Opinion

The future is polarised

Are the UK and global hotel industries as highly fragmented as recent analysts Alison Morrison, Paul Phillips or Warwick Clifton and Naeem Shah have argued?[1] ***David McCaskey*** *challenges the accepted logic by proposing that the model for the future should be a polarised structure.*

As larger and more frequent mergers and acquisitions create concentration at one pole of the industry, at the other pole more hotels are failing and departing the industry. This is the new face of the industry for the first decade of the new millennium.

Consider the following extracts concerning events, which were widely reported in the financial and trade press:

Bass is making every effort to establish itself as a hotel company. . . .the leisure giant's latest venture is a £128 million purchase of 59 hotels in the Asia–Pacific region including some 24 Australian properties well placed for the Olympic's 2000 rush. . . . last year's purchase of the Inter-Continental chain added an impressive portfolio of brands, which already included Holiday Inn and Crowne Plaza. Profits from hotels are growing rapidly—last year they rose 23.5% to £321 million and long term growth prospects are good.

A near £5 billion hostile bid is being prepared by Granada to intervene in the proposed surprise merger between United News & Media and Carlton Communications. In doing this, Gerry Robinson and Charles Allen had to shelve plans for a transformational 'megabid' in the hospitality industry.

A good deal, despite the reservations, is how the City greeted Whitbread's £578 million purchase of the Swallow Hotel group most of which will be converted to Marriotts over the next eighteen months. It is also estimated that Whitbread have the wherewithal for another £1/2 billion acquisition to be do-able so are Thistle or De Vere in the frame?

Radisson has built one of the industry's most extensive global hotel systems with operations in 53 countries. Through a series of multiple acquisitions and company-managed projects, it added 55 hotels in '99 and plans for similar expansion in 2000.[2]

The polarised or bifurcated model projects an industry with a small number of increasingly large hotel groups (including consortia) and a myriad (gradually dwindling) of small independent or unaffiliated hotels. But the middle ground previously occupied by small to middle-sized hotel groups disappears as a no longer financially-tenable position. Without the economies of scale to be gained by the larger groups they are also denied the yields obtained by the large groups from their global distribution networks and inventory management systems. The middle-sized hotels also lack the defined branded images that induce confidence in both occasional as well as professional buyers and corporate and leisure business intermediaries.

Both the unaffiliated independents and the SMEs find that their reasonably (though in many instances marginally) profitable hotels are tipped into a loss making situation with the arrival of the industry's increasingly voracious 'Pac Man'—the budget hotel. The result initially is an inevitable downturn in investment: 'Can we afford to paint the front of the hotel this year? Can we afford *not* to paint the front of the hotel this year?' The era of the 60s, 70s and into the 80s when many UK locations were 'under-bedded' and where many customers' choices were ruled by inertia and 'better the devil you know', are well and truly over.

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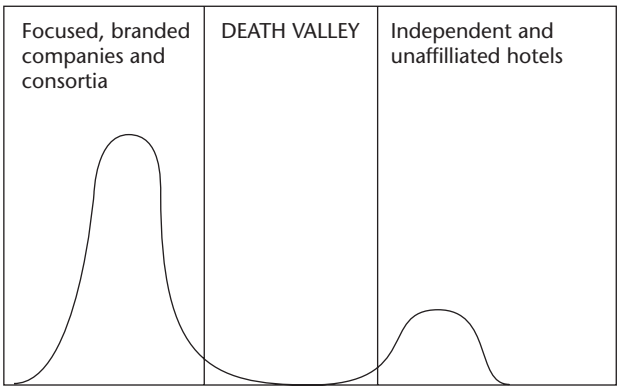
Following a take-over, in the mid-70s, the author managed (for a couple of years) a provincial hotel for a national chain notorious for its under-investment. Soon after his arrival, he condemned every bed in the house. The ensuing battle with area directors unused to spending money and who could not see a problem with a hotel that was performing at 90% occupancy with significant repeat business, took a year to resolve. On the Sunday when all the new beds were installed, the detritus which emerged, a paltry collection of putrid palliasses, were refused by the local Salvation Army Hostel 'Yuck, we're not having any of that'. One hesitates to think what may still lurk beneath the sheets at some of the UK's 22,000 plus hostelries. By contrast, Whitbread Travel Inns automatically put in brand new beds every three years. Paul Slattery captured this investment dichotomy well:

