self-healing technology.
- In-room product innovation will continue, but consumers, not hotels, will define the future technologies they require.

To be successful in 2015, the industry needs to address these problems. The key areas of technological development are likely to be online booking and mobile technology, Customer Relationship Management (CRM), smart card technology, online social networking, data security, Artificial Intelligence (AI), self-healing technology and in-room product innovation.

“The problem with technology is that because its development is evolving so quickly, there is a danger of spending a lot of money on new technologies only for it to be insignificant or outdated in a few years.”

Laurence Geller, Chief Executive Officer, Strategic Hotels Capital

Justifying investment

Technology spend in the sector has risen in absolute terms since 2005 with a compound annual growth rate of approximately 5.7 per cent from 2005 to 2008.¹ This is broadly in line with retail as a whole and is ahead of the airline sector, which has suffered a difficult few years. However, as the sector was progressing from a low base, there is still some way to go to catch up over the coming years.

Technology spend clearly needs to increase across the industry and Table 9 shows that the spend is forecast to stay behind the majority of other industry sectors over the coming few years. The key challenges facing Chief Executive Officers (CEO), Chief Information Officers (CIO), board members and investors are justifying the required investment, and assessing how technology affects return on investment and share price.² Over the next five years, the focus on budgetary constraints will mean that investment in technology will need to prove a tangible return through revenue generation or cost savings.

However choosing not to invest carries a significant risk. If companies opt to lengthen the lifecycle of IT systems in order to reduce costs in the short term, by 2015 there may be a large number of owners and operators with ageing legacy core systems that may no longer be fit for purpose.

Online booking growth

As online usage has soared over the last decade the internet has become a vital outlet for all retailers. Internet users have risen globally from 957 million in 2005 to 1,536 million in 2009.

Table 9. Growth in IT spend from 2009 to 2013 (%)

Sector (%)	2009	2010	2011	2012	2013	Forecast CAGR* 2008 to 2013
Restaurants and hotels	-6.8	3.5	0.6	3.5	4.2	0.9
Agriculture, Mining and Construction	-8.1	2.4	3.6	3.5	3.4	0.9
Communications	-5.6	3.3	4.0	4.5	4.5	2.1
Manufacturing	-12.0	2.3	3.1	3.8	3.6	0.0
Education	-4.2	3.0	3.3	3.8	4.0	1.9
Financial Services	-7.0	3.5	3.9	4.6	4.9	1.9
Healthcare	-3.8	4.1	4.6	5.0	5.7	3.1
Local and Regional Government	-3.8	3.1	2.8	3.3	3.6	1.8
National and International Government	-2.0	4.6	3.8	4.1	4.2	2.9
Process Manufacturing	-7.1	2.3	3.2	3.5	3.4	1.0
Retail Trade	-6.5	2.4	3.5	4.2	4.3	1.5
Services	-4.3	3.2	3.0	3.7	4.0	1.9
Transportation	-8.3	3.2	3.7	4.2	4.3	1.3
Utilities	-6.2	3.5	3.2	3.9	4.1	1.6
Wholesale Trade	-5.6	2.2	2.7	3.0	2.8	1.0
Weighted Average	-6.3	3.2	3.5	4.1	4.2	1.7

Source: Gartner – Forecast Enterprise IT Spending by Industry Markets, Worldwide, 2007-2013, 4Q09 Update

*Compound Annual Growth Rate (CAGR)

Asia's internet access has also risen considerably. In 2009 internet penetration in China was 25.8 per cent, more than double the figures we anticipated in our Hospitality 2010 report. India's internet users have also more than doubled from 27 million to 64 million users and are forecast to almost double again by 2014. India and China are forecast to contribute an increase in internet users of more than 300 million by the end of 2014. This is more than the total internet users in the US and UK combined in 2009.³

Booking hotels via the internet remains the most popular method, especially for those seeking to put together their own mainstream holiday package, with more than 50 per cent of major hotel brands made via the internet in 2009/10.⁴ This is increasingly pushing travel agencies into specialist and niche holidays where they are still able to offer a differentiated service to consumers.

Hoteliers are capitalising on the rise of internet booking, through the use of CRM, to build a relationship with the consumer from the initial booking through the stay, to post-stay surveys and follow-up communication. However, it is not yet clear whether CRM has been successful in generating the additional revenues needed to justify the investment.

Has CRM delivered?

At the time of Hospitality 2010, CRM was considered to be a vital component in the future success of the industry with many executives seeing it as one of the top priorities for investment in technology. Over the past five years, the results obtained from CRM have been mixed. CRM in relation to loyalty programmes is widely accepted as a success in the industry, delivering significant repeat business and above average spend per night. However around 60 per cent of other CRM projects have had little impact on sales performance and over half of these projects have failed.⁵

The apparent failure of some projects may be a consequence of the attempt to bundle the concept into a purely technological package. In order to ensure that companies are able to benefit from CRM in future, it must be seen as more than a technological concept. Companies will need to give greater thought to the strategic and philosophical fit of the package within the organisation. The implementation of CRM can still offer many benefits, but the chance of successful execution will be increased by the consideration of CRM as a broader, all encompassing concept.

Getting smart

Smart Card technology is now being widely used in the European casino industry, enabling gamers to play in a cashless environment. Smart cards also hold a wealth of consumer information, enabling casinos to develop improved marketing campaigns to target, attract and retain consumers.

This technology can also be used in a hotel environment, and in destination hotels and casino resorts the information gathered from the card can be used to market and promote both gaming and non-gaming activities.

Table 10. World internet penetration rates by geographic regions, 2005-2014 (%)

Country/Region (%)	2005	2010	2011	2012	2013	2014
China	8.6	29.2	32.5	35.6	38.4	40.8
India	2.5	6.6	7.9	9.3	10.9	12.6
United Kingdom	65.4	74.4	75.0	75.5	75.7	75.9
United States of America	69.6	76.6	76.7	77.0	77.3	77.5
World	19.4	32.7	35.4	38.1	40.6	42.8

Source: The Economist Intelligence Unit, 2009 – Internet users

“There is no doubt that the hotel's overall competitiveness today is determined by how well it manages its internet market.”

Max Starkov, President & Chief Executive Officer, e-Business Strategist⁶

Hotels embrace mobile world

Coda Research estimates that 74 million Americans will have video technology built into their phones, by 2015, up from 15 million in 2009, and 78 million will be able to access mobile banking via their phone.⁷ These figures reaffirm the importance of communicating with tomorrow's consumers via mobile technology.

Within the industry, mobile technology is now being used to reach those travellers who are 'switched on' at all times. We believe that access to consumers by this method will grow significantly by 2015.

Hilton is among those operators that have embraced the mobile world by launching an iPhone application to enable guests to manage their bookings. Within a week of the launch the Hilton application had been downloaded more than 6,000 times.⁸ By developing a service of this kind, hoteliers are able to foster a greater degree of loyalty, ensuring that their services fit the consumer's needs more than the offerings of their competitors.

Hotels must ensure their websites are mobile-friendly in order to maximise the benefits of mobile technology. When Marriott launched a version of its website built for smart phones, it reported sales in excess of US\$1.25 million through the site in the first 100 days.⁹

Additional mobile services, already implemented by some hotels, include interactive maps/GPS, reward programmes for quick mobile bookers, confirmation texts and pre-arrival texts. These ideas could be stretched further to encourage greater loyalty and ensure that hotels are providing the best possible service for their guests. This could be done via post-stay surveys and promotional texts between visits. Further individual customisation may be possible via mobile phones, enabling guests to text through specific requests.



Airlines continue to lead the way in technology:

- Online check-in from mobile devices.
- Selecting seats and in-flight meals online.
- Printing own boarding cards.
- Selecting baggage options online.

Most of this was established technology for airlines when we issued our Hospitality 2010 report five years ago and yet hotels still do not offer similar services to guests.

Social networking revolution

Concepts of traditional advertising are no longer applicable in the global online marketplace. The focus is now on 'brand communications' rather than advertising. Marketing has moved through a number of phases over time and is now entering a new era where companies no longer own their brands anymore, the consumer owns the brand, and the consumer decides whether companies are communicating correctly or not. Hotels need to understand this changing landscape if they are to survive and thrive in the new marketing era.

The technological channels through which operators communicate their brand to consumers are also changing. The focus is on social networking across the internet, on sites such as Facebook.

"Networking will be the second most popular online activity by 2012. It will overtake shopping and surpass communications like email. So hoteliers have no choice but to understand the channel quickly or be left behind."

Aleck Schleider, Vice President of Media Strategy and Services, TravelCLICK¹⁰

Facebook has over 400 million active users,¹¹ highlighting the potential reach and impact that businesses can tap into. A hotel can alter its entire image by embracing this new concept. The pod hotel in New York targets single travellers and encourages them to contact one another via their online social network. According to the company, the social network has contributed to a 400 per cent revenue increase.¹²

Research carried out by the UK media regulator Ofcom in the first quarter of 2009 demonstrates that social media is now far from being the preserve of young adults, but is a growing phenomenon amongst older age groups. Half of those aged 15-24 used social networking sites, however usage by those aged 25-34 increased to 46 per cent – from 40 per cent in 2008 – and usage by the 35-54 age group increased to 35 per cent – from 28 per cent. Social media is now part of the mainstream.¹³

Securing the data

As hotel bookings move increasingly online, via PC and mobile device, data security must be a top priority. In recent years a number of information security breaches have become front page news. Most industries have been affected by these incidents in both the private and public sectors. Security incidents can be a result of basic human error, organised crime or high-tech intrusion attacks but the overall consequences are the same: loss of reputation, direct financial impact and regulatory fines.

Data security is an increasingly important consideration for the industry since many hotels process and store large amounts of personal information, making them prime targets for data theft and fraud.

The risk of data breach in hospitality is often greater than other industries due to trends such as online booking, wireless broadband, multiple communication channels, the integration of multiple customer service technologies and centralised reservation systems. Hotel operators are often reliant on a wide range of third parties to deliver cost savings, improved agility and a high quality of service to consumers. Operators frequently need to share sensitive data and resources with other companies, extending the traditional boundaries of the organisation and becoming dependent on third party controls to protect consumer data.

Hotel operators are already required to comply with local data privacy legislation, for example, the UK Data Protection Act. They must also meet data security standards such as the Payment Card Industry Data Security Standard that sets out the minimum standard for all organisations that process, store or transmit payment card details.

Hotels must be clear about their responsibilities and ensure that internal controls and procedures are followed to ensure they have taken all necessary safeguards to protect their guests. This area is becoming increasingly complex and onerous as technologies advance. The industry needs to ensure it does not lag behind other sectors, otherwise operators run the risk of suffering serious damage to their brand and losing the confidence of the consumer.

Back office systems

Operators have focused in the past on maximising revenue through yield management systems, but the focus in the future will shift towards cost efficiencies, particularly in food and beverage.

Sustainability is moving up the hospitality agenda. All businesses are coming under mounting pressure to consider the environment in their everyday activities. Reaffirming the United Nations (UN) message in February 2009, calling for a 'food waste revolution',¹⁴ the recent Copenhagen Climate Change conference has placed an even greater emphasis on the importance of addressing these matters.

In the US alone, food waste contributed over 30 million tons – 12.1 per cent – of the total US municipal solid waste in 2005 and this has continued to rise, both in absolute and percentage terms since then.¹⁵

By 2015, AI-based technologies will be used to forecast food and beverage demand with a higher degree of accuracy, enabling hoteliers to reduce food wastage and manage labour costs more efficiently. The Pan Pacific hotel in San Francisco was reported to be on track "to save four per cent in costs in the first year of using this AI technology."¹⁶

Over the next five years we also predict a significant increase in the role of 'self-healing' technology across the industry.

Integration of back office systems is now improving and addressing the previous problems associated with too many data interfaces. However, as companies become more technologically complex, the risk of technical problems occurring becomes ever greater. Self-healing technology uses a dynamic platform to constantly monitor hotel systems for problems and fixes them before they start to affect other systems.¹⁷ This reduces the risk of technological failure and is likely to save significant sums for hotel operators.

Technology is always noticed most when it fails and operators must aim for seamless, invisible systems and pre-emptive problem solving. David Kantrud, Senior Vice President of Development, Multi-systems Inc., sums this up: "The thing about technology is that many hotel employees don't realise they have it, and if the employees don't notice it, the guests won't notice it and that is our ultimate goal. If this kind of pre-emptive action is taken, theoretically it should enable travellers to have a glitch-free stay and guests are likely to leave pleased with their choice of accommodation."¹⁸

Hotel room of the future

In Hospitality 2010, we predicted that many of the features considered as luxury items at the time would become standard in many budget hotel rooms. As early as 2007, the budget UK operator Travelodge rolled out flat screen digital TVs and wireless broadband across its hotel network.¹⁹ As these features become the 'norm' in all hotels, the luxury market continues to seek in-room technological innovations to enhance the guest experience and further differentiate its offering from the mass market.

By 2015, we expect hotel rooms to include features such as alarm clocks to wake up guests by increasing the light in the room, rather than emitting a noise, giving a calmer start to the day. Floors may have built in sensors to light the way for guests, to avoid the midnight stumble to the bathroom.

Televisions may work via voice recognition to answer any questions guests may have, avoiding the obligatory call to reception to find out what time breakfast is served. Instead of keys, doors may be unlocked via mobile phone interface. All rooms are likely to be fitted with iPod docks, broadband, laptop docking and universal phone chargers to make the stay as comfortable and as functional as possible.

Guests should be able to text or email their exact preferences in advance through their mobile device so that rooms are set up to their requirements upon arrival. They could be able to request a room on their preferred floor, temperature and lighting set to their required specification, music chosen for a particular ambience, a cold drink waiting and perhaps even a hot bath already run for them.

Other innovations may take a little longer, such as windows that turn into televisions at the touch of a button; beds that rock guests to sleep; or multi-functional pillows with built-in speakers and wireless capability so guests can make that midnight conference call without having to find their phone.

The question remains, of course, do consumers really want all this? Do the majority of guests simply require a room that enables them to feel at home when they are away from home and one that can also function as an office space when necessary? All other 'add-ons' may simply be surplus to requirement. Ultimately, of course, the consumer will decide.



Conclusion and recommendations

Keeping up with technology is no longer an optional decision for the industry; technology and the business are inseparable.²⁰ To be successful in 2015, hospitality companies must invest in technology. However the assessment of projected returns on that investment will need to be more rigorous than ever.

In a context of budgetary constraint, tangible returns through both revenue generation and cost savings will need to be virtually guaranteed before investment is committed.

Operators will need to upgrade or replace creaking core legacy systems. New systems should use self-healing technology as a matter of course. Cost management systems in food and beverage should become commonplace by 2015, driven by the need to make cost savings and pressure to reduce food waste as sustainability becomes embedded in the industry. Many solutions will be driven by AI technology.

The battle to drive bookings through proprietary websites will continue, but all major operators will also develop applications and websites for mobile devices as consumers increasingly rely on their Smart Phones. At the same time, as hotel bookings move increasingly online, regulation and risk to brand reputation will force operators to raise their game on data security.

Online social networking will become more mainstream as a marketing tool, building brand awareness and attachment, via a sense of community and delivering new guest connections. Finally, in-room product innovation will continue, but consumers – the owners of the brand – will define the future technologies they require.

Human capital

A post-recessionary strategy for talent



High employee turnover continues to plague the industry, impeding company competitiveness and brand consistency. Many operators lack robust strategic plans to retain their critical employees and many are unprepared for the intensification of staff turnover that is likely to accompany economic recovery.

Key findings

- An average hotelier spends 45 per cent of operating expenses and 33 per cent of revenues on labour costs while employee turnover in the industry is as high as 31 per cent.
- High employee engagement correlates to high levels of customer satisfaction, customer retention, corporate performance and brand consistency.
- Operators need to rethink their talent strategies prior to entering new markets, identifying where to source the right talent, perhaps from outside the industry.
- As well as developing an effective talent management plan, companies need to rethink their operating model to effectively execute business talent strategy.

The recession has temporarily slowed down the rate of staff turnover, with less hiring and fewer job transitions, but the turnover rate is expected to increase rapidly as the economy begins to pick up. For example the average labour turnover for the UK hospitality industry is around 30 per cent,¹ and 31 per cent in the US.² Those rates represent nearly twice the average rate for all other sectors.

Hoteliers are likely to face a 'resume tsunami' as new job opportunities abound.³ Companies with robust talent management programmes will be well positioned to benefit from recovery over the next five years, particularly as global companies expand into new markets and face new consumer segments.

