Trends Analysis: Luxury Segment of the U.S Hotel Industry

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Introduction

The purposes of this review are: (1) to analyze the past performances of overall hotel industry and the luxury segment of the industry, (2) to identify the contemporary issues affecting hotel industry including the luxury segment, and (3) to discuss the future of the industry. To accomplish the first purpose, the financial and operational performances of the industry and luxury segment are analyzed. The analyses of the industry including luxury segments cover the period 1990-1996 inclusive. For the second purpose this study reviewed issues reflected by articles published in journals during the period. The journals reviewed for this purpose include: *Management Today, Institutional Investor, Hotels, Management Review, Nation's Restaurant News, Fortune, New York Times, Business Travel News, Meeting & Conventions, Journal of Travel Research, Hotel & Motel Management, American Banker, Lodging Hospitality, Real Estate Finance, Cornell HRA Quarterly, International Journal of Hospitality Management, FIU Hospitality Review, National Real Estate Investor, Travel Weekly.* By reviewing these journals, a current profile of the luxury hotel industry is identified and the key events shaping the industry over the past six years are discussed. New events just emerging but likely to have an impact on the industry are also identified and discussed. Based on the past business patterns of the luxury segment of the hotel industry, this study mainly discuss the future of the industry and the segments for the third purpose of this study. The data bases used in this study include: ABI Inform (business topics), InfoTrac, PAIS, EconLit, National Economic Social and Environmental Data Bank (NESE).

A Current Profile of the Hotel Industry

Introduction

The hotel market in U.S. has been gathering pace since 1992. Since the recession, occupancy has steadily grown with the hotel markets in New England and the Middle Atlantic areas recording strongest demand growth in 1994. The south Atlantic area, including Miami and the Florida Keys, saw no change in occupancy levels in 1994. To analyze today's business pattern and to see the future, it is good to review how the industry has performed so far. The following is a report tracing economic and financial trends in hotel industry for the past years and analyzing the current performances of hotel industry.

Recession

As the recession went on, the hotel industry experienced unfavorable economic conditions; low GDP growth rate, high inflation, low disposable income, high interest rate, and tight monetary and fiscal policy. In the process of overcoming these difficulties, many trends were found in the hotel industry. The major trends can be summarized into four categories including: downsizing, market diversification, aggressive promotions, and restructuring. Among the

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trends in this period, one of the most notable trend was the downsizing. The hotel industry tried to cut their expenses to adapt to the recession by cutting the number of employees, selling not-profitable properties, and reducing operating costs. Hotel companies diversified their markets intensively in the recession period. The main hotel chains diversified their business from the luxury to economy segment instead of focusing one segment. For example, the Marriot corporation, which traditionally has been focused on up-scale, launched their subsidiary companies to mid-price or limited-service segment and various related business like silver town. As the spending pattern of customers changed, new kinds of products were developed; for example, newly developed super budget guest room has the one third size of regular room with the cheap room price. Value-added promotional tools, such as discounts and coupons were extremely used to attract customers in the recession period. The other trend of promotion was the development of package products. The hotels with the advanced reservation system were able to offer the package commodities with the cheaper price for the convenience of the customer who lives in the busy daily life today. During the recession, the number of conversion independent to a chain and chain to chain had been increased. The conversion of independent to chain increased from 240 in 1989 to 565 in 1992. Also, the conversion of chain to chain increased from 313 in 1989 to 512 in 1991. Typically, independents converted to a chain because they felt an affiliation is the best way to succeed in their lodging environment. For these hotels, the added costs involved-usually franchise, marketing and reservation fees-were offset by the benefits of potentially higher occupancies and room rate. Chain-to-chain conversions were driven by the owners' desire to seek the most profitable affiliation. As their competitive environment changes, they were often forced to reposition their product-and so a change is made.

Recovering

The general economic environment is favor to the hotel industry. The inflation, 2.7 percent on average, remained remarkably stable due to the low wage growth. To boost the US economy, the government slacken the reigns of monetary policy. The percentage change in monetary base reached 9.6 percent in 1993 and 7.9 percent in 1994. The percentage change in M1 has risen dramatically, but the savings have shown the decreased trends. As a result of increased monetary base, the interest rate started to go down. The short term interest rate fell to 3.02 percent in 1993 from 8.12 in 1989. The low interest rate, which encourages customer spending, besides the stable inflation rate and good performances of hoteliers increased the hotel value and stimulated the investors. However, the tight fiscal policy of the US increasing the taxation and decreasing the budget on the hotel industry has been unfavorable environment to the hotel industry.

The most notable pattern of the growth period was the fast recovery rate in the luxury and up-scale segments. Thus, large chain hotels started to penetrate to these segments. The investment of the Marriot to the Ritz-carlton is a good example. Also, several of the hotel industry's largest companies restructured their business in which their lodging businesses were separated from other operations. For example, in an effort to enhance shareholder value, Marriot separated its hotel and real estate businesses into two companies and Hilton also has a plan to separate its hotel and gaming business in 1996.