> *From an investment perspective, the improving industrial context, the growing profits, the expansion of low capital cost formats and the reduced assets value combine to produce significantly growing returns, higher cash flows and earnings growth well ahead of the market.*
>
> *These developments are not industry wide. The chasm between UK Hotels plc and unquoted companies is widening by the day as worryingly large numbers of unaffiliated hotels degenerate into slums.*



Adapted from Manchester Business School model

Figure 1 The bi-polar model emerging in many industries

Caterers might appreciate an analogy drawn from cheese making where we find increasingly large rich clumps of curd in a rapidly thinning sea of whey

> *The size of hotel chain has become a key variable with the larger companies performing materially better than smaller chains and we expect this trend to remain as an industry norm.*[3]

A report commissioned by Milliken, Europe's leading commercial carpet company, from the Henley Centre, *Investigating Space Futures*[4] analysed the future structure of a variety of industries in an attempt to estimate potential carpet demand for offices and projected a bi-polar pattern emerging in many industry sectors. Figure 1 above captures this bifurcation well.

Few readers would have any difficulty in agreeing, for example, that this model fits the UK (and increasingly the global) food retailing industry which is very polarised. The current big five food retailers, Tesco, Asda (Wal-Mart), Sainsbury, Safeway and Morrisons take some 75% of the industry's annual £90 billion turnover, yet there are still tens of thousands of small unaffiliated shops. The contract catering industry is also polarised, with giants such as Gardner Merchant-Sodexho, Eurest-Compass and Granada Food Services and most mid-sized operators have been subsumed in the unquenchable growth drive of these market leaders, yet there are still many thousands of small independent contractors.

The Hospitality Review's January 2000 article by Warwick Clifton, Naeem Shah and Peter Antenen prepared an excellent, original and useful examination of the structure of UK foodservice outlets which they introduce as 'an accurate reflection of foodservice brands in the UK'. However they are fixed on fragmentation 'highlighting a distinctive feature of this industry is fragmentation and a high number of relatively small players'. Against this view, we set out to question the convention and to suggest that this industry, albeit some years behind other sectors, is well into the throes of polarisation. Had they continued their decomposition of the industry beyond that quoted below, they would inevitably have exposed its polarisation.

> *The study identified 347 companies that operated branded foodservice units. These companies operated 713 brands (an average of 2.05 brands per operator, (sic) and represented 22,859 units across the UK.*[6]

Analysis would have shown that it is doubtful if 10% or even 5%, in other words 71 or 36 of the 'brands' quoted, fulfilled in any way the true requirements of brand status/criteria beyond a different name above the door and on the menu. Fiona Gilmore states that

> *Brands are clearly positioned and confidently delivered through their core competencies and, more importantly, have a coherent core value and emotional brand proposition for their consumer.*[7]

As consumers, we carry in our minds perceptual maps which inform our purchasing decisions for products and services. These often take the form of invoked sets in which we readily list a small number of brands which form our first, second and third choices and it is essential for a brand to achieve recognition and occupy this mind-space.

Again, few readers would have any difficulty in concurring that the UK licensed retailing and restaurant industry is rapidly polarising. For example, the absorption of the Pelican Group by Whitbread, of Brown's by Bass and Allied Domecq's estate by Punch Taverns (and others in concert) in many cases providing new formulae as the future growth engines of the market leaders. There is mounting speculation and much agreement amongst City analysts that both Bass and Whitbread will shortly divest themselves of their original core businesses in brewing.[8] They will concentrate their investment and futures in higher-returning businesses such as hotels, pubs and restaurants by developing formats which they roll out and replicate, in turn further accelerating the bifurcation process. And yet again many small pubs and restaurants will remain and will continue to thrive.

Caterers might appreciate an analogy drawn from cheese making where we find increasingly large rich clumps of curd in a rapidly thinning sea of whey. Of course all recognise why these industries inevitably arrive at this structure or configuration. It is the natural outcome of the momentum generated through three decades of consolidation, where plcs replaced sole proprietor and family business ownership. By contrast with motor car manufacture or petroleum extraction and refining where small businesses cannot exist, the relatively low barriers to entry and the lack of onus from stakeholders to seek a proper or realistic return on capital employed allows many individuals to remain in all forms of retailing. Exit barriers can also be high.