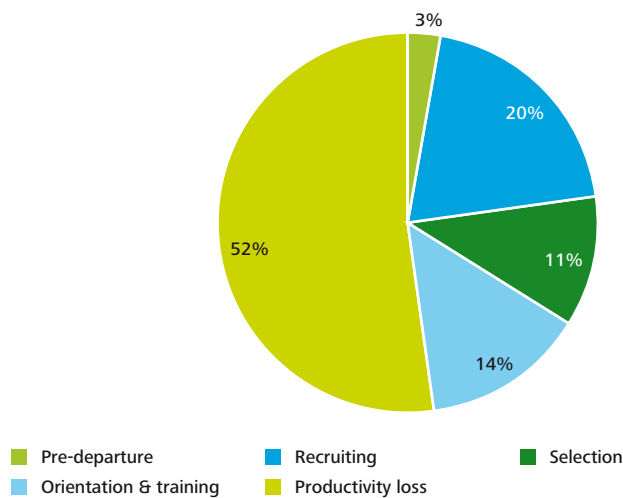
The cost of employee turnover

The value of human capital in the industry is self-evident. The average hotelier spends approximately 45 per cent of operating expenses and 33 per cent of revenues on labour costs, namely employee compensation and benefits. This figure increases with hotel size: larger hotels with US\$20 million or more in payroll related costs spent up to 49 per cent of operating expenses on labour in 2008.⁴ These costs have decreased slightly during the recession but remain the single largest expense faced by operators.

Despite these significant levels of labour spend, employee turnover in the industry continues to remain high. This combination of high labour spend and high turnover is costly for the industry. For many employers the cost of turnover of an employee, in particular a critical employee, can be between 100 and 200 per cent of the total remuneration of that employee.⁵

The estimates vary by type of employee, but turnover costs generally fall into five categories: pre-departure costs, recruitment, selection, onboarding/training and loss of productivity.

Figure 9. True cost of turnover



Source: Tracey and Kruse, How to Keep Your "Stars" from Defecting During Tough Times, 4th Annual National HR in Hospitality Conference and Expo, Feb 22-24, 2010

Hoteliers are likely to face a 'resume tsunami' as new job opportunities abound.



Engaged employees and brand consistency

High employee turnover not only incurs costs but also directly affects the maintenance of brand consistency that is crucial for success in today's industry. Retention rates are closely associated with the morale of employees and their loyalty to the brand. Customer service is a key element of brand experience, and committed employees represent the brand in a better and more consistent fashion. Companies with low retention rates find it harder to develop brand loyalty amongst employees who are likely to deliver inconsistent customer service experiences.

Employees with longer tenures and higher degrees of brand loyalty are more likely to possess competencies that enable long-term brand consistency. Marriott and Four Seasons, for example, have maintained lower levels of turnover and higher consistency of their brand globally. Marriott continues to invest in innovative talent practices and consistently appears in Fortune magazine's list of 100 best places to work in the US, as well as *BusinessWeek's* top 100 places to launch a career, with 35 per cent of staff who start at the company remaining there after five years.⁶

Research consistently shows that high employee engagement is correlated with customer satisfaction, customer retention and corporate performance.⁷ Many companies are shifting their focus from a property-centric to a customer-centric viewpoint. A sustained focus on employee engagement and retention is a key driver for customer satisfaction, directly impacts the bottom line and offers companies a competitive advantage.

The impact of employee engagement⁸

At Marriott strong performance is driven by employee engagement. Higher employee engagement has meant 12 per cent higher revenue per compensation dollar, and nine per cent higher house profit margin. In addition, effective employee engagement means nine per cent of guests are less likely to experience problems and 11 per cent are more likely to return to a Marriott property.

“It is easy to copy the ‘hardware’ but not so easy to copy the ‘software’, which is our talent and our experience in this field; knowing what the customer wants.”

Sheldon Adelson, Chairman & Chief Executive Officer, Las Vegas Sands Corporation⁹

Emerging market challenges

As companies expand into new and emerging global markets they also face new regulatory and talent sourcing challenges.

Labour laws vary widely and limit a company's ability to operate. In Macau, for example, casino resorts can only hire local residents as dealers. With multiple mega-resorts opening over the coming years and a population of only 510,000, talent shortage is a serious issue.

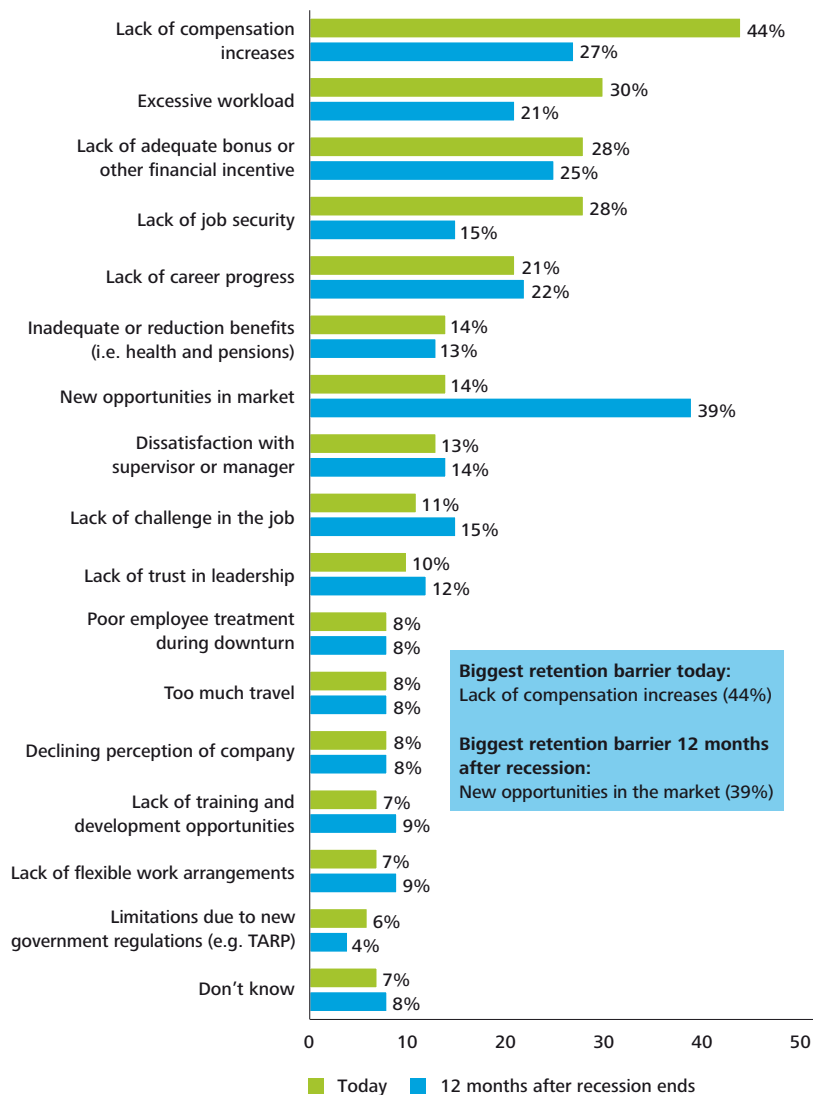
Asian markets also lack the traditional sourcing venues and well defined talent pipelines found in the US and Europe, where graduates of hotel management programmes follow a more structured career path.

In these more established markets talent 'poaching' is also a common practice, particularly in concentrated tourism locations such as Las Vegas, where industry salary raises are often standard and uniform. Employees often go to competitors to gain larger raises, thereby exacerbating an already difficult high turnover problem.

In emerging markets, however, hoteliers face a different set of problems. Many global operators will need to rethink their talent sourcing strategies prior to entering new markets, firstly defining their critical workforce needs and then identifying where and how to source the right talent, perhaps even looking outside the industry.

Varying standards across different geographies and properties, coupled with high turnover rates, also make it hard to maintain brand consistency and customer service across new markets. Companies will need to establish new and innovative approaches to talent management in these markets, designed to align the workforce with the strategic goals of the company, reduce staff turnover and enhance the brand and customer experience.

Figure 10. Top barriers to retaining employees: Today vs. 12 months after recession ends



Source: Deloitte Study "Managing talent in a turbulent economy; clearing the hurdles to recovery," July 2009

Creating a talent management plan

As the global economy recovers and companies return to pre-recessionary hiring levels, they are likely to face a 'resume tsunami.'

A Deloitte survey of global talent trends shows that many companies lack robust strategic plans to retain their critical employees and are unprepared for the increase in employee turnover. Many employers are simply unaware of the pent-up demand for talent currently building within the industry.¹⁰

The survey also shows that many employers are concerned about losing their top talent.¹¹ As the economic recovery accelerates, hiring will increase but voluntary turnover will also rise as opportunities for top talent will open up. Companies can proactively manage this problem via innovative talent management practices that help them to retain their critical employees.

As an initial step, many companies need to conduct an analysis of their assets and liabilities when it comes to attracting and retaining key employees, including a catalogue of retention barriers. These barriers can vary depending on the state of the economy and the market. During a recession, compensation and incentives are the key barriers to retention, but in a growing economy, new job opportunities become the driving force of staff turnover.

Once the relevant retention hurdles have been identified and an initial assessment of the current state of talent has been carried out, an appropriate management plan can be developed combining elements of strategy, solutions, catalysts, and infrastructure that could be part of the overall approach to talent management.

Business needs and strategy should determine the talent agenda. Companies need to consider how their workforce needs will change in the years ahead, what kinds of people they will need and by when they will need them, where in the world they will come from and how progress will be measured.

Every investment in developing a solution should be directly tied to the elements of company strategy. Some solutions will be focused on talent issues like employee recruitment or career development. Others will be focused on work issues: the what, when, where and how of work.

Companies may also have to implement new infrastructure in order to facilitate the talent solutions they require. Some of this infrastructure may already be in place, but hoteliers may need to upgrade their systems and even their culture in relation to areas such as technology, HR service delivery and diversity. Improvements should be focused on delivering the specific solutions necessary to support the strategy.

Rethinking the operating model

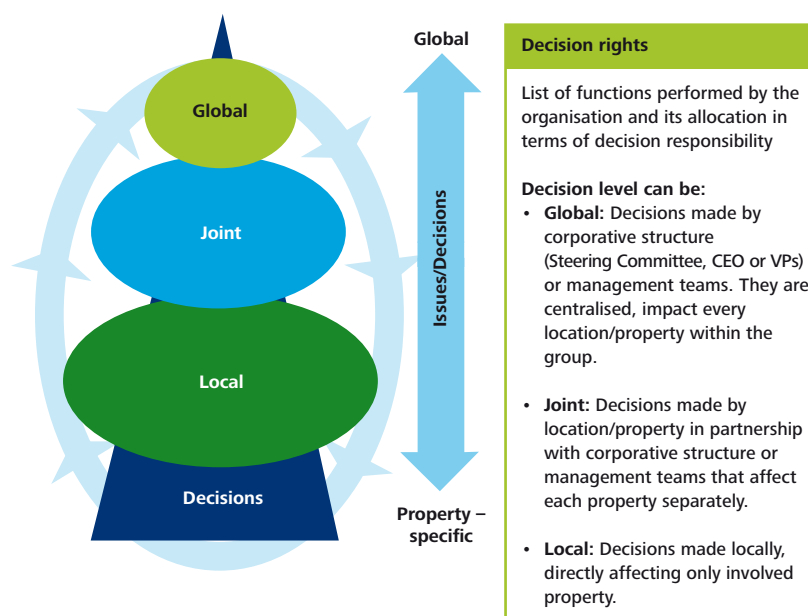
However, an effective talent management plan alone is unlikely to be enough to achieve optimum competitive positioning. Many companies will need to redesign their global operating model: the blueprint that connects their strategic vision with their detailed functional business processes. This operating model provides the critical link that translates the higher level vision into specific people, processes, technology and organisational detail.

The operating model is tightly linked to talent because employees execute their duties within the context of the organisational infrastructure. Employee performance largely depends on reporting relationships and the policies and procedures that exist in different geographical locations.

Since many hospitality companies tend to be property-centric organisations, practices may not be consistent across multiple locations. This is a frequent factor in decentralised organisations where local managers make local decisions that may or may not be consistent with the corporate strategy. This can be true even if corporate policies are standardised throughout the globe.

In these decentralised organisations there is often inefficiency in operations and back office functions, such as HR, IT, Finance and Shared Services. This inefficiency has become an issue for US companies expanding into Asia, where local leadership teams define local talent management practices such as performance appraisal and rewards that may be in conflict with the corporate talent management approach.¹²

Figure 11. Operating Model Considerations: Decision making – Global, local, and joint decision rights¹²



Source: Deloitte Research, 2009

A global Chief Financial Officer (CFO) who provides direct reports with performance feedback and rewards around the world may face different evaluation criteria, compensation review schedules and merit percentages, depending on the location. This inconsistency can inhibit successful team-building, limit employee engagement and ultimately contribute to increased inefficiency.

Back office operations in the hospitality industry have traditionally suffered from underinvestment, notably IT but also functions such as HR and Finance. Many HR functions focus more on customer-facing talent initiatives, but they often lack sufficient focus to manage global talent for IT, HR and Finance.

Many companies need to rethink their operating model in order to address the issues affecting corporate property relationships as well as front and back office interactions. For many companies this will involve reassigning roles, responsibilities and accountability as well as customer service delivery models. This will also involve considerations such as the centralisation or decentralisation of operations and decision making and aligning the talent strategy with the organisational structure.



Conclusions and recommendations

As executives continue to face changing market conditions and strategic choices over the next five years they will need to proactively evaluate their talent management programmes and consider how talent fits into their overall business strategy. As the global economy recovers, companies are likely to face an increase in employee turnover and a 'flight risk' of top talent.

Companies will need to develop innovative talent programmes and solutions aimed at reducing employee turnover as well as attracting and retaining top talent. These programmes must be integrated globally and executed consistently, as employee engagement will be a significant driver for employees to become living examples of the brand.

Many hospitality companies will also need to redesign their operating models and organisational structures to align roles, responsibilities, accountability, and authority for effective execution and decision making. This is of particular importance for organisations evaluating centralisation versus decentralisation issues as well as property versus corporate relationships.

Sustainability

Taking a 360-degree view



Sustainability will become a defining issue for the industry in 2015 and beyond. Rising populations and increasingly scarce resources will provide a challenging business environment in which sustainability will need to be embedded within all facets of the industry, rather than regarded as a standalone issue.

Key findings

- Sustainability is increasingly seen as a prominent factor in hospitality decision making, but is not yet fully embedded in business thinking.
- The key challenge faced by the industry in 2015 will be the adaptation of the existing asset base, which will be expensive and disruptive.
- Regulatory, economic and stakeholder pressure will drive sustainability in the industry, creating a virtuous circle that will see social and business norms change with surprising speed.
- 95 per cent of business travellers surveyed believe the hotel industry should be undertaking 'green' initiatives.

Operators must keep pace with changing social views, business norms and government regulation in order to adapt quickly to the changing expectations of stakeholders. Hospitality is a discretionary purchase, as highlighted by its volatility in the recent recession. By 2015, the consumption of goods and services seen as environmentally irresponsible is likely to be challenged by new social norms. Luxury items that fall into this category risk being seen as increasingly unacceptable.

"Current global consumption patterns are unsustainable ... it is becoming apparent that efficiency gains and technological advances alone will not be sufficient to bring global consumption to a sustainable level: changes will also be required to consumer lifestyles, including the ways in which consumers choose and use products and services."
Sustainable Consumption Facts and Trends from a Business Perspective, World Business Council for Sustainable Development, 2008.

By 2015 we are likely to have reached a tipping point. Those who have not kept pace may struggle to effect change across their businesses and their competitive positioning and profitability may be adversely impacted. Operators need to develop business models that incorporate a 360-degree view of sustainability, embedding environmental responsibility at the core.

The bigger picture – convergence of agendas

Over the past five years sustainability has risen up political, consumer and business agendas faster than any other issue.

Sustainability is now an accepted dynamic in the socioeconomic and political environment of the 21st century, although it remains the subject of much debate and there is still often a gap between what governments say and what they do.

In 2015 the cornerstones of political debate are likely to remain similar to those of the post war period: economy, health, justice, defence and social welfare will maintain their dominance of the agenda. However future policy will also actively consider the implications of sustainability far more than in the past, seeking to change both corporate and individual behaviour.

Today's consumers see sustainability as desirable but not yet as a key driver of activity and, as with government, there is often a clear gap between what people say and what they do or buy. However we are in the midst of a significant cultural shift. At the start of the last decade there was little consumer recognition, yet a recent survey¹ by Deloitte found that in most countries 30 per cent of consumers now buy with sustainability in mind and a further 30 per cent are aware of the issue.