The demand for hotel room is increasing. Table 1 shows the trends of occupancy percent, average daily rate, and room supply and demand. The rise in demand for rooms significantly outpaced the increase in industry supply, according to Smith Travel Research. The hotel value is increasing due to the increased demand for hotel. The economic environment such as low interest and loosed money policy, high interest rate in hotel (9 percent in 1995), and rising profitability of hotel attracts the investors.

The industry is now aggressively managing its customer mix, cutting back on the level of discounts and/or the number of rooms being made for discounted customers. The result is a slower rate of occupancy growth but faster room rate increases, as mix improvement combines with straightforward price hikes to raise realized ADR. There are some reasons why occupancy rates are not rising at a faster clip. Many hoteliers are reducing corporate and other discounts, reducing the number of rooms that they will make available to discounted programs, or simply turning away low-margined business (e.g., airline crews). Many hoteliers hopes that they can fill the rooms with higher profit walk-in or transient business travelers. This has resulted in continued sharp increases in ADR as noted in Figure 1.

Another Boom or Another Overbuilding?

Unlike the 1980's, the 1990's can be characterized by restrained room expansion in the domestic hotel industry. Cautious lenders, rational tax laws, long development lead times and barriers to entry in the upper end of the market are expected to continue to limit capacity expansion. After four years of limited growth, an estimated additional 460,700 rooms were planned for 1995 as it seen in Table 1. Although this is almost double the number built in 1994, it is around half the number built each year in the latter part of the 1980s.

Several factors have curbed new hotel development in the USA, even when market justified. These include: (1) financing for new hotel development is still extremely limited as traditional lenders still perceive hotels as risky investments, (2) In most markets, hotel values are still low enough to make buying an existing property the most economical way of entering a market area, (3) while market occupancies have recovered, the lag in average rate growth makes financial justification of new projects more difficult to support. Net room demand through the first nine months of 1995 was up 1.5%, the result of stable room supply increases (+1.5%) and solid demand for rooms (+3.0%). Coopers and Lybrand forecasts that room supply growth will remain in a range of just 1.4% to 1.6% through the year 2003. This contrasts sharply with average annual growth of 2.7% from 1984 to 1994. Figure 1 shows the trends in room supply and demand. Since an overbuilding issue has been raised above it is necessary to know more about the trends in the new hotel construction. The datailed analysis for this issue is followed.

Table 1. U.S Hotel Industry Historic Data
Occupancy Rate and Average Daily Rate, Room Supply and Demand

Period	Occupancy Rate	% Change	ADR	YR/YR % Change		Room Supply	% Change	Room Demand	% Change
				% change	CPI-U				
Year-1978	69.2	2.60%	26.72	13.60%	7.6%	2,271,000	1.40%	1,572,000	2.60%
Year-1979	71.9	3.9%	31.27	17.0%	11.3%	2,303,000	1.41%	1,656,000	5.34%
Year-1980	70.6	-1.8%	36.03	15.2%	13.5%	2,321,000	0.78%	1,639,000	-1.03%
Year-1981	67.9	-3.8%	39.64	10.0%	10.3%	2,356,000	1.51%	1,600,000	-2.38%
Year-1982	66.7	-1.8%	42.02	6.0%	6.2%	2,372,000	0.68%	1,581,000	-1.19%
Year-1983	64.4	-3.4%	44.21	5.2%	3.2%	2,400,000	1.18%	1,545,000	-2.28%
Year-1984	64.0	-0.6%	47.27	6.9%	4.3%	2,436,000	1.50%	1,559,000	0.91%
Year-1985	63.2	-1.3%	49.45	4.6%	3.6%	2,504,000	2.79%	1,582,000	1.48%
Year-1986	62.5	-1.1%	51.04	3.2%	1.9%	2,587,000	3.31%	1,616,000	2.15%
Year-1987	61.9	-1.0%	52.88	3.6%	3.6%	2,685,000	3.79%	1,661,000	2.78%
Year-1988	62.3	0.6%	54.81	3.6%	4.1%	2,797,000	4.17%	1,742,000	4.88%
Year-1989	63.2	1.4%	56.74	3.5%	4.8%	2,898,000	3.61%	1,831,000	5.11%
Year-1990	62.4	-1.3%	58.49	3.1%	5.4%	2,997,000	3.42%	1,870,000	2.13%
Year-1991	60.9	-2.4%	58.83	0.6%	4.2%	3071000	2.47%	1,871,000	0.05%
Year-1992	62.1	2.0%	59.65	1.4%	3.0%	3,111,000	1.30%	1,933,000	3.31%
Year-1993	63.1	1.6%	61.3	2.8%	3.0%	3,150,000	1.25%	1,989,000	2.90%
Year-1994	65.2	3.3%	63.63	3.8%	2.6%	3,194,000	1.40%	2,082,000	4.68%
Year-1995E	66.4	1.8%	66.49	4.5%	3.3%	3,245,104	1.60%	2,154,870	3.50%
Year-1996E	67.3	1.4%	69.15	4.0%	3.0%	3,297,026	1.60%	2,219,516	3.00%
Year-1997E	68.2	1.3%	71.92	4.0%	3.0%	3,349,778	1.60%	2,286,102	3.00%