Successful independent operators will always exist in all sectors of the hospitality industry though an inherent knowledge and understanding of the needs of their individual customers, through their sheer 'mine host' drive and through their individuality and differentiation which attracts and inculcates loyalty. Len Louis, Marketing Director of Best Western (including Consort) calls this 'The Independent's Advantage'[9]. Consortia membership, with its customer-confidence-inspiring guarantee of a consistent high-quality experience has the added bonus of giving individuality, even eccentricity, at each location. Whilst this is anathema to many of the hard-branded formulae which currently prevail, it is also their greatest future challenge, as self-assured customers begin to seek excitement through variety. Comparisons may be drawn with the holiday industry where the individualised 'go as you please' type vacation has taken over from the tight packages of the 70s and 80s. In much the same way, today's Ford Focus with its innumerable options and choices is far removed from the Model T where you 'could have any colour so long as it was black'.

the Whitbread Hotel Company will only develop and build their Travel Inns on sites which are guaranteed to return at least 80% occupancy by the end of their second year of trading

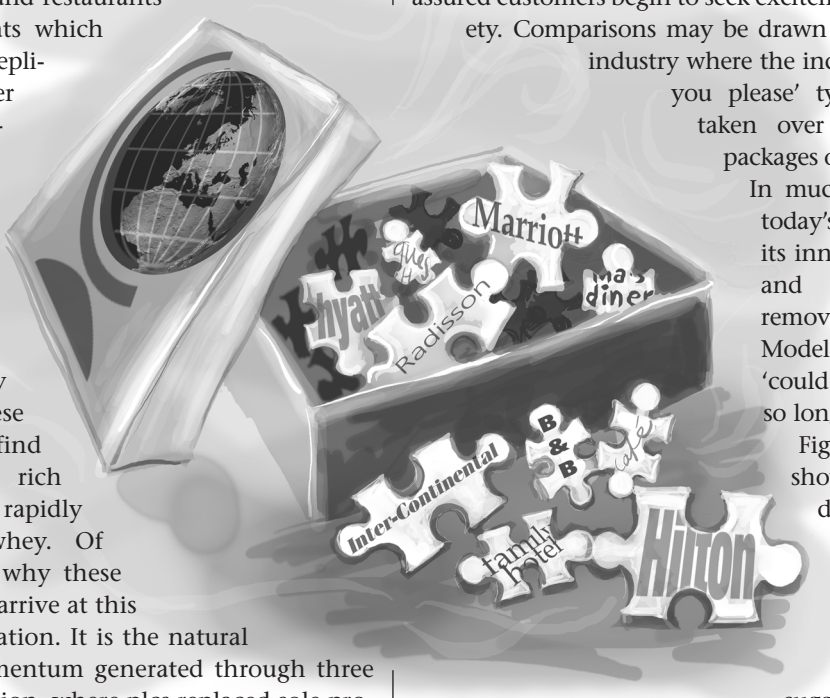


Figure 2 (overleaf) shows the significant decline in the number of retailing outlets and tracks the demise of small retail chains. It is suggested here that the hotel industry along with other sectors is following a not dissimilar pattern of change. The next few years will witness the continued disappearance of the low-quality independents and of the small unfocused groups; some niche operators may remain, this process catalysed by the next, inevitable, economic downturn.

Using estimates from a variety of sources, just over 25% of UK hotel room stock is operated under the aegis of a plc or consortia. However, these hotels take

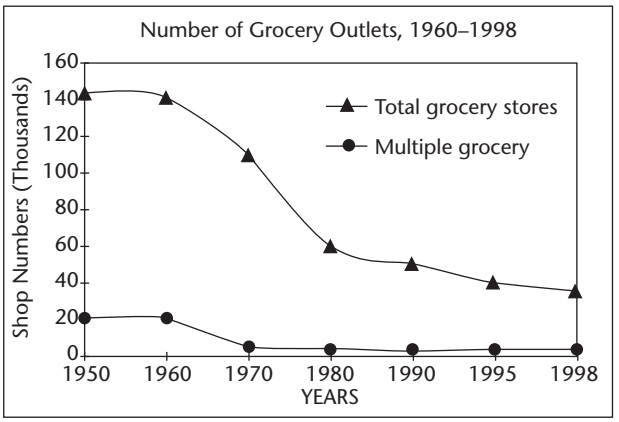


Figure 2 Decline in numbers of retail outlets
Source: A C Nielsen [10]

over 40% of the estimated £8 billion annual turnover and demonstrate even greater profitability.