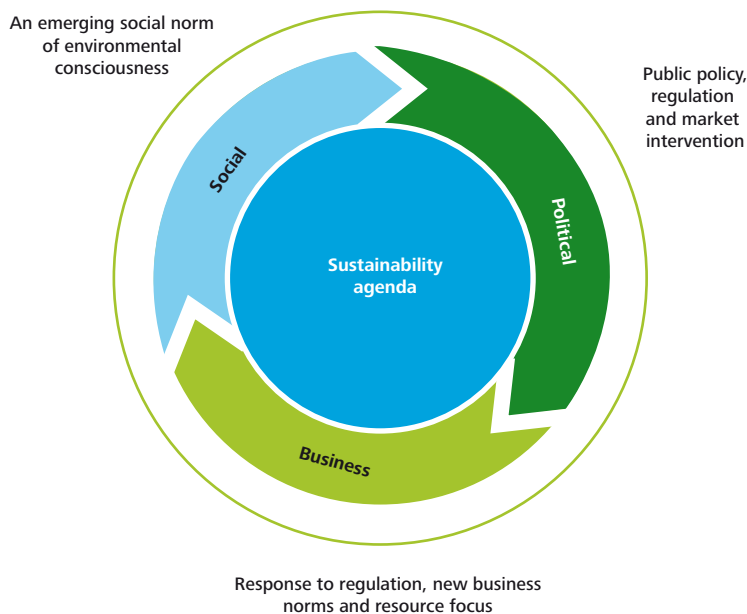
In 2015 the cornerstones of consumer choice will remain similar to those of the last decade. Price, quality, brand and convenience will continue to drive consumer spending, but sustainability will also play an increasing role in determining consumer preferences long before the point of consumption.

In the business world sustainability is already changing the commercial landscape. Business, in the main, has not led this change but must be responsive to it. The hospitality industry may not be able to counteract the structural effect of limited natural resources or the increasing cost of energy supply. However, a reluctance to acknowledge those issues and to address their long term consequences may increasingly be seen as a failure to adapt to new commercial realities.

In 2015 the cornerstones of business decision making are likely to remain similar to those of the last decade, but sustainability will also be built into the market within which those decisions are made. Sustainability will become the 'business norm' and increasingly be seen as part of a 'license to operate'.

Sustainability is a social issue that impacts us all collectively. By 2015, shifting consumer and voter attitudes will have continued their current trajectory, forcing governments and political parties to address the socio-economic landscape and 'real' market in which businesses operate. We believe that the convergence of political, consumer and business agendas around sustainability will be a major historical landmark in the development of our society.

Figure 12. Building towards a tipping point



“IHG views sustainability as a business issue and it is core to the company’s five year strategic plan.”

David Jerome, Senior Vice President, Social Corporate Responsibility, InterContinental Hotels Group

Growing importance in hospitality

Sustainability has been important in the hospitality industry for some time. The broader tourism sector contributed an estimated five per cent of total global CO₂ emissions in 2005.² Although air travel was the largest component of this, accounting for 40 per cent of tourism emissions, accommodation also made a significant contribution with 21 per cent.

Hospitality is vulnerable to water shortages, relies heavily on built assets, consumes significant amounts of electricity and, generally speaking, is an item on which spending is discretionary. These factors ensure that hospitality will be significantly impacted by sustainability issues in the future.

Sustainability began to gather momentum as a mainstream competitive issue in 2006, with the launch of the environmentally conscious luxury brand '1' by Barry Sternlicht, Chief Executive Officer and Chairman of Starwood Capital Group. Since then, almost all major hotel chains have launched some form of environmental sustainability programme.

This trend is not just visible in the west; hotels in India and China are also catching on. In India, ITC Limited's new luxury hotel in Bengaluru was awarded the US Green Building Council's Leadership on Energy and Environmental Design (LEED) platinum rating, making it the first hotel in India to achieve the highest rating for green buildings.³

Sustainability initiatives currently range from operational changes such as linen and towel re-use programmes, energy management projects or using green cleaners to development initiatives such as pursuing green building certifications like LEED.

Our interviews with hospitality executives confirm that sustainability is no longer considered primarily as a marketing issue and is now increasingly seen as a prominent factor in decision making, although it is yet to be fully embedded into business thinking. By 2015 we expect sustainability to become a business imperative, requiring companies to educate their organisation on the changing consumer and regulatory environment and to derive strategies to maximise their market position.

"Sustainability is one of our top five strategic priorities because it impacts our business and reflects our core values."

Faith Taylor, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

Table 11. Sustainability trends at major hospitality companies

	Publicly announced sustainability targets?	Target summary
Hilton	Yes	Five year reduction targets (energy, waste, water, and CO ₂ emissions) from direct operations.
IHG	Yes	Three-year energy reduction targets per available room night and plans to launch 'Green Engage' programme in 100% of owned and managed facilities.
Marriott	Yes	Ten-year energy and water consumption reduction targets per available room Established green building targets and implementing green-sourcing programmes.
Starwood	No	No formally announced targets – however the company has launched the Element brand which incorporates the LEED construction standards.
Wyndham	No (In-Progress)	Defined sustainability strategy and identified core focus areas. In-process of establishing sustainability targets.

Source: Based on information on company websites and Deloitte interviews

Sustainability drivers for hospitality

1. Hospitality is an asset-heavy sector with a large environmental footprint

Hotels rely on a wide range of natural resource inputs and generate significant waste through their lifecycle. Once built, buildings are expected to last for decades and major retrofits can be expensive.⁴ Since existing buildings contribute almost 80 per cent of the carbon emissions in some large cities⁵ through their energy use, there is significant risk of economic cost and negative media publicity as marketplace concern around climate change grows. As consumer attitudes and public policy continue to change the sector will not be able to hide.

2. Regulatory changes and commodity prices will impact the bottom line

Reliance on scarce resources such as water, electricity, and natural gas for building operations exposes the industry to commodity risks and falling margins as prices rise. Planned and pending regulation around the globe targeted at increased efficiency and putting a 'price' on carbon will further impact the industry. For example, in the UK, the CRC Energy efficiency scheme will see hotel brands required to participate in a new cap and trade scheme aimed at reducing carbon emissions and creating a market mechanism to facilitate this. A public league table will also explicitly measure performance and seek to influence consumer attitudes. Sustainability will become a driver of improved profitability as the regulatory landscape evolves and resource prices increase.

3. Marketplace awareness of environmental sustainability is growing

Recent studies by Deloitte indicate a growing consumer preference for green hotels. Rating agencies are recognising this growing trend and plan to introduce EcoRating of hotels in 2010. Current consumer behaviour suggests that location and price remain the most important selection criteria and guests will only select a green hotel if all other things are equal. However this is changing. In the next five years sustainability will increasingly become the norm and part of consumer expectations. Strategy and operations that are considered environmentally irresponsible will negatively impact stakeholder decision making from investors through to consumers. As consumer attitudes continue to change, expectations that influence choice and inform perceptions about product and brand will also change.

Economic drivers of sustainability

In the US an average hotel spends about US\$2,196 per available room in energy costs, representing six per cent of all operating costs.⁶ The Energy Information Administration expects most fuel prices to continue rising in 2010 and beyond. These prices will increase further with forthcoming CO₂ regulations, making energy efficiency an important issue for hotel operators.

Water is an additional concern for many luxury hotels. As water resources become more constrained, governments will begin charging higher rates or limiting water use at commercial properties. Water use reductions will limit a hotel's ability to use fresh water for landscaping, spas and swimming pools.

Just a ten per cent reduction in energy consumption would have the same financial effect as increasing the ADR by US\$0.60 in limited-service hotels and by US\$2.00 in full-service hotels.⁷

Given the importance of these features for resort guests, such reductions may have an impact on revPAR. However, improving water efficiency can also lower a hotel's sewage bill, which is sometimes even larger than the cost of water.

As input prices rise, the industry is exposed to commodity risks and margin reductions, so hoteliers will need to focus on operational efficiency. Modifying existing properties is expensive and, in the short term, we expect the industry to focus on efficiency initiatives primarily on new construction and major retrofits.

“Technological improvements have progressed so quickly that it is possible to save money and protect the environment – so I am optimistic for the future.”

Laurence Geller, Chief Executive Officer,
Strategic Hotels Capital

Operational efficiency has always been central to effective hotel management but sustainability is refocusing attention on this area and raising the bar for new builds. The City Center development in Las Vegas, one of the largest single site hospitality projects ever completed, has sustainable practices at its core, with Gold LEED certification and operational focus in this area.

The key challenge that the industry will face in 2015 and beyond is the adaptation of the existing hospitality asset base, which will be expensive and disruptive. Companies that do not address this may find themselves displaced by new assets and large operators will need to watch this dynamic carefully. A weak portfolio from the perspective of sustainability is likely to have an increasingly detrimental impact on brand perception and profitability.

Structural changes take time to implement and some operators may fail to keep pace if they do not address these changes proactively. Additional value should be generated through enhanced efficiency, shared services and sustainable supply chains. Current portfolios present an opportunity for system-wide sustainability that can differentiate businesses from their competitors right across the operating model from distribution to asset management. However, without action, these portfolios will quickly become a burden.

Emerging regulations

Regulation will continue to be an important initiator of change and driver of momentum in business sustainability between now and 2015. This is particularly evident in the hospitality sector.

The building sector accounts for 30-40 per cent of global energy use, according to the UN Environment Programme's Sustainable Construction and Building Initiative (SBCI).⁸ In larger cities, such as New York, buildings represent 80 per cent of green house gas emissions. There is increasing consensus among scientists and regulators that climate change cannot be addressed without stricter new building construction and retrofit programs.

Governments around the world are using both 'carrot' and 'stick' approaches to improve building efficiency. US and European governments offer a variety of lower cost financing, tax credits and tax deductions for sustainable development. While none of these incentives are specifically targeted at the hospitality sector, many would apply.

In cities like San Francisco, pursuing a LEED certification can expedite site plan permits. Carbon taxes and cap and trade schemes are in place for energy intensive industries already and, across Europe, plans are in place for these to be extended to 'normal' business operations. The UK Carbon Reduction Commitment (CRC) energy efficiency scheme, which came into force in April 2010, is an example of this. For hotels this will lead to brand owners becoming responsible for carbon reduction, not just at their managed hotels but at the franchise properties as well.

Regulations are not just limited to energy efficiency. The UN has described the global situation surrounding water availability as 'a disaster in the making'. Legislative actions are being considered to address this problem. Some US states, facing more immediate concerns, have taken water scarcity issues to the courts. Construction recommendations related to water conservation are also emerging in large cities like Mumbai, where voluntary use of dual-flush Water Closet (WC) and grey water recycling systems⁹ is becoming more common.

"New property development by 2015 will increasingly be impacted by regulations and codes requiring buildings to be built more sustainably. It is already happening in Europe."

Faith Taylor, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

We expect the pace of regulation to increase in the future. We believe the industry needs to be more proactive in helping to shape these regulations, not to minimise their impact, but to help educate regulators and ensure that sensible, balanced actions are taken. Given the lifespan of most hotel properties and current and pending regulation, it is in the best interest of developers and operators to consider sustainable design, construction, and operation principles in any new development or major retrofit project in order to avoid future penalties and future retrofitting costs.

Changing social norms

Marketplace awareness of the environmental challenge is increasing and an overwhelming majority of consumers express concern about environmental sustainability. According to a survey by Deloitte of US business travellers, 95 per cent of respondents believe the hotel industry should be undertaking 'green' initiatives.

While consumers express interest in sustainability, this interest does not necessarily translate into purchasing decisions which may result in a price premium or significantly higher occupancy rates for 'green hotels'. Such hotels have enjoyed increasing media publicity which helps to lower marketing costs and generate awareness. However green hotels cater for only a niche segment of socially conscious and upwardly mobile consumers who seek out sustainable properties and demand higher standards of themselves and the companies they do business with.

“Carbon reporting will become increasingly regulated by Governments. This will allow consumers to make more informed decisions.”

Faith Taylor, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

Consumer awareness of and interest in sustainability is rising, but this will not be the primary driver of sustainability in 2015. The definition of sustainability remains unclear to many consumers today and, whilst they are ‘conceptually aligned’, they are sceptical about sustainability’s direct impact on them as individuals.

Regulatory, economic and stakeholder pressure will drive changes in the industry, creating a virtuous circle that will see social and business norms change with surprising speed.

Operators who fail to keep pace with this change will not only incur additional regulatory costs but, in the longer term, risk losing a ‘missed generation’ in terms of consumer recognition of sustainability performance. The majority of consumers may not require a ‘green’ hotel as such, but will increasingly prefer brands that are environmentally responsible, requiring sustainability to be embraced throughout the organisation. As this expectation becomes the norm it will be a defining factor in suppressing those brands that are seen as less environmentally responsible.

Over time we believe consumer preferences will start to drive sustainable consumption, not through a premium on sustainability but through a reluctance to consume in a way that is considered to be environmentally irresponsible. This dynamic has already emerged in other sectors, notably car sales where 4X4’s have seen negative sentiment in many markets for this very reason, having in many cases previously been seen as aspirational.

In the short term, whilst brands and operators will have to balance sustainability against other competing initiatives aimed at gaining market share, sacrificing environmental responsibility should be avoided. As social norms change and attitudes towards sustainability become more acute, brands and properties will need to operate within redefined boundaries in relation to sustainability. Resistance to this change may generate short term savings, but it poses significant risks of longer term damage to product and brand, coupled with higher adaptation costs.

Starwood’s mid-market Element brand, which incorporates LEED construction into the brand standards, recognises this dichotomy. LEED certified buildings improve efficiency and lower operational costs, allowing the hotels to maintain price competitiveness while catering for consumer interest in green hotels and capturing niche market share. Markets such as this will remain niche, but they can be used to develop sustainability practices and business models that can be applied across the broader business in due course. This helps to position companies for the future whilst recognising the needs of the existing business.

Stakeholder influence

Although consumer preference and willingness to pay for environmental features remain unclear, brands and operators cannot ignore the need to communicate progress on sustainability. Stakeholders, including corporate travel departments, government and tour operators, influence consumer hotel purchases and will increasingly do so.

Companies across all industries are now developing internal sustainability targets and asking hotels about their sustainability performance as part of the sourcing process for business travel. This trend will continue to grow as companies seek to measure, report and improve their sustainability performance in response to government, consumer, and other stakeholder demands. As the availability of environmentally-friendly hotels increases, companies are likely to direct their employees to these preferred hotels, provided they meet other important criteria related to quality, location and price. Similarly, governments in the US and Europe are already beginning to consider sustainability purchasing policies.¹⁰

Tour operators are also beginning to realise that sustainability and climate change have the potential to impact some key tourist destinations around the globe, directly affecting their revenue streams. Tour operators are developing sustainability targets to minimise their impact during excursions. Hotels that rely on large tour groups may have to demonstrate their commitment to improving efficiency and lowering their environmental impact in order to be considered as preferred properties.

Conclusion and recommendations

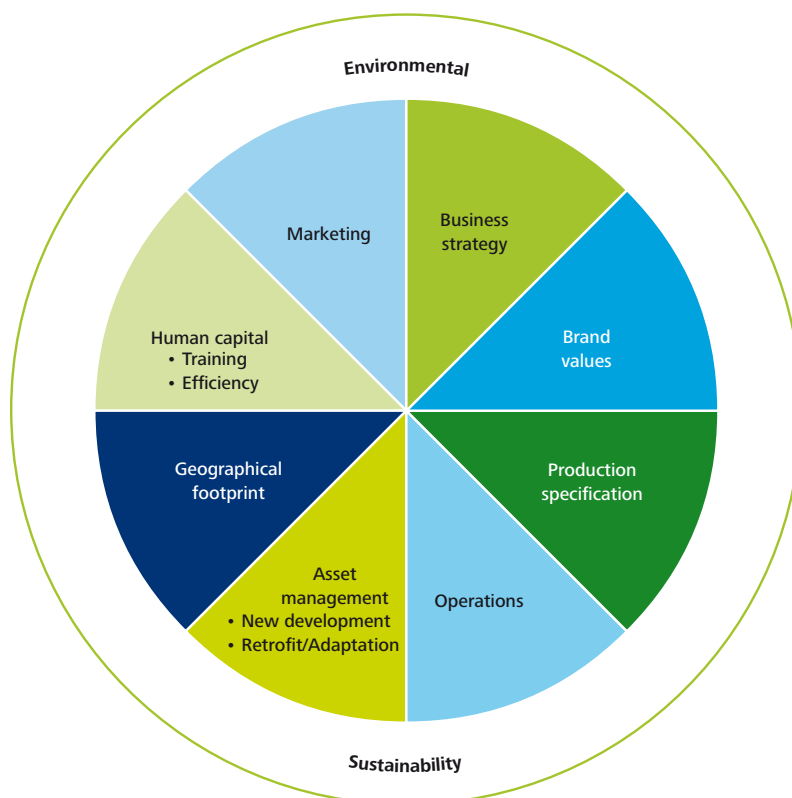
The pace of change will differ across the globe but we are approaching a tipping point. The largest opportunity and challenge today lies within the existing estates that dominate the hospitality sector in the developed world. It is here that the pace of change will be fastest and the need for change greatest. Initiated by regulation and changing stakeholder attitudes, by 2015 the political, business and consumer sustainability agendas will have converged on the hospitality industry.

Looking further ahead, by 2030 the hospitality landscape will be unrecognisable compared to that of today and sustainability will be one of the pervasive drivers of change. Technology, people, business models, physical assets, operational practices and financial efficiency will all need to be harnessed to address the long term sustainability challenge from a 360-degree perspective.

Industry leaders today are engaged with the sustainability agenda but few recognise the transformational impact it will have on the way hospitality is provided and consumed. Those who keep pace and effect change, embedding sustainability across their businesses from strategy to operations, from brand value to asset management, will be prominently positioned. Those who fail to do so risk finding themselves lost in the landscape of 2015 and beyond.



Figure 13. Embedding sustainability – A 360-degree view



Source: Deloitte Research

Planning for the unpredictable

Exogenous events and cycles



The key to surviving unpredictable shocks and minimising their impact is to establish appropriate responses, protocols and risk management programmes in advance. Businesses also need to capitalise on the new opportunities that may present themselves in challenging times.

Key findings

- During the recent recession, hotel demand fell four times faster than GDP, the most dramatic fall over the past century.
- In 2009 revPAR fell 17 per cent and 2010 is expected to be a year of stabilisation and fragile growth with recovery more firmly underway by 2011.
- The supply/demand gap is expected to ease in 2010 and improve over the next five years.
- If sudden crisis events are seen as isolated, recovery tends to be quicker and patterns of commerce remain relatively normal.
- Best practice in a crisis includes organisational re-structuring, business continuity planning, flexible pricing, loyalty and customer care.

Many aspects of a hospitality business can be planned and many contingencies foreseen and prepared for, but the industry will always be susceptible to financial and operational impact from unpredictable exogenous events and cycles.

These impacts can be large, such as the recent recession, affecting revPAR on a global scale and reducing average occupancy to historic lows. They can also be on a smaller scale such as the impact of a terrorist attack, a natural disaster or a major health scare on travel to a specific destination.

According to the International Monetary Fund, the recent economic crisis represented “by far the deepest global recession since the Great Depression.” A US housing bubble inflated by sub-prime mortgage lending quickly spread into a liquidity crisis across the global financial system. Coupled with high oil prices and fluctuations in exchange rates, this has had an overwhelming impact on the hospitality industry.

Hospitality is heavily affected by economic uncertainty as consumers rely on discretionary spending to meet their travel needs. Unemployment in the world’s 51 largest economies increased from 8.1 per cent in 2007 to 9.3 per cent in 2009.¹ Credit markets dried up and real estate prices fell. As a result, global consumer confidence moved from 97 index points in the first half of 2007 to a low of 77 index points in the first half of 2009, rebounding partially to 86 index points during the second half of 2009.

Consumer spending has become more conservative with the highest savings rates seen for decades. Travel spending was one of the first things that consumers and businesses cut back on as the global economy went into recession. During 2008 the US hospitality industry posted an eight per cent decline in pre-tax profits.² The average length of stay is down and many travellers are opting for cheaper room categories. Now that consumers are looking for more value in their spending, the industry needs to be creative in order to build up lost demand.

Figure 14. Economic cycles – impact of recession

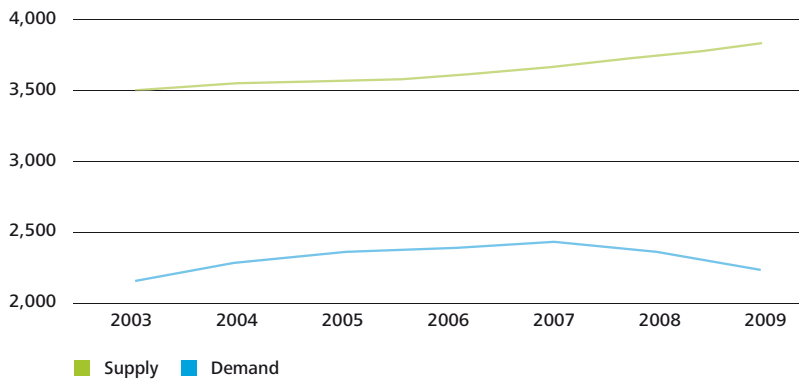


Source: STR Global & Smith Travel Research Inc. Year-to-December 2009 results



Figure 15. Global supply and demand

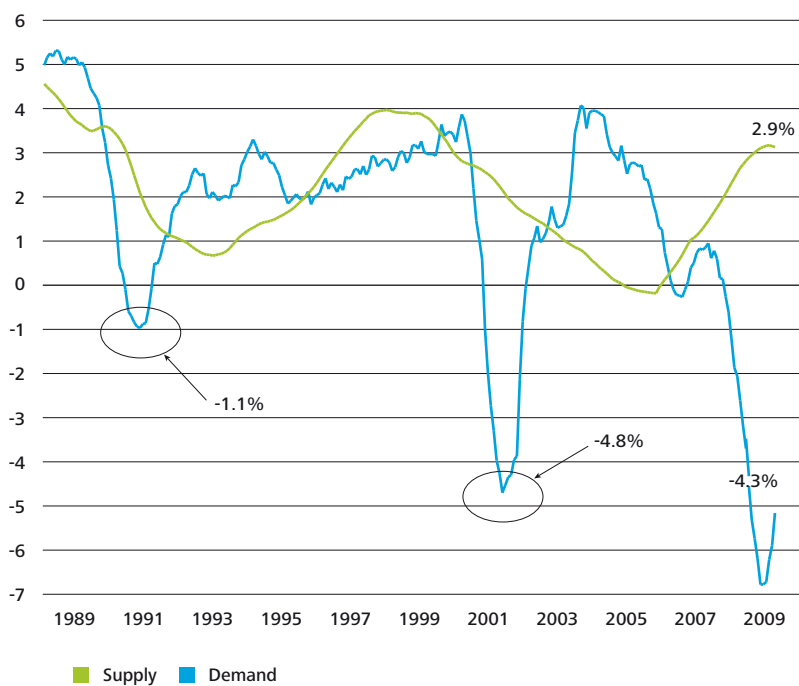
Rooms (actual annual, millions)



Source: STR Global and Smith Travel Research Inc (STR), January 2010

Figure 16. Total US room supply and demand

% change



Source: STR, 12 months moving average (1989 to April 2009)

Legacy of over-supply

A major problem faced by the industry is that supply is currently greater than demand and the gap has been growing since 2007. Current levels of supply were created by aggressive construction prior to the recession, continuing well into 2008 and 2009. Demand is driven by a number of economic factors, such as unemployment, consumer confidence and GDP growth. During the recession demand fell much more sharply than supply, creating a large imbalance. Figure 15 illustrates the gap between supply and demand on a global basis.

According to Starwood Hotels & Resorts Worldwide, President and Chief Executive Officer, Frits van Paasschen, "today there is still supply coming online that was planned prior to the current meltdown," however "there are very few new projects being announced so supply will fall off in 2011." The current lack of credit for construction will also help to slow down supply growth.

This mismatch in supply and demand will benefit consumers in the short term, keeping average hotel rates down. Suppliers will have to battle for market share over the next five years until consumption catches up. As seen in Figure 16, after the recessions of 1991 and 2001, supply gradually declined for a number of years. Demand, on the other hand, grew sharply after a steep drop.

We believe that the current supply/demand gap will begin easing as early as late 2010 and improve over the next five years, as was the case in prior recessions.

Aftermath and recovery

The current recession has had an unprecedented impact on the industry and we are in uncharted waters in terms of being able to accurately predict a recovery.

The EIU expects the UK economy to grow only slightly over the next two years by 0.7 per cent in 2010 and 0.8 per cent in 2011. The US economy is expected to grow 2.5 per cent this year and 1.4 per cent in 2011. Japanese GDP is forecast to grow 1.4 per cent in 2010 and 1.0 per cent next year.

This modest shape of anticipated recovery in the major developed economies contrasts sharply with EIU expectations for the emerging markets. Growth in the region of eight to nine per cent is forecast annually for China up to 2015, and growth of seven to eight per cent is forecast annually for India over the same period.

Demand for hotels overall has fallen four times faster than GDP during the recession, the most dramatic fall seen over the past century. The correlation between GDP and hotel demand has been approximately one-to-one since the early 1900s, until now. Following previous recessions, the industry has been able to return to and exceed prior levels of performance. This time the recovery is likely to be slower and longer than in the past because of the dramatic shift in the correlation.

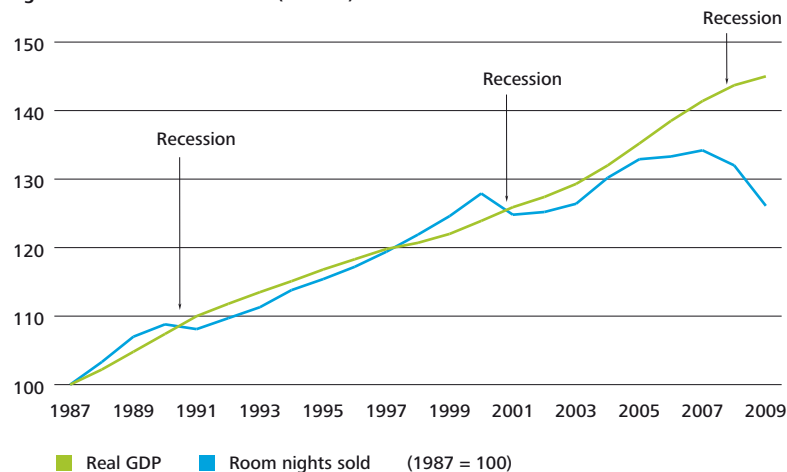
Overall revPAR was down by 17 per cent in 2009. We expect 2010 to be a year of stabilisation and fragile growth with recovery more firmly underway by 2011. Steep declines in occupancy and revPAR are beginning to level out or even show positive growth in some regions, but there is a long way to go if we are to return to the heights of 2007.

STR Global data for February 2010 showed revPAR for the Americas down two per cent year-on-year; European revPAR rose 11.9 per cent; revPAR in Asia-Pacific climbed sharply by 21.6 per cent; and the Middle East/Africa region grew by 3.6 per cent. These trends are positive but performances are recovering from a low base and will take some time to reach and surpass pre-recessionary levels.

Two key sectors have been particularly hit by the recession: business and luxury travel.

The recession has caused companies to sharply reduce their travel budgets, seek cost saving alternatives and find more economical ways to travel. US business travel declined approximately eight per cent in 2008 and a further ten per cent in 2009.³ This decline is partly a result of increased public scrutiny, described as 'the AIG effect', following the criticism of the insurance giant in 2008 for spending freely on travel and entertainment while the economy was in turmoil. Business travel is unlikely to recover until sustained economic growth is restored.

Figure 17. US demand vs. GDP (millions)



Source: STR & US Bureau of Economic Analysis, January 2010

Luxury hotels are generally hardest hit during recessions as consumers choose less expensive hotels and spend less during their stay. During the recession of the early 2000s, US revPAR for luxury hotels declined by 40 per cent,⁴ but following that recession, luxury was the quickest sector to recover. According to Frits van Paasschen; "Rumours of luxury's demise during the financial crisis were greatly exaggerated. The meltdown of luxury is more due to perception than actual income effect." He described the impact on luxury as; "short term ... and it will come back again. Luxury is fundamental to the human experience."

Terror, medical threats and natural disasters

The ebb and flow of the industry is affected not just by unpredictable economic cycles, but by unforeseen events such as terrorism, medical threats and natural disasters, which can also play a part in determining supply and demand. The past 12 months have seen further examples.

The earthquake in Port-au-Prince in January 2010 delivered a devastating blow to Haiti's tourism industry, just as it was showing signs of recovering from a series of political, social and natural crises and was achieving enough stability to attract visitors again. This was followed in February by an earthquake in Chile. The US State Department has advised Americans to avoid travelling to Chile, although tourism infrastructure has been relatively unscathed.

The emergence of swine flu in Mexico in April 2009 spread internationally with unprecedented speed. In previous cases, flu viruses needed more than six months to travel as widely as the new strain spread in its first six weeks. Swine flu had an immediate impact on the travel and hospitality industry. When news of the virus broke, investors wiped US\$5 billion off the value of leading US airlines within ten minutes of the announcement of a public health emergency. Those carriers most heavily exposed to Mexico suffered double-digit losses.

Similar large scale losses were experienced during the Iceland volcano ash cloud which spread through Europe in April 2010. Airlines estimated losing some £130 million a day with TUI reporting that daily costs ran at about £5 million.⁵

As these cases demonstrate, organisations exposed to the epicentre of a major event bear the brunt of the impact. However this can also work to the advantage of others.

Consumer travel decisions are affected by a number of factors including cost, economic conditions, a mix of personal, regional and global health concerns, security issues and the weather. Each of these factors affects the level of demand and lead booking times to varying degrees, based on the severity of the factor and the perception of impact in the consumer's mind.

Research conducted by the UK trade magazine Travel Trade Gazette found that more than half (54 per cent) of consumers said that incidents such as the ETA bombing campaign in Spain or swine flu made no difference to where they booked their holidays.

“As always, when one country is suffering, other countries take advantage to improve their own situation, and swine flu has been no exception. While Mexico was losing its place as a tourist destination, neighbouring countries were benefiting.”

Gabriel Escarrer Jaume, Co-Vice Chairman and Chief Executive Officer, Sol Meliá Hotel Group

However, 41 per cent said they would definitely avoid or consider avoiding a destination with a terrorist or medical threat. This indicates the significant potential for disruption posed by terrorism and health scares.

Analysis of specific events and their impact on hotels in the markets affected, shows that if the incident is seen as isolated, recovery tends to be quicker and patterns of commerce remain relatively normal. Following the Madrid and London bombings, bookings and lead times dipped slightly, but then recovered within 30-45 days.⁶

In the case of the swine flu pandemic, the immediate impact was dramatic. On 24 April 2009 Mexican occupancy was at 58.8 per cent. By 10 May 2009 occupancy had dropped to its lowest point of 14.6 per cent. Lead times fell by 34 per cent and revPAR fell by almost 70 per cent at the height of the outbreak but performance also continued to be affected for many months. The global recession also exacerbated the impact of swine flu.⁷

Figure 18. Mexico revPAR and bookings lead time



Source: STR and TravelCLICK, January 2010

Expecting the unexpected – what can be done?

Faced with unexpected events, how should operators respond? When demand suddenly plummets one of the most drastic actions is to cut rates to encourage an increase in occupancy. Some hotels in Mexico even offered free holidays to tourists who had caught swine flu in their resorts in a bid to restore confidence in the destination.

This radical approach has had mixed success in localised events, but is an insufficient strategy for a global economic crisis, shown by the fact that global revPAR has not yet recovered to reach the levels seen in 2007/08.

Andrew Cosslett, Chief Executive Officer of InterContinental Hotels Group argues that efficiency and effectiveness are the best responses to the current economic crisis: recognising that customers come first and that brand standards remain paramount. For IHG, its employee engagement and guest satisfaction scores have gone up, proving there are still benefits to be had in an economic crisis.

Many management tools are brought into sharper focus during uncertain times. These may include cutting staff and non-essential spend to counter the drop in bookings, adopting a flexible approach to capital spending, accurate forecasting and using resources already paid for.

Booking policies must also remain flexible: for example cancellation policies that encourage advanced bookings, length of stay restrictions, differentiating rates, up-selling and offering last minute deals. Approaches such as these can be the keys to securing revenue and finding new markets.

Hilton has restructured its global organisation to drive efficiencies and be more effective. It has restructured the senior management team and brought in new talent. IHG is also in the process of integrating the group into one organisation following an internal restructure. Both Hilton and IHG have also found that reviewing their operating models and management agreements has led to improved relationships with their owners and franchisees.