These hotels occupy the foremost primary and secondary locations, are at the upper market levels, are generally larger and thus closer to size/profitability optimums and have generally strong, developed, widely distributed and well-understood brand propositions. By contrast, most of the unaffiliated outlets are in tertiary locations or worse, are smaller and less economically efficient, are often low or ungraded market levels, and are seen by many bookers (unfairly?) to carry a high risk warning of a poor quality experience.

In the licensed retail sector the highly branded units like All Bar One (Bass), TGI Friday's (Whitbread) are often referred to as 'category killers' as, on entry into an area, they often bring about the demise of local indigenous businesses. Much of their successful entry can be attributed to the location selection techniques they use. Each new site is identified by using a mixture of geo-demographics, current user profiles for each brand they control and a dash of fuzzy logic to ensure that each new unit matches catchment needs and thus opens trading with immediate good cashflows.[11]

A glittering array of establishments offering every possible human convenience, clean, comfortable, reliable, reasonably priced

Earlier, we flagged up lodges as a sort of voracious 'Pac Man' of the industry, a statement that requires further explanation and justification. In 1999, we established that the Whitbread Hotel Company (and its internal franchisees) will only develop and build their Travel Inns on sites which are guaranteed (using a similar geo-demographic methodology) to return at least 80% occupancy by the end of their second year of trading.[12] Their latest results demonstrate that this is achieved, with Travel Inns achieving 89% occupancy across the whole group (without discounting or travel agent commissions), and registering an astounding +79% repeat occupancy. From a nil start in 1985 there were around 30,000 total lodge rooms by the end of 1999.

Table 1 Scale of leading lodge brands

	Brand	units	rooms
1	Travel Inn	235	12,600
2	Travel Lodge	190	9,000
3	Premier Lodge	94	5,400
4	Holiday Inn Express	53	4,666
	others estimated	130	7,200

Source: Travel Inn Marketing 23 Feb 2000

A simple calculation shows the dramatic inroads which lodges have and will continue to make for the foreseeable future, given that all main operators have impressive investment plans. Whitbread will invest £300m in the next five years to double in size to over 20,000 rooms. 30,000 rooms less a generous 10% newly enfranchised sleepers per night = 27,000. 27,000 rooms at an average lodge occupancy of 80% = 21,600 rooms let per night. 21,600 x 366 nights (leap year) = 7,905,600 room-nights per year which are captured. This may be set against recorded demand data. In 1995 Kleinwort Benson estimated that UK plc hotels sold 30.23 million room nights.[13] In 1996 Kleinwort Benson estimated that UK plc hotels sold 31.35 million room nights.[14]

So, somewhere between seven and eight million room nights per year (in excess of 20% of demand) are being gobbled up by these relative newcomers. Whilst some of this demand may in part be cannibalised from the existing brands of the major plc operators at higher market levels, most of this is being taken from the smaller groups and unaffiliated hotels who traditionally drew their custom from this market segment. There are many reports of the sleepless nights—or should that read sleeper-less nights—being caused by this rapid migration of demand and significant bankruptcies, or transference and conversion to hostels, are being recorded in this part of the industry.

These levels of withdrawal from the industry may be evidenced in the work of Clifton and Shah where they record the following:

Table 2 Number of hotels in the UK

	ETB1990	ETB1996	ETB1998
Number of hotels	27,574	22,803	22,069

All authors identify the difficulty of agreeing counts, with Clifton and Shah, proposing the HCRC estimates of 19,000 in 1992 and 18,000 in 1998. Thus a loss of 1,000 hotels in 6 years by HCRC records or 5,505 in 8 years if ETB figures are used.[15]

It is essential to note that, in many cases the nemesis of these small hotels—lodges—grew by about 500 units, so apart from any other new-build supply coming onto the market, we can see the decimation of the market in the loss of some 1,500 or 6,005 hotels, depending on whose estimate is used, a process expected to continue and to accelerate in the next recession. The author contends that many of these losses may be directly attributed to the arrival of the lodge format.

Conrad Lashley also witnesses a similar cleansing and renewal process in the licensed retail sector when he states

> *Mintel estimates that there has been a six percent reduction in pub outlets between 1993 and 1998—with some 5,000 fewer properties—and industry analysts suggest that there is scope for still further shrinkage in pub capacity. Another 5,000 could easily go, though releasing properties for private use is being matched by new licensed applications in new buildings.*[16]

As with pubs there are many small hotels sitting on the edge of the precipice.