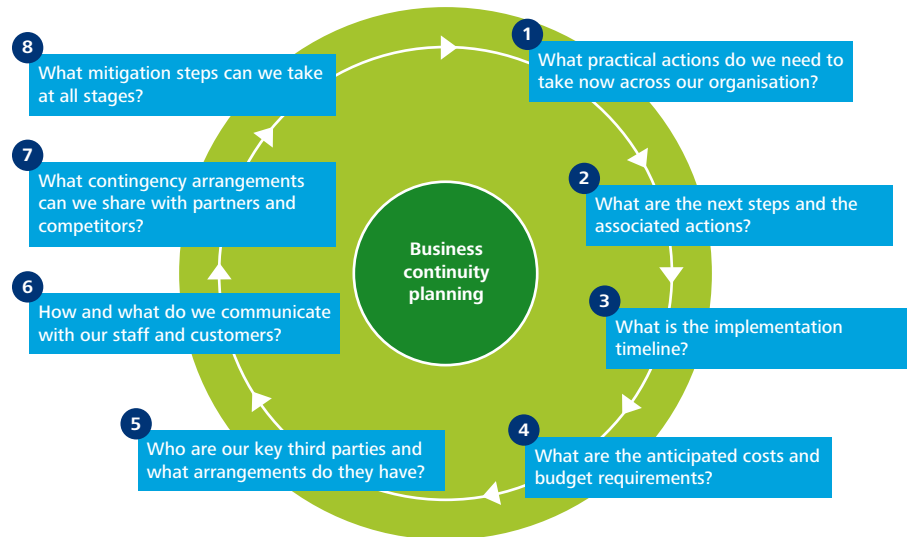
Business continuity planning

For sudden disruptions such as terrorist attacks, natural disasters and medical events, the impact of high levels of staff absenteeism on the continuity of business-critical activities is a key challenge for business planning.

The cross-training of employees is an important component of ensuring continuity. Marriott follows the 'Spirit to Serve' philosophy, where employees are cross-trained and involve themselves wherever necessary to keep the business going as normal. It is also important to be fully aware of what skills employees have, so that they can be transferred to other areas of the business.



Figure 19. Business continuity planning



Source: Deloitte Research

Operators should consider the impact of the crisis on critical suppliers; knowing whether they also have plans in place and what their level of commitment is to maintaining critical supplies. This is especially the case in a time of economic difficulty when the impact of a further disaster may tip suppliers, who are already in financial distress, into administration. In this event, contingency plans will be needed.

The diagram above highlights some of the key questions that need to be asked in preparing for an unforeseen event. Practical actions could mean reallocating people to deal with high levels of staff absenteeism and ensuring the continuity of business-critical operations. They could also mean taking steps to identify alternative sources of revenue, such as the transportation of medical equipment, or the provision of beds for hospitalisation in the event of a medical emergency.

Conclusion and recommendations

History shows that unexpected events are also recurring events. Terrorism, pandemics and natural disasters do not follow any predictable patterns, but they appear to be inevitable nonetheless. Likewise, economic recessions have come and gone throughout history and will undoubtedly recur in the future.

Operators will have to manage their exposure to these risks through future cycles. Success will be measured by effective crisis management and emerging from the event with the reputation of the brand intact. Operators can also capitalise on the opportunities that these cycles may bring. The overall goal for companies is to survive the impact, to contain costs and work to drive efficiency, and gain ground on competitors by winning market share.

Appropriate actions will vary according to the scale and impact of the event. Successful responses will typically include: organisational re-structuring; business continuity planning; the implementation of a clear and flexible pricing policy; strengthening loyalty schemes; offering extras to entice guests; adding value rather than lowering rates; and reaffirming customer care.

Properly managed, a crisis can be reconfigured as an opportunity to reinforce brand values and enhance the consumer relationship. Forward thinkers, cautious optimists and operators who embrace a progressive philosophy will be well positioned. Those who innovate in a crisis are likely to benefit most from the ensuing recovery.

The interdependent industry

The hospitality sector is inextricably linked with the other sectors in the wider tourism, hospitality and leisure industry. In this section of the report we explore the relationship between the hospitality industry and other sectors which make up the wider travel experience, illustrating the link between them and discovering the lessons to learn.



Flying high after the recession

How aviation trends will shape hospitality



As we have seen many times, the aviation industry is susceptible to external shocks. Whether it be terrorist attacks, pandemic flu or even volcanic eruptions. However, the long-term performance of the industry is closely linked to the growth in global GDP and, despite any short term problems we would expect the industry to continue to recover as the global economy picks up after the recent financial crisis in the west.

Figure 20 illustrates the interdependency of the global hotel and aviation sectors with key Key Performance Indicators (KPIs) for the two industries tracking each other closely over the last ten years. Therefore, the expected return of the global aviation sector to long term growth is a positive indicator for hoteliers.

For the year to 31 July 2009, the International Air Transport Association (IATA) recorded a global drop of 3.8 per cent¹ in capacity and 6.8 per cent² in volume compared with the previous year. All regions, with the exception of the Middle East, recorded a reduction in volumes with the largest reduction recorded in Asia-Pacific.

Despite this short term correction, the airline industry should regain momentum in tandem with global economic recovery. In this section we discuss the likely future developments for the various regions, business models and routes to market and the impact of these developments on hospitality.

Regional prospects

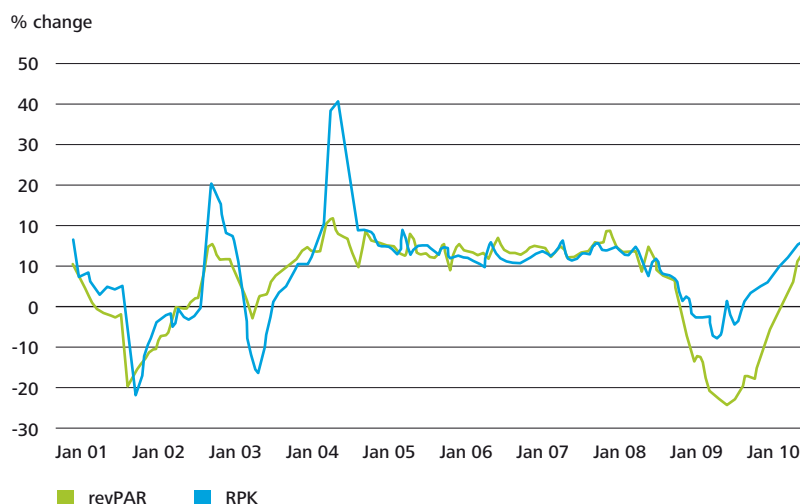
North America remains the largest and most mature aviation market in the world and is likely to be so in 2015. During this period, traffic growth is expected to come primarily from international traffic, with domestic traffic remaining relatively stable.³

The Asian domestic market is growing rapidly. Chinese domestic scheduled air traffic has tripled and Indian domestic scheduled air traffic has doubled over the past ten years. Rapid economic growth in this region should drive further demand for both business and leisure air travel.

The European market will continue to be characterised by growing traffic with Asia and the Middle East as well as intra-regional traffic. The impact of the inclusion of aviation within the CO₂ emissions trading scheme is not yet clear and this may dampen growth in the sector.

The Middle East will continue to act as a key regional hub between Asia, Africa and Europe. Significant available capital in the region is driving long term investment and airport expansion is more politically acceptable here than in Europe.

Figure 20. Global revPAR versus global RPK*



*Revenue Passenger kilometres (RPK)
Source: STR Global and IATA

More aircraft are forecast to be delivered to Asian airlines than to European and Middle Eastern airlines combined⁴ over the next ten years. The aircraft delivered to Asian airlines are also likely to be larger: Asian airlines are expected to take delivery of 41 per cent of very large aircraft – super-jumbo class. The North American market is expected to take delivery of the largest number of smaller, single aisle aircraft.⁵

In the longer term, technological development may diminish the importance of hub airports as consumers prefer point-to-point routes. However, the significant cost savings which are currently achieved by routing traffic through major hubs should continue to favour the Middle East's strategic position until 2015. Substantial investment is also being made to transform the region into a major business and leisure destination, as well as a transit point.

Network consolidation

Network carriers have faced difficult market conditions in the last five years. These have included the loss of economy traffic to low cost carriers, an extremely volatile fuel price and the legacy of social welfare costs.

Network carriers have become increasingly focused on premium travel, which is far more volatile than economy travel. This poses significant challenges in a business requiring substantial long term capital investment in aircraft as well as in product and brand differentiation.

These conditions have triggered the start of regional consolidation, particularly within Europe where, following the BA and Iberia tie-up, three major airlines are emerging. This process is expected to continue as legacy network carriers in Europe disappear and the anticipated consolidation among US network carriers takes place.

Airlines are positioning themselves for the coming global consolidation, likely to be made possible by the relaxation of ownership rules between territories, despite the failure to achieve this in the second round of US-EU Open Skies negotiations.

At some point this process is likely to allow foreign ownership of major airlines. Global consolidation should provide considerable cost and revenue synergies for major carriers and allow the industry to move towards sustained profitability for the first time in its history. The current three global alliances are a step towards this consolidation and are likely to presage the future shape of the industry.

Low cost developments

The low cost model originated in North America and has also been extremely successful in Europe over the last ten years. The ability of these carriers to significantly reduce the cost of aviation has been a significant driver of overall growth in the size of the air travel market.

The low cost model has proved remarkably resilient in Europe through the recession with continued growth in passenger numbers and revenues, driven by an increasingly mobile population throughout the European Union. The European low cost market has not yet reached saturation, particularly in Spain, Italy and France where there is considerable scope for further market penetration.

The European market remains far more fragmented than in North America. In Europe 60 per cent of low cost traffic is carried by 30 airlines, whereas in North America four airlines have 95 per cent of the market share. The European market is likely to see consolidation in the next five years as Northern European markets become saturated.

Asian low cost carriers have seen rapid development in recent years with 19 per cent more traffic in 2008 than in 2007. Budget airlines now account for 14 per cent of total aviation market share in domestic Asian markets and 62 per cent market share in Associations of the organisation of Southeast Asian Nations (ASEAN) markets.⁶

Despite this growth, the Chinese and Japanese domestic markets continue to be dominated by legacy carriers. Low cost airlines should continue to expand significantly in the Asian market up to 2015, fuelled by fast economic growth. Low cost growth could be far more substantial if the Chinese or Japanese markets were to open up further.

Low cost carriers have primarily focused on short haul routes but they are likely to develop longer haul services over the next five years, driven by passenger growth between regions and the opening up of international markets. The development of cheaper, smaller long haul aircraft should also make longer point-to-point routes more viable.

Low cost carriers are used increasingly by business travellers for short haul trips. In Europe, the recession has accelerated a structural change in business travel away from short haul premium services and short haul business flights are now seen as more 'routine'.



The low cost carriers have led the field in developing ancillary revenues to allow them to reduce the price of their flights. However, network carriers are also developing their ancillary revenues and facing the challenge of doing so in a way that does not damage the differentiation of their existing product. These revenues come from a number of sources including seat allocation, inflight services, shopping and advertising, related travel products – hotels, car hire, travel insurance – and airport lounges. In 2010 airlines are anticipated to generate US\$58 billion⁷ in ancillary revenues, 12 per cent of total airlines revenues.

Changing routes to market

Aviation distribution has been through major changes in the last decade and airline websites have become increasingly important distribution channels. For low cost carriers the website provides the majority of their distribution. For network carriers, global distribution systems retain a significant proportion of their overall sales as corporate clients continue to book their travel through these systems.

Websites have given airlines significant control to unbundle their products and to change their offerings quickly. They have allowed low cost carriers to generate additional sources of revenue and enabled network carriers to differentiate their products. They have also become increasingly important for attracting traffic as consumers have booked flights directly rather than through intermediaries.

The large volumes of traffic that airlines are able to attract to their websites have enabled them to act as distributors for other products such as hotels and car rentals. Websites have also removed the commissions historically paid by airlines to third party distributors.

The global distribution systems have traditionally acted as aggregators, not only for airline tickets but also for these other products. However they have not provided the ability to unbundle services and provide differentiated products. All the major global distribution systems are currently tackling this challenge and developing their systems to provide this functionality.

Over the period to 2015, low cost carriers are likely to continue unbundling their products to generate additional revenue and developing their websites to provide the full range of third party products travellers are likely to require.

Implications for hospitality

The hospitality industry is likely to change rapidly to reflect the changing regional balance in global aviation. Substantial additional volume will be required to provide accommodation for the increase in domestic and intra-regional travellers in Asia, particularly in the under-developed midscale and economy segments.

Hotels in Europe and North America will need to focus on the increasing number of travellers from the Middle East and Asia, who are likely to have an impact on the cultural aspect of services such as food and entertainment.

Global consolidation amongst the network carriers is likely to have a significant impact on the premium end of the hospitality industry. Major regional and global hotel operators will be able to form agreements with the major airline alliances and consolidated carriers to drive vertical revenue, benefiting both parties.

Network carriers are likely to use their websites to promote their brands, using product unbundling to differentiate their offerings and selling products from third party providers that are in line with the host carrier brands. Premium hotel chains will be able to form alliances with major airlines to attract particular market segments.

As corporate travel budgets remain under scrutiny, some low cost business fliers may seek hotels with a similar ethos: smart, modern accommodation at low cost with extras, that have historically been included in the basic price, stripped out and offered for an additional charge to those who require them.

However, there is no clear-cut relationship between budget airline and budget hotel usage. A significant segment of budget airline passengers are affluent travellers who use these carriers for commuting to and from their holiday homes and luxury hotels for weekend breaks. This is likely to remain the case.

Finally, hotel chains operating at the economy end of the market may no longer be able to source their customers primarily through the global distribution systems and may have to sign distribution agreements with major low cost airlines. Managing the relationships with multiple airlines may increase the complexity of distribution for these hotels.

Hotels and restaurants

A tasty combination or a recipe for failure?



Familiar restaurant and café brands, from Gordon Ramsay and Joel Robuchon to Dunkin' Donuts and Costa Coffee, are a growing presence in hotels around the world; and new partnerships are still being forged even in the midst of economic crisis.

Pierre Gagnaire has recently made his US debut with Twist in the Mandarin Oriental Las Vegas; Guy Grossi opened a Grossi Trattoria at Bangkok's InterContinental Hotel in September 2009 and Heston Blumenthal announced a new restaurant in the London Mandarin Oriental Hotel, which opened in May 2010.

In this section, we discuss the motivation for such partnerships, the key lessons learnt by hoteliers and restaurateurs and how restaurants may evolve in the hotel market over the next few years.

Drivers of partnership

Hotel restaurant co-branding is not a new concept, but was started by Victor Bergen in the 1930s who established fast food restaurants within highway hotels in the US. More recently, however, such partnerships have proliferated. The appeal of restaurant brands – including celebrity chefs – in hotels has two key drivers.

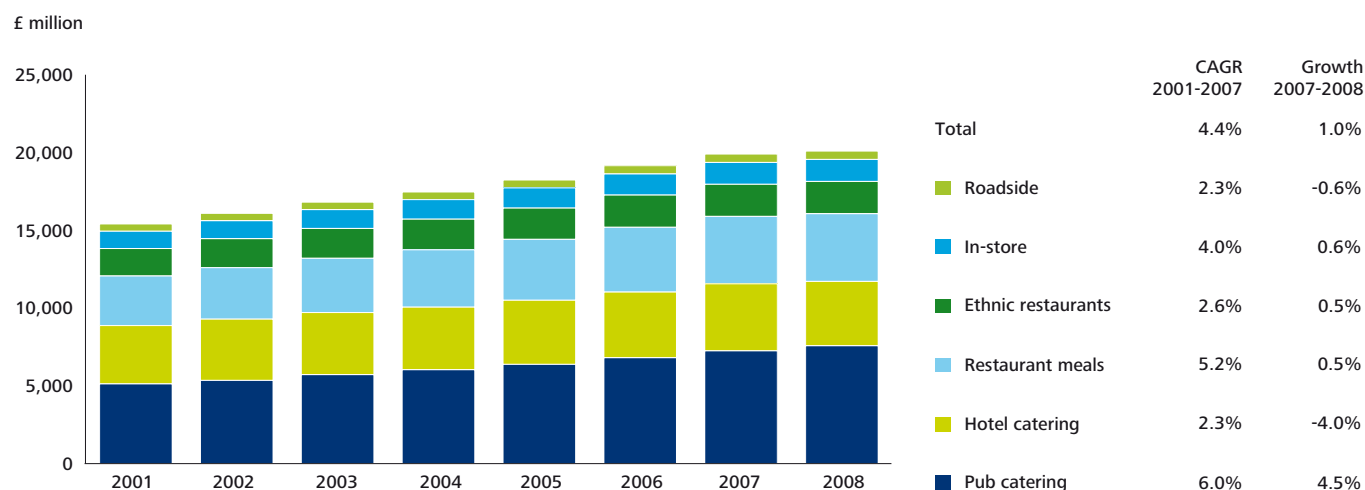
Food and beverage revenues in hotels have been generally sluggish when compared with the core business of hospitality.

Some recent data highlighted that operators regularly experienced a return on investment from food and beverage operations 50 per cent lower than that achieved on rooms.¹

Consumers have also become more sophisticated in their dining out habits, influenced by celebrity chef and cookery programmes on our television screens. Restaurants have been forced to raise their game to meet consumer demands and brands across all parts of the eating out spectrum, from fine dining to fast food, have to be better than ever. Hotel catering, however, has lagged behind the overall market, as illustrated by the UK example in Figure 21.

UK hotel catering has underperformed compared to other dining out sectors. Between 2001 and 2007, hotel catering Compound Annual Growth Rate (CAGR) was 2.3 per cent compared to 4.4 per cent for all restaurants. Hotel catering has also been badly affected by the recession. Between 2007 and 2008 the category shrank by four per cent compared to growth of one per cent in the restaurant sector overall.²

Figure 21. UK restaurant market by category



Note: Hotel catering includes drinks revenue

Source: Mintel July 2009

Partnerships across the spectrum

Most high profile partnerships are those in the fine dining/celebrity chef category but, as our selection of UK and US partnerships in Table 12 demonstrates, restaurant brands exist in hotels right across the quality spectrum.

Table 12. Examples of restaurant brands located within hotels in the UK and US

UK

Hotel operator	Restaurant brand/operator	Comments/details of particular hotels
Claridges, London Marriott, London	Gordon Ramsay	Gordon Ramsay restaurants are also located in other parts of the world.
The Cumberland Hotel, London	Gary Rhodes	Other Gary Rhodes restaurants include Rhodes Twentyfour in Tower 42, London, cruise ships and others.
Premier Inn	Table Table, Brewers Fayre, Beefeater	Hotel and restaurants are owned by Whitbread and regularly sited together.
Travelodge	Marstons	Travelodge and Marstons announced a plan to co-locate in October 2009 following a trial in Somerset.

US

Hotel operator	Restaurant brand/operator	Comments/details of particular hotels
Best Western Hotel	Beef O'Brady	Florida, opened in 2009. Beef O'Brady is actively looking for further hotel partnerships.
Fontainebleau Resort, Miami	Hakkasan, Alan Yau	There is another Hakkasan in West London, not located in a hotel.
The London NYC The London West Hollywood	Gordon Ramsay	Gordon Ramsay restaurants in other parts of the world.
Marriott	TGI Fridays	Chicago, Indianapolis, Ontario (Canada) and others.
MGM Grand Hotel & Casino, Las Vegas Four Seasons Hotel, New York	Joel Robuchon	Joel Robuchon has other restaurants around the world.
Starwood Hotels & Resorts	Jean-Georges Vongerichten	Vongerichten signed a deal (in 2006) with Starwood to open restaurants in its hotels. Private equity backing from Catterton Partners.

Source: Deloitte Research 2010

Other food outlets opening in hotels include Dunkin' Donuts, which has entered the market in Great Wolf Lodge resort in North Carolina and has plans to roll-out through other large hotels and resorts in the US.

Earlier this year in the UK, Costa Coffee also teamed up with Hilton which will roll-out Costa Cafés in 60 of its hotels. Costa, owned by Whitbread, is already located in another Whitbread subsidiary, Premier Travel Inn.

The vast majority of hotel restaurants, however, are still internally operated and in-house brands are being created by some hotel chains. Although there is plenty of evidence of outsourcing it still only affects a small section of the market.

Some other hotel brands are innovating around food and beverage. For example, the UK based Hotel du Vin, owned by MWB Group, has changed its emphasis from accommodation to bistro food and fine wine, challenging the traditional image of an in-house hotel restaurant.

Mutual benefits

As Table 13 shows, there are numerous potential benefits for both parties if the venture is successful and if lessons are learned from previous partnerships. A number of key issues need to be considered and resolved in order to realise these potential benefits.

Brands should share consistent values and should be focused on the same target consumers. The arrangement also needs to be financially attractive to both parties, striking an equitable balance and motivating both of them from the start. The most attractive financial structure will be dependent on individual circumstances but typical structures used are outlined in Table 14.

The restaurant must be both attractive to guests and accessible to non-guests. Non-guests are a core customer group for a hotel restaurant. Desirable or essential features include a separate entrance to the restaurant or a dedicated desk for the restaurant separate from the hotel.

Zuma, the Japanese restaurant chain with seven successful outlets worldwide has yet to locate in hotels but owner Rainer Becker does not rule it out.

“We’ve considered such an option on numerous occasions and remain interested. It is key that we are seen as a restaurant in our own right, however, and not as the hotel’s restaurant. Ease of access for all our customers and not just the hotel’s guests is of paramount importance.”

Rainer Becker, Owner, Zuma Restaurant

Table 13. Potential benefits of hotelier restaurateur partnership

Hotel operator benefits	Restaurant operator benefits
Freedom to focus on the core business of rooms.	Cost effective way to expand restaurant portfolio.
Fixed income stream, low risk (increase in revenue).	Access to a building or part of town not normally available.
Competitive edge.	Built-in customer base from the hotel customers.
A well known restaurant brand increases restaurant covers.	Possible to diversify portfolio.
Operational efficiencies from restaurant may reduce operating costs.	

Source: Deloitte Research 2010

Table 14. Contract structures

Structure	Description
Management contract	<ul style="list-style-type: none"> Restaurant operation is outsourced for a fixed fee. Operator has limited risk and control.
Royalty fee (franchise)	<ul style="list-style-type: none"> Operator pays a fixed fee for use of the brand. Operator is required to work within restrictions to keep restaurant within brand guidelines. Potential financial help with restaurant setup.
Profit share/joint venture	<ul style="list-style-type: none"> Both parties invest in the venture and share the risk and reward.
Lease (full outsourcing)	<ul style="list-style-type: none"> Option giving most autonomy to the restaurant. Restaurant has most of the risk and reward.

Source: Deloitte Research 2010

Other considerations such as hotel guest restaurant special offers, priority booking and dress codes need to be established in advance.

Hotels also need to consider whether the market in which they operate is appropriate for such a partnership. Not every location globally needs this solution. There are numerous regions and countries where the hotel brand is 'king' and the hotel's own restaurant is the 'must visit' eating out destination. To use an old adage ... 'If it ain't broke, don't fix it.'

Successes and failures

A significant number of these partnerships now exist and, with new collaborations emerging all the time, it appears that a degree of success is being achieved. However tangible data on investment returns for such ventures is limited and can be masked by the type of deal struck between hotel and restaurateur.

Failures are also apparent and finding a good partner is not in itself a guarantee of success. Brian Turner's restaurant in the Millennium Hotel London and his grills in the Copthorne Hotels in Birmingham and Slough-Windsor were closed during 2008-9. In the US, the Boston Park Plaza hotel and Towers severed its relationship with Todd English and his Bonfire Steakhouse in August 2009.

Hotel restaurants have been hit by the recession. A reduction in both the number of hotel guests and the number of people dining out has contributed to some of these high profile failures. Despite this, partnerships are still being formed because they establish a point of difference for hotel operators and enable them to attract more guests.

New ventures

Even under difficult operating conditions some restaurateurs seem dissatisfied with the general success of hotel partnerships and are keen to go one step further. D&D London operates 30 restaurants in major cities around the world. The group recently announced its entry into the London hotel market with plans for an 80-bedroom boutique hotel in the heart of the city, leapfrogging the hotel restaurant niche altogether. The successful Corbin and King partnership, which is behind London's iconic Wolseley restaurant, also has plans to establish a boutique hotel.

Evidence of this trend can also be seen in the US. Thomas Keller has recently had a planning application approved for a luxury 20 room inn opposite his French Laundry restaurant in Yountville. Whether this business plan will be a success remains to be seen but there appears to be little shortage of contenders willing to try.

Overall, the next five years are likely to see many more openings and new ventures. The future of hotelier/restaurateur partnerships continues to make sense.

"It's a compelling proposition for the hotel operator. Not only does the hotel have an additional attraction for residents but we bring additional footfall from non-residents, who may well be guests of the future."

Caroline Teeling, Gary Rhodes Management

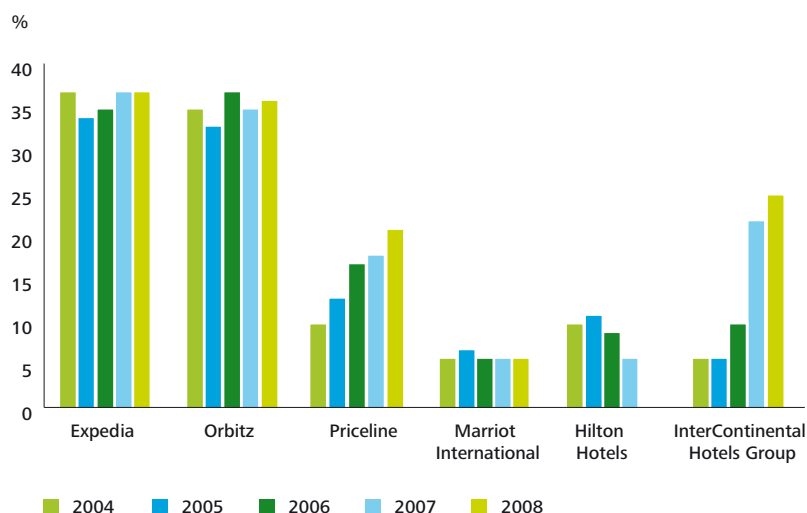
Hotels and online travel agents

From confrontation to collaboration



Hotel operators and online travel agents (OTAs) have often been in competition in recent years. Yet, they often share common strategic aims and by 2015 we are likely to see a more collaborative approach to achieving common benefits.

Figure 22. Advertising and marketing spend as a percentage of revenue, OTAs vs Hotel companies



Source: US Securities and Exchange Commission & Annual Reports

Table 15. Market share by region

Market share by region (in terms of 2008 gross bookings)	US %	Europe %
Expedia	37.8	20.1
Orbitz	23.9	5.0
Travelocity	20.7	8.6
Priceline	8.1	12.8
Other	9.5	53.50
Total	100	100

OTA share of overall online bookings	%
2006	42
2007	40
2008(e)	39
2009(e)	39
2010(e)	39

Source: Expedia Q3 FY09 – Company Overview
(e) estimate

The debate

The relationship between the OTAs and hotel operators has been the subject of wide debate in the industry since IHG's fraught negotiations with Expedia in 2004. The issue resurfaced at the end of 2009 after stalled negotiations between Expedia and Choice Hotels over renewal of a distribution agreement came publicly to light.

Hotel operators are concerned about losing control over inventory and pricing to OTAs. Hoteliers can also feel there is pressure to enter into long term contracts without exit clauses at rates that they believe are not always commercial. OTAs, on the other hand, seek rate and inventory parity for their own customers who, they believe, trust them to provide the best price available.

In the current economic context hotel operators are also concerned that OTAs are capitalising on the decline in occupancy. This happened after 9/11 when shell-shocked hotel companies released inventory to OTAs, which was then sold on at significant mark-ups. Early investment by OTAs in technology and significant marketing spend was effective in selling rooms to help struggling hotel companies.

Since then, hotel companies have invested in developing and marketing their own websites. Some hotel companies like Marriott are even imitating OTAs by offering flights and car hire online. Given the current market conditions, both travel companies and hotel operators are increasingly advertising both online and offline to attract consumers directly.



Value of visibility

A recent study by Cornell University tested the 'billboard effect' enjoyed by a hotel operator as a result of its property being listed on an OTA website. The research concluded that these operators not only receive additional bookings via the OTA channel, but also increase the number of reservations made through their own website and hotel booking system, ranging between 7.5 and 26 per cent, as well as a slight increase in the ADR for these properties.

Whilst limited in depth, the study does indicate that hotel companies need to be aware of the total impact on bookings and revenue of their exposure to different distribution channels including OTAs.

Hotel companies, OTAs and tour operators share common strategic aims that would be better furthered by working together. Many travel and hospitality companies are seeking to secure a foothold in emerging markets, to lower the cost of customer acquisition and transactions, to maximise asset utilisation, to build a quality brand and to offer differentiated, exclusive products to their customers.

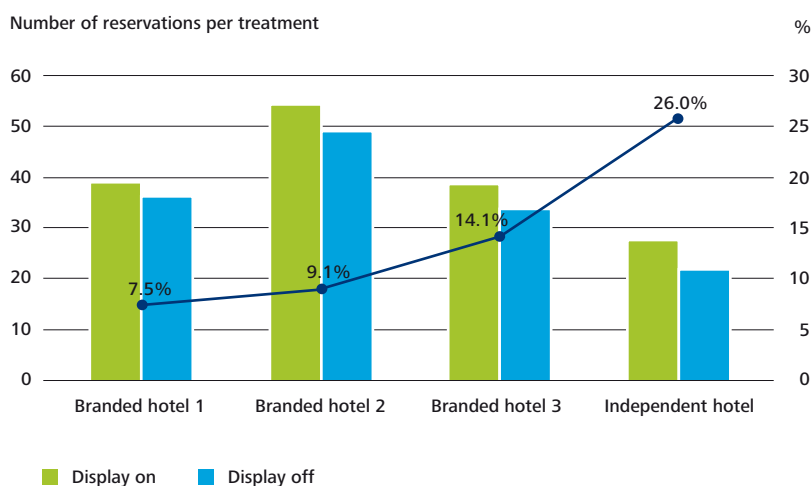
Finding common ground in emerging markets

Emerging markets offer clear mutual benefits for both OTAs and hotel operators. Most international hospitality groups have launched expansion programmes into these markets, particularly China and India. OTAs are also seeking to expand their geographical reach and forge a global identity.

In the case of Expedia, it does not want to be considered a US company that is international; it wants to be considered international by all. Dara Khosrowshahi, President and Chief Executive Officer of Expedia Inc. says the company's strategy is "to work with strong local partners" to gain credibility in the emerging markets and to provide additional revenues to those partners by expanding their distribution.

Hotel operators and OTAs face a similar set of challenges in emerging markets including different regulatory environments, different currencies, fluctuating exchange rates and changing consumer behaviour. OTAs, particularly those from the US, need to adapt their business models as they expand into new markets.

Figure 23. Average reservations per treatment and per cent increase when being displayed or not on the OTA website



Source: "The Billboard Effect: Online Travel Agent Impact on Non-OTR Reservation Volume" *Cornell Hospitality Report*

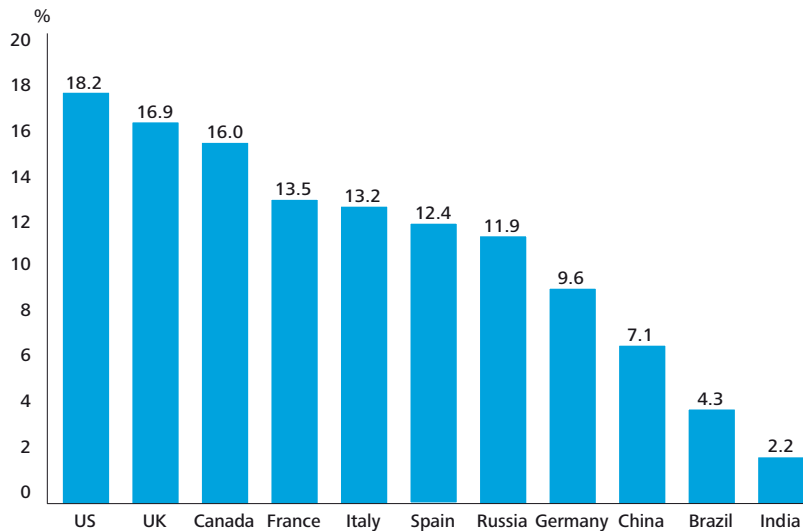
Acquisition may provide a more appropriate model and an immediate footprint in a new market. Expedia has demonstrated this with the acquisition of Kuxun in China and Venere in Europe. The latter acquisition provided Expedia with an agency model more appropriate for the higher number of independent hotels in Europe.

Using technology to match supply with demand

Travel companies need to attract consumers through effective technology and the right products and pricing. Booking online is becoming easier, faster and enhanced through online payment facilities and through improved website design, content and new applications for smart phones. OTAs need to match suppliers with demand. Consumers increasingly expect OTAs to know their preferences and tastes, and to customise packages that suit their individual needs. Future technology will focus on customer segmentation, offering consumers more relevant product options.