Parallels may be readily drawn with food retailing where out of town stores and the newly introduced metro formats (an attempt to achieve even greater market penetration) are squeezing out many existing providers. For the more evolved US hotel industry Bill Bryson embraces this well in *The Lost Continent*. Bryson had left America before the rapid expansion phase of its economy/budget hotel sector. His earliest memories of travelling in the 60s with his parents are of poor quality hotels and eating places. Not dissimilar to the experience of Kemmonds Wilson on his family trip to Washington D.C. which stimulated the formation of Holiday Inns. Bryson recorded his surprise some ten to fifteen years later when he discovered significant improvement, most apparent at the lookalike neon strips which had sprouted up around most American towns. Following a number of encounters, he recognises the benefits that the changes have wrought (especially pertinent to UK operators as we are in this growth phase).

> *By the time I reached Tupelo it was dark. Tupelo was a bigger place than I had expected, but by now I was coming to expect things to be not like I had expected them to be, if you see what I mean. It had a long bright strip of shopping malls, motels and gas stations. Hungry and weary, I saw for the first time the virtue of these strips. Here it all was, laid out for you. . . . A glittering array of establishments offering every possible human convenience, clean, comfortable, reliable, reasonably priced where you could rest, eat, relax and re-equip with the minimum of physical and mental exertion. On top of this they give you glasses of iced water and free second cups of coffee, not to mention free bookmatches and scented toothpicks wrapped in paper to cheer you on your way. What a wonderful country I thought.*[17]

From fragmentation to polarisation via consolidation

In his work *Competitive Strategy* Michael Porter devoted a whole chapter to unlocking the fragmented structure of historically highly fragmented industries where owner-managers abounded. As these industries became more consolidated there would emerge 'market leaders with the power to shape events'.[18] He identified a number of factors which would act as accelerants in this transition namely, economies of scale, technological innovation and the experience curve, also projecting that 'overcoming fragmentation can be a very significant strategic opportunity, the payoffs can be high'. In an examination of the strategic environment in 1987 McCaskey saw these factors as catalysts in the rapid movement from fragmentation to consolidation.[19] He concluded that the only certainty was further and unabated consolidation.

We are now approaching the latter phase of this process and all the latest merger and acquisition (M&A) activities record the opportunities and payoffs which Porter predicted. The common factors to emerge from the Stakis/Hilton, the Whitbread/Marriott/Swallow, and the Best Western/Concord deals of recent months are

1. Significant economies of scale through cost dilution, central cost savings and increased buying power.
2. A larger portfolio giving better representation and/or critical mass, filling portfolio gaps and allowing some below par units to be released.
3. A higher market profile and more effective and efficient distribution, improved yield management and better relationship marketing processes.
4. In all of the more 'junior' partner hotels, better occupancies at better prices are achieved, converted into higher RevPARs (Revenue Per Available Room).

The following example will illustrate this.

> *Bass had an excellent start to its current financial year. The groups Inter-Continental hotels saw Revpar increase by 10.1% in Europe and 5.2% in North America.*[20]

These payoffs are well understood and form the ration-

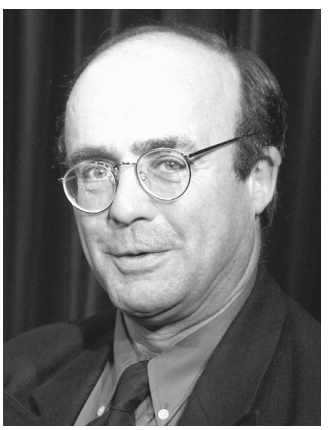
ale for much of the increase in M&A activity.

Conclusion

The industry has gone through momentous change over the last couple of decades driven by the combined forces of

- increased internal competition engendering professionalism
- the rapid entry of the lodge format relentlessly mopping up market share
- the emergence of the 'prosumer', a well informed and more discerning customer

In turn, this has led to the exit of some of the low-quality operators who have, for too long, been allowed to degrade this industry's repute. May this cleansing of the stables continue. It is a truism in the business that the UK hotel (and catering) industry is under-demolished. Have the bulldozers finally arrived?



Following hotel school at Portrush in N Ireland, David spent some twelve years with Strand Hotels (J Lyons & Co) in various management positions. After their takeover, he managed a small provincial hotel for two years before entering teaching at Colchester Institute Centre for Management Studies. He holds an MBA, is about to be confirmed as a Chartered Marketer and is in the throes of a PhD—applying general systems theory to hotel industry structure.

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10 Source A C Nielsen, extracted from *The Retail Pocket Book 1999* (NTC) with kind permission of the editor Neil Prothero (p 134)

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