Dara Khosrowshahi says that "Expedia has gone beyond being an online travel agent to being an online travel company through its advertising and media businesses. Its technology needs to recognise its consumers and to provide them with the products they want quickly and effectively."

Figure 24. Mobile internet penetration by market



Source: Nielsen Mobile

Table 16. Top 10 travel mobile sites and applications gauged by unique monthly visitors in the US

	October 2008 '000s	October 2009 '000s	% Growth
1. Travelocity	955	1,263	32.3
2. Expedia	1,201	1,258	4.7
3. Priceline	860	1,200	39.5
4. Orbitz	904	1,120	23.9
5. Delta Airlines	827	995	20.3
6. American Airlines	633	982	55.1
7. Southwest Airlines	934	956	2.4
8. Hotels.com	NA	725	NA
9. Continental Airlines	539	669	24.1
10. United Airlines	387	554	43.2%

Source: Nielsen Mobile

Hospitality companies and OTAs are both trying to entice consumers to buy hotel rooms. OTAs can be a trusted source of additional revenue to hotel companies through their understanding of consumer behaviour and the ability of their technology to match suppliers and consumers.

Internet search engines such as Bing and Google have also been exploring ways of expanding their reach and the travel sector is one of the avenues they are considering. For instance, Google is testing a new feature within Google Map which allows a user to search for hotels in a region and, based on the date and the number of nights entered, can check the prices of hotels based on advertised prices from sponsored results. It is therefore vital for OTAs to protect their market share by investing in technology that will keep them ahead of new entrants.

Online consumer behaviour and travel industry technology now includes an increasingly important mobile dynamic. In the US nearly 50 million mobile subscribers access the internet via mobile devices on a monthly basis. The US mobile internet audience grew 74 per cent between February 2007 and February 2009. According to Nielsen the US has the highest penetration for mobile internet adoption, with just over 18 per cent in the first quarter of 2009, followed by the UK with almost 17 per cent.

Hospitality companies are also entering the mobile market with applications (apps) for smart phones such as Hilton's iPhone app or the 'Best Western to Go' app, allowing consumers to book hotel rooms via their mobile phones. It is the OTAs, however, who are currently leading the battle for the mobile consumer as Table 16 demonstrates.

Cutting the cost of booking

OTAs have aggressively focused on hotels to provide a higher share of their revenues as the commission from selling flights has declined, and they have tried to attract consumers by reducing the cost of booking as much as possible.

For example, Expedia stopped charging additional fees for all phone bookings in November 2009. The company claimed to be the only major OTA to offer a fee-free service to consumers, a service for which others charge up to US\$25 per transaction. This move is expected to give Expedia an advantage over airlines who typically still charge a fee for phone bookings. The company also removed all online air and cruise booking fees earlier in 2009, as well as virtually all fees for changes and cancellations.

Travelocity and Orbitz responded to Expedia's move by removing fees on services such as hotel bookings, cancellations and amendments made via their websites. This will undoubtedly put pressure on OTAs to invest in reducing their own transaction costs.

OTA corporate travel potential

OTAs have attracted business travel demand in a relatively unstructured way, with bookings tending to come from small and medium-sized enterprises that do not use traditional Travel Management Companies (TMCs) such as Carlson Wagonlit and BCD Travel.

Sabre led the way in targeting the corporate traveller with the launch of its policy-led online booking tool GetThere in 1999. Expedia acquired the French based TMC Egencia in 2004 and later the Canadian TMC Synergi, signalling its intention to create a global online brand for the corporate market.

The challenge for larger OTAs who are seeking to provide a global corporate booking platform is to provide a wider range of hotels in secondary locations, particularly in parts of the world where hotel chains do not dominate.

Table 17. Gross bookings comparison of the big four OTAs: 2006-2008 (US\$ million)

	2006	2007	2008
Expedia	16,883	19,632	21,268
Priceline	3,320	5,061	7,400
Orbitz	9,780	10,791	10,808
Travelocity	10,100	10,495	10,567
TOTAL Big Four	40,083	45,979	50,043

Source: Deutsche Bank Report – Rising Above Industry Turbulence – Expedia company report (20 July 2009)

Trusted partners?

By 2015 we expect to see the development of a more collaborative approach. Hospitality companies can take advantage of large OTA investment in technology and marketing to achieve common benefits for both, through growing market share, reduction in consumer acquisition costs and sharing costs of promotions.

OTAs want to be seen as the partner to hotel companies, offering a channel for additional leisure and corporate business that those hotel companies would not otherwise have attracted. The main challenge the OTAs face is to become trusted partners for a wide range of hospitality suppliers.



Cruising to success

Lessons to be learned



The cruise industry has nothing but growth plans for the foreseeable future and still has huge scope for further expansion. An estimated 17.5 million cruise holidays were taken worldwide in 2008, accounting for just 1.9 per cent of all international tourists.¹

In the next few years the industry is expected to add additional capacity of 61,800 berths. If these new ships are an indicator of future expansion, the industry is likely to experience 25 per cent growth, gaining a further 4.5 million annual passengers by 2015.

Focus of expansion

The next three years will witness the maiden voyages of some of the largest and most luxurious ships ever to sail the seas, many of which will debut in the Caribbean, the world's most popular cruising destination.

As supply in the Caribbean increases, the focus of industry expansion will turn towards new ports of call in both existing and emerging markets. Recent years have already seen an increase in cruise travel around the Mediterranean and Alaska. As new destinations also emerge in the United Arab Emirates, Chile, and Malaysia, all with access to commercial ports, the industry will be able to redeploy some of its more mature and smaller ships to these newer markets.

Cuba offers another significant opportunity for expansion. If this market opens up, the cruise industry is likely to invest in the infrastructure needed to allow cruises to dock and provide access to a destination that has so far proved elusive.

Key source markets

Cruise operators are targeting consumers in three key source markets. North America is the number one cruising market with 13.1 million passengers in 2008 (Figure 25). This market is mature, but continues to provide opportunity for growth due to the large number of people who have not yet taken a cruise.

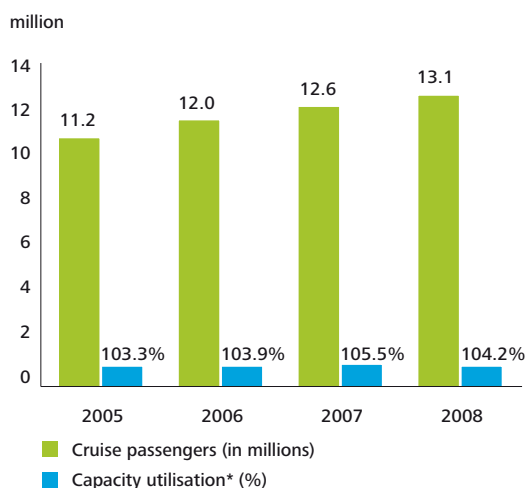
Europe is the second largest source market, though significantly smaller than North America with 4.4 million passengers in 2008 (Figure 26), just under one third of whom were from the UK. The European market is expected to show significant growth in volume as the industry heads into 2015.

The Asian source market is also expected to grow significantly in terms of percentages, as the market becomes more consumer driven, offering new opportunities for industry expansion over the next five years.

According to a recent study,² conducted by Cruise Lines International Association (CLIA), the median age of cruisers was 46, falling from 49 previously, with an average household income of around US\$40,000.

Cruising caters to groups of all ages and has gradually extended its appeal to younger markets and multi-generational family units in recent years. Nevertheless, the progress of the baby boomer population into retirement offers significant opportunities for a sector with a traditionally strong appeal to a middle-aged market.

Figure 25. Global summary statistics for the North American Cruise Industry, 2005-2008

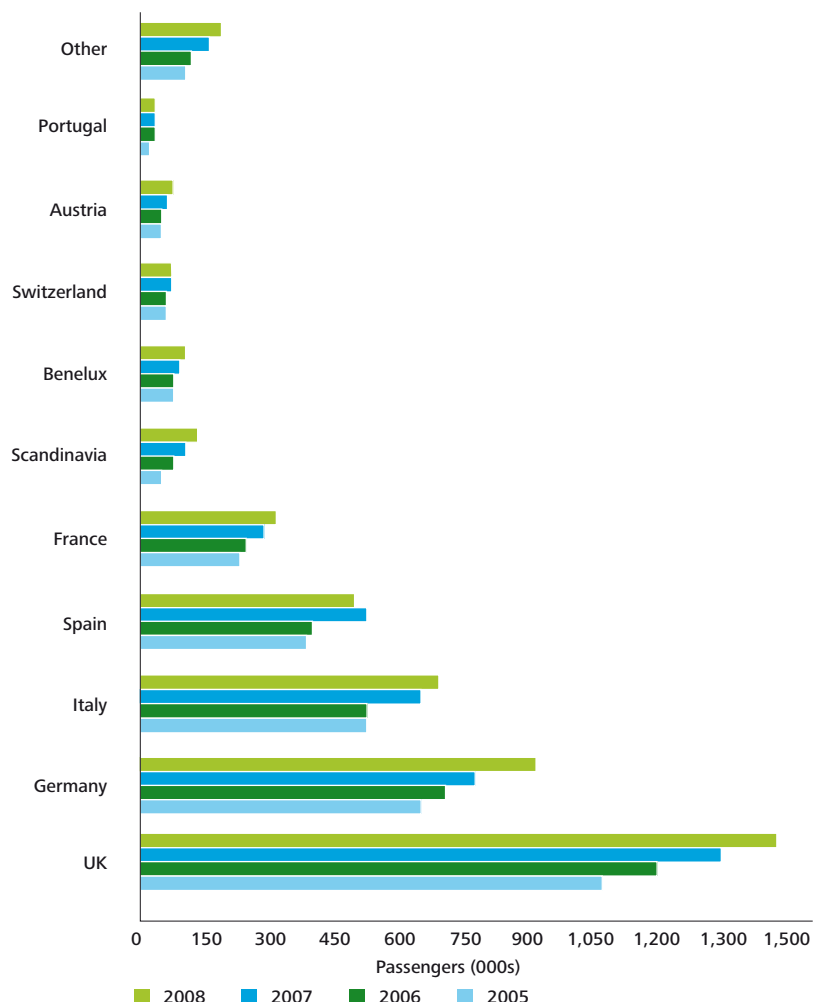


Summary "The Contribution of the North American Cruise Industry to the US Economy in 2008"

*Capacity is based on double occupancy

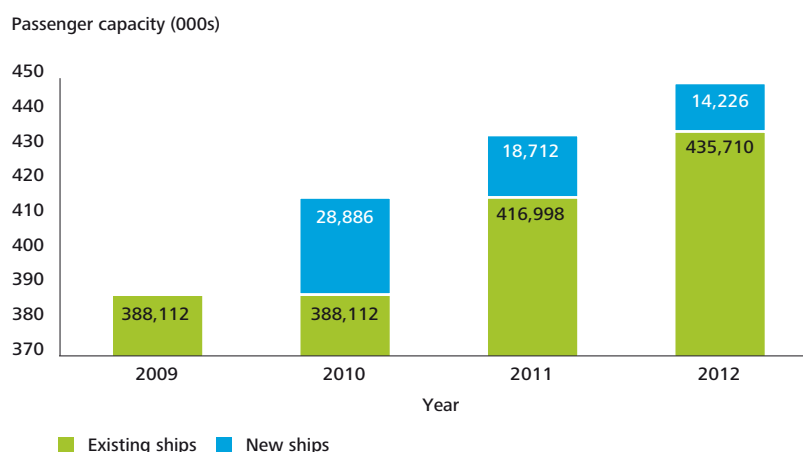
Source: Business Research and Economic Advisors Executive

Figure 26. European cruise market by country, 2005-2008



Source: European Cruise Council, statistics and markets 2008

Figure 27. Shipbuilding summary – Supply



Source: Cruisemarketwatch.com/blog1/growth/

The value-focused consumer

The industry offers one of the best holiday value propositions available and is currently benefiting from providing continued quality service to the value-focused consumer.

A key strength of cruising, and its relative resilience in difficult economic times, lies in its appeal to the value-oriented consumer. According to the European Cruise Council, the European sector achieved 12 per cent passenger growth in 2009, with all European countries reporting an increase, despite an overall downturn in the travel industry.

The cruise industry benefits from a large number of home ports of call that are easily accessible by car, and can significantly reduce the cost associated with air travel.

The all-inclusive model is at the heart of the value for money appeal of cruise holidays; enabling consumers to budget in advance and exercise greater control over their holiday spend, while also allowing consumers the ability to travel to exotic destinations. Over the years, the all-inclusive model has been tailored to meet the expectations of its consumers, exemplifying the industry's constant focus on adding value for its consumers. Some cruise lines are developing a hybrid model, offering guests the option of dining in their restaurant of choice for a small fee. These additional options provide a wide range of flexibility and opportunities for consumers.

The success of the all-inclusive cruise model mirrors that of land-based holiday resorts. According to Mintel in April 2009, the number of land-based all-inclusive holidays taken abroad by UK residents grew by an estimated 32 per cent over the previous five years.

Over the next five years many travellers are likely to remain highly price-sensitive in the post-recessionary environment. However the overall quality of the product, services and amenities included will also continue to form part of the value appeal of cruise holidays therefore the industry will continue to put emphasis on quality for consumers.

Tailoring the product

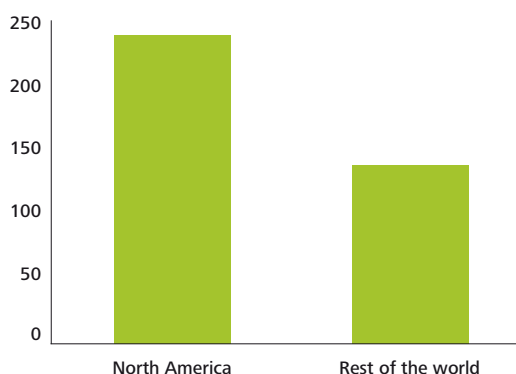
Cruising offers a variety of locations and a diversity of experiential holiday styles, from pampering to adventure travel, to suit a variety of markets and consumers. Travellers can visit multiple destinations without the inconvenience and increased cost of air travel and enjoy the amenities and on-board activities while travelling.

Cruise operators constantly seek to understand their consumer interests, desires and habits in order to tailor products to meet their consumers' expectations. The industry's focus is twofold, first to attract new guests and secondly to keep existing guests. New guests are enticed by amenities such as water features, spas, fitness facilities, rock climbing walls; these amenities are key influencers in attracting first time cruisers. Repeat guests are influenced by the quality of the overall onboard experience, driven by the quality of service provided by the crew as well as the onboard activities. The success of the industry lies in understanding these needs and providing a carefully differentiated cruising experience unique to each brand and to each ship.

In recent years, the industry has tailored its products by offering more itineraries and options, providing new experiences for both new and repeat consumers:

- New vessels;
- New itineraries;
- Casinos;
- Onboard entertainment;
- Internet cafes and Wi-Fi;
- Multiple themed restaurants;
- Health and fitness facilities;
- Expansive spas;
- Basketball courts;
- Bowling alleys;
- Ice skating rinks;
- Outdoor theatre;
- Rock-climbing walls;
- Surfing pools;
- Volleyball courts; and
- Multi-room 'villas'.

Figure 28. Total worldwide cruise capacity at the end of 2009 (000s)



Source: Cruisemarketwatch.com/blog1/#capacity – Passenger Capacity

Unique advantages

Mobility allows the cruise industry to redeploy ships to new or existing destinations, adapting to changing demand or external factors such as natural disasters, pandemics, increases in fuel cost or market saturation.

This mobility gives cruising a unique advantage.

For example, a hotel must evacuate its guests following a hurricane warning, whilst a cruise line can simply re-route its ships. Such changes may be costly and operationally challenging but, in most cases, guest activities are not interrupted.

The service received onboard a ship is the industry's second greatest competitive advantage, and a key reason to attracting repeat guests. The industry employs people from a wide range of nationalities whose cultures have a tendency to provide higher levels of service to consumers. The overall experience and higher level of service provided by a diverse crew is a key differentiator for the industry and clearly is a model that can be deployed in the hospitality sector.

Land and sea

According to a study,³ 80 per cent of passengers agreed that cruise holidays were a good way to sample destinations they might wish to visit again in the future. Further research showed that 38 per cent of passengers had returned to destinations for a land-based holiday after first visiting by cruise. These findings suggest significant opportunities for the hospitality industry to target cruise consumers.

The two sectors already work together via 'Land and Sea' packages. Hotels situated close to ports often partner with cruise lines and offer discounted rates, allowing consumers to park their vehicles in hotel car parks during the cruise and encouraging them to stay in the destination prior to embarkation.

Success factors

The cruise market has expanded quickly in recent years and proved more resilient than most travel sectors through the recession. Projected capacity increases over the next few years are expected to drive further passenger growth. This growth, including the industry's expansion into emerging markets, should also result in the need for additional rooms and opportunity for the hospitality industry.

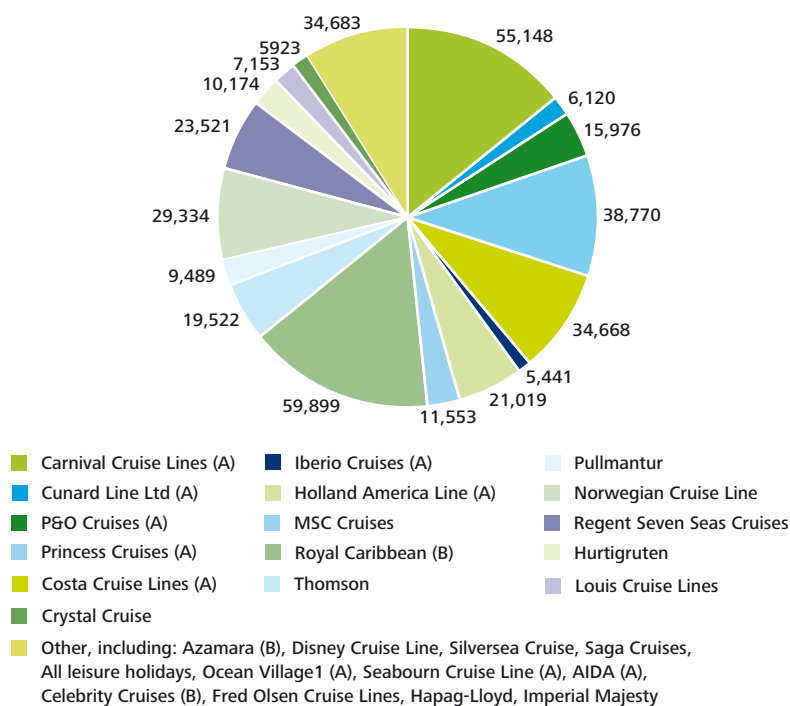
Three success factors associated with cruising are of particular relevance to hospitality:

Value and quality are the most important of these factors. The cruise industry constantly seeks to understand the expectations of its guests. This understanding provides the industry with the knowledge required to develop a product and upgrade/make changes to existing products to satisfy and cater to their guests' expectations. Hotels too can build this factor into their business model; by ensuring that hotels are catering to the specific consumers they seek to attract, while continuing to provide value. Value and quality are interrelated and the key to the sectors success is in ensuring that each sector understands and adapts to what their target market perceives to be value. The definition of value depends on each target market's specific desires, needs and expectations, so the industry must focus on understanding their respective consumers.

The core all-inclusive model offers a clear value-for-money concept that has an enhanced appeal in a post-recessionary world of continuing economic uncertainty. Hotels can also target this need, either through the further development of fully all-inclusive options or by expanding the range of facilities and services within the packages they currently offer.

The experiential style of cruising with its emphasis on physical, cultural, educational, wellness and entertainment activity also resonates with current travel trends. This applies to all generations but has a particular appeal to the affluent and travel-hungry baby boomer generation. Hotels can benefit by developing diverse and rich lifestyle experiences beyond a bed for the night and a meal. A cruise is an experience and each cruising experience is different from the next. Hotels can also appeal to consumers by differentiating themselves and providing the 'hotel' experience that the specific consumers expect. By providing such value and quality, each sector can expand their market share in a highly competitive market.

Figure 29. Total worldwide cruise capacity at the end of 2009, capacity – 388,112/Ships 241



(A) A subsidiary of Carnival Corporation Plc. and subsidiaries

(B) A subsidiary of Royal Caribbean International and subsidiaries

Source: Cruisemarketwatch.com/blog1/#capacity – Passenger Capacity

Hotels and gaming after the storm

Prospects and opportunities



Before the recent crisis, many people believed the gaming industry was recession-proof, citing performance data from the last two economic downturns in 2001-2002 and 1990-1991 as evidence of its invincibility. That notion has now been firmly dispelled.

Operators in key markets such as Las Vegas, Atlantic City, the UK, Macau and local casinos across the world have reported significant declines in gaming revenue across the board as consumers have cut back on discretionary spending. Gavin Isaacs, Executive Vice President and Chief Operating Officer of Bally Technologies, confirms that demand is down this past year and says that, "purchasing has been affected by the economic environment."

Shares in Sands China, which operates Las Vegas Sands' three casinos in Macau, fell 15 per cent in November 2009 amid concerns over the health of the local market.¹

In the UK the impact of the recession has been exacerbated by the smoking ban, increased gaming taxation rates, and a reduction in the number of gaming machines permitted in casinos. Research published in July 2009 showed that almost a quarter of UK gamblers had cut back on gambling with a further 16 per cent planning to cut back in the near future.²

In Las Vegas revenues have been in decline since the economy began to slow down in late 2007. Both occupancy and ADR have fallen, and the impact has been exacerbated by the large increase in room supply and convention facilities developed in the city during the boom years.

Gaming categories

The global gaming industry can be divided into two main categories, virtual gaming and bricks and mortar. The virtual category includes internet, mobile and interactive gaming. Bricks and mortar includes casinos, betting shops, lotteries, cruise gaming and all private gambling.

This analysis focuses primarily on destination casinos that are integrated with hotels in resorts such as Las Vegas, Atlantic City and Macau. The hotel and casino relationship is crucial in this sector because, in order to lure travelling high rollers, casinos need to offer luxurious and extravagant hotel suites.

Casinos generally represent the bulk of gaming company earnings in these resorts, but non-gaming amenities support the overall gaming experience and contribute significantly to revenue. In recent years, destination resorts in markets such as Las Vegas have generated up to half of their revenue from non-gaming sources. Casinos offer free or discounted amenities such as dinners, tickets to shows and even hotel rooms in order to attract visitors and encourage gaming.

Post-recessionary landscape

Before the recession, destination casino resorts enjoyed a decade of solid growth with ample credit available, enabling the construction of large capital projects. At the time of writing this report, recently completed developments in Las Vegas and Macau include the Encore at Wynn Las Vegas, MGM MIRAGE's City Center in Las Vegas and the Sands Macau.

Many companies were left stranded, facing liquidity problems and high debt levels as the pool of available credit dried up in the recession. For example, several hotel and casino companies declared bankruptcy during 2009, at the peak of the liquidity crisis. While some of the lucky few were snapped up by opportunistic bargain hunters, across the whole length of the Las Vegas strip, there are half-finished construction sites which may never open their doors.³

Credit problems have slowed down construction globally. The Las Vegas Sands hotel and casino resort was due to open in Singapore in January 2010, but this was delayed and opened in April as subcontractors struggled to secure short-term credit. Overall, billions of dollars have been lost as developments have stalled or been cancelled altogether.

The gaming industry experienced a rapid increase of hotel rooms during the boom years, and this over-supply has now become a liability. However, Las Vegas casino resorts are likely to aggressively market its room supply and new convention facilities in their city to bring new businesses to the strip as the world emerges from recession. This will be in direct competition with other large hotel chains that rely on convention business as a key revenue stream.

Over the next five years we expect to see lower returns on casino hotel room ADR and also lower discretionary spend in hotels. Companies are likely to focus on cost cutting to maintain profit margins.

We expect to see some new developments completed by 2015, but we also expect these to be on a smaller scale and less lavish than many of the developments completed in the last decade.

The regulatory environment presents a complex matrix of requirements from state jurisdictions, Tribal Gaming Regulators and international bodies. Mark Lipparelli, of the Nevada Gaming Control Board, believes the varying requirements across jurisdictions create challenges for companies who seek to lower the cost of innovation and also for the operators who strive for more consistency in their IT infrastructure, marketing and audit procedures. The regulatory complexity from market-to-market also may serve to impede progress in system and gaming functionality.

The recession may, however, spawn further gaming expansion within the US. Some US state legislators and governors see legalised gaming revenues as a means to shore-up their deteriorating tax bases. Some states are considering proposals to add casinos or expand their current gaming structures. The situation is fluid in many states where legislation, amendments and support can change quickly.

Online expansion

The key to future success will be to identify new growth areas and revenue streams. Online gaming is likely to be a key area of expansion.

Online gaming was growing significantly before the passing of the Unlawful Internet Gambling Enforcement Act in the US in September 2006. This Act prohibited the transfer of funds from a financial institution to an illegal internet gambling site. As a result, all listed online gaming companies such as PartyGaming Plc and Sportingbet Plc have withdrawn from the US market.

There are now signs that online gaming may be legalised in the US. In May 2009 the US Congressman Barney Frank introduced a bill to overturn the gambling aspects of the Act.

Harrah's aims to take advantage of this trend and has appointed former PartyGaming Chief Executive Officer, Mitch Garber, as the head of its new online gaming division, Harrah's Interactive Entertainment (HIE). HIE will explore the use of online and interactive gaming technologies to effectively broaden its global reach. Additionally, HIE will help cultivate and grow Harrah's existing customer base.

“We believe that online gaming in the US will be legal in some form in the near future. The key issues that need to be addressed are the taxation system and deciding who will have responsibility for regulating the market.”

Patti Hart, President & Chief Executive Officer, International Game Technology (IGT)

“We expect to see internet gaming, particularly poker, expand in the US over the next five years. The domestic licensing of entities or individuals formerly or currently engaged in internet wagering in foreign markets will be one of a series of seminal issues in legalisation and a major challenge for US based entities structuring business relationships.”

Mark Lippavelli, Member, Nevada Gaming Control Board

“We certainly view online gaming, and online poker specifically, as an increasingly important component of growth in our company. We believe that our brands, customer relationships, and capabilities of HIE give us permission to compete and win in this area.”

Jonathan Halkyard, Chief Financial Officer, Harrah's Entertainment Inc



Major operators now see online gaming as a way to encourage people to visit their destination hotels and casino resorts. Casino table games can be intimidating if the customer does not know the rules of the game. If potential gamers can practice online they may subsequently visit a bricks and mortar casino to experience this form of gaming 'in the flesh'.

International gaming companies may be attracted by the lower capital investment required to set up online gaming sites, especially in view of current liquidity problems. The rising popularity of wireless internet devices such as the iPhone and Blackberry will also offer consumers more opportunities to gamble online.

Technology and the consumer experience

The bricks and mortar casino industry continues to introduce new technologies to improve the overall consumer experience. The Smart Card is already being widely used in casinos in Europe and is beginning to gain prominence in America.⁴ Smart Card technology will enable gamblers to play many games in a cashless environment. More importantly the card will hold individual consumer information, including betting patterns, allowing casinos to develop marketing campaigns to better target, attract and retain consumers.

This technology can also be used in a hotel to simplify and speed-up payment methods at all outlets/points of sale within a hotel. This would represent an improvement from the key card and signature method currently used in many hotels. In destination hotels and casino resorts the information gathered from the card can be used to market and promote both gaming and non-gaming activities to guests on a real-time basis.

“The future of the gaming experience will be dependent on social networking and social media channels. The consumer or video game player will crave increased communications with interactive gaming technology that simulates reality and delivers more choices and preferences.”

Gavin Isaacs, Executive Vice President & Chief Operating Officer, Bally Technologies

The use of ‘gaming personalisation’ software is also likely to become an important influence on the future of the industry. The ability to customise and make changes to the games on the casino floor should ultimately decrease the number of machines needed. This should reduce the need for excess real estate and help to streamline costs, a key focus for companies over the next five years.

Demographics change the game

The recession may help to change consumer demographics in the gaming industry. The luxury market, accounting for most of the inventory on the Las Vegas strip, has been one of the hardest hit segments.

According to Patti Hart, Chief Executive Officer of IGT, consumer discretionary spending is now being reset and the luxury end of the business may continue to struggle. She believes that people will continue to spend on entertainment but will spend less, creating a new, more budget-focused consumer. Several high end hotels in Las Vegas are cutting room rates to boost occupancy and engage with this emerging audience.

Social media is also shaping the gaming landscape and the consumer experience. Generation Y has grown up with innovative gaming technology and the ability to connect through tools such as Facebook and Twitter. This generation is drawn to gaming experiences with a focus on personalisation and interaction.

Many gamers are adapting to advances in technology. But others may resist these changes and remain nostalgic for more traditional forms of gaming. Companies will need to balance the preferences of different consumers.

Emerging market potential

Emerging markets are likely to be a key area of potential growth for the leading global companies as government deregulation of gaming continues.

Deregulation has led to significant growth in gaming income in Macau over the past few years. The Chinese resort has followed the Las Vegas model, incorporating gaming, fine dining, Broadway-style shows and other high-end entertainment. Macau surpassed Las Vegas in terms of gaming revenue in 2006. Leading global companies, such as Harrah’s, MGM Mirage, Wynn Resorts and Las Vegas Sands, have acquired licenses and developed casino resorts in Macau, highlighting their ambition to expand into emerging international markets.

Other Asian countries, notably Singapore, South Korea, Vietnam and Cambodia, have followed Macau’s example by deregulating gaming. Their governments see legalised gaming as a way to increase tax revenues and to drive increased spending on tourism and hospitality. Destination resort casinos are under construction in these areas.

However, the impact of global recession has affected the pace of growth in the Asian gaming markets. Las Vegas Sands has halted two expansion projects at the Venetian, and Hong Kong’s Galaxy Entertainment has postponed the opening of its new Cotai casino and resort until early 2011. The problem of raising finance to embark on new projects is likely to hinder further growth in the short term.

Mixed picture ahead

The gaming industry environment is likely to remain challenging for some time. The completion of the Cosmopolitan Resort & Casino may be the final major development to be completed on the Las Vegas strip for some years to come, and further expansion in other domestic and international jurisdictions are also likely to be delayed.

New opportunities do still exist. Deregulation will continue to open up emerging markets despite the impact of the recession. Internet gaming is likely to be a key area with the potential for growth both online and via bricks and mortar casinos, as companies seek to encourage visitors to their casino resorts by cross-selling promotions to online gamers.

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Cruising to success – Lessons to be learned

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Deloitte

Deloitte is one of the world's leading professional services organisations with more than 169,000 people in over 140 countries worldwide. Our member firms serve over half of the world's largest companies, as well as large national enterprises, public institutions, and successful, fast-growing global growth companies.

We have assembled a dedicated team to serve the Tourism, Hospitality and Leisure (THL) sector across the globe, providing a range of integrated services including Audit, Tax, Consulting and Corporate Finance. Deloitte is recognised as one of the leading advisors to the THL industry, with unrivalled knowledge of both the industry and the business issues facing individual clients.

We act for owners, operators, developers and investors and our global network of local offices and strong presence in emerging markets, provides our clients with exceptional analysis and a unique perspective of the hospitality market during these challenging times. We provide an outstanding service with a focus on creating value for our clients, enabling them to make informed decisions to maximise their opportunities.

Our practice has long standing relationships with all major players in the industry. Each client relationship is led through a lead client service partner to ensure we provide maximum value to our clients.

In the UK we work with:

- All five of the global hospitality companies and seven out of ten of the world's largest hospitality companies.
- Five out of the six THL companies in the FTSE100 and 19 of the 25 THL companies in the FTSE350.
- Most of the world's leading online distributors, tour operators and agents, and all the travel companies in the FTSE350. Deloitte is a leading advisor on specific travel related issues such as TOMS (Tour Operators' Margin Scheme) and bonding.
- The majority of the hotel companies in the FTSE350 and the overwhelming majority of the branded hospitality companies in the UK.

- Owners, operators, developers and investors and work with most of the world's leading companies in each of these categories, as well as fast developing branded hotel groups domestically and internationally.

In the US we work with:

- 50% of the Fortune 500 Hotels, Casinos & Resorts, and over 40% of the Fortune 1000 Hotels, Casinos & Resorts.
- 25% of the Fortune 500 Food Service Companies and 30% of the Fortune 1000 Food Service Companies.
- 25% of the Restaurant Power Players.

In the US, we also provide attest services to:

- 100% of the Fortune 500 Hotels, Casinos & Resorts and over 85% of the Fortune 1000 Hotels, Casinos & Resorts.
- 100% of the Fortune 500 Food Service Companies and 90% of the Fortune 1000 Food Service Companies.
- Over 85% of the Restaurant Power Players.

www.deloitte.co.uk/tourismhospitalityleisure



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