Source: Smith travel Research/Laventhol & Horwath; The Seidler Companies Incorporated Estimates

Figure 1 Trends of Occupancy, ADR, and CPI-U

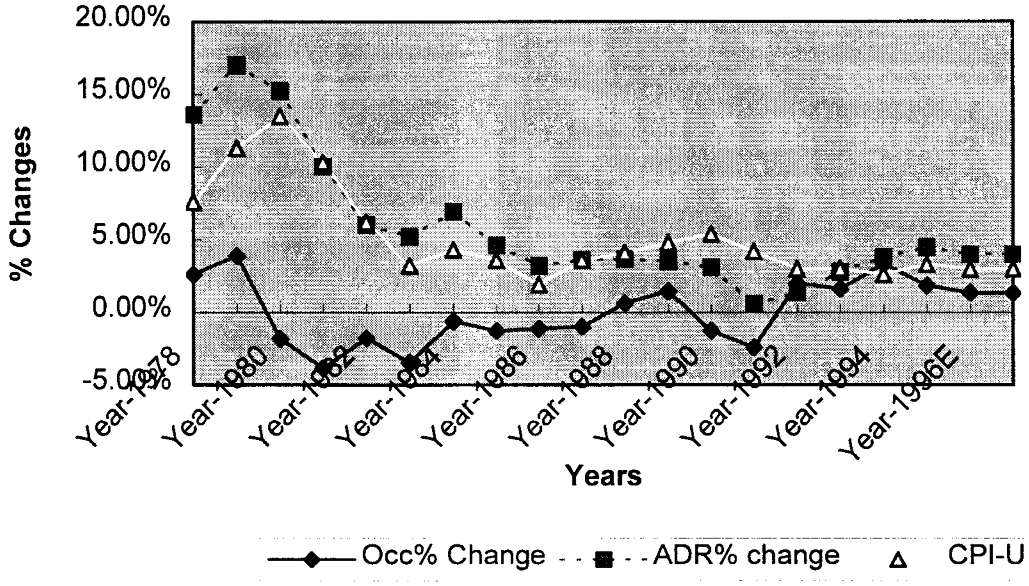
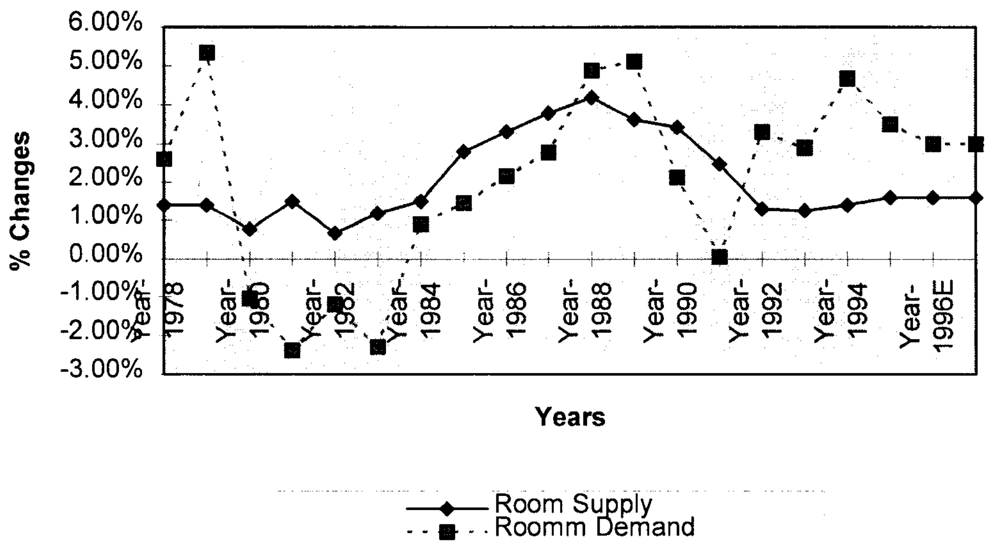


Figure 2. Room Supply and Demand (% Change)



New Construction: Over-building? Not yet, But Soon

U.S. new hotel construction data have been reported by F.W. Dodge show that the pace of new hotel construction is beginning to pick up, but remains well below the historical peaks experienced in the early 1970s and mid-1980s. Thus, it is projected to have a favorable supply/demand balance for the industry as a whole for at least the next several years.

The table 2 tracks new construction in the U.S. hotel industry based on information from F.W. Dodge. The table shows that 11.4 million square feet of new hotels went into construction during the third quarter of 1995, compared with 9.5 million square feet in 1994's 3Q, a 21% increase. The most important to note is that while new hotel construction is picking up. The estimates for total new construction for the next several years (specifically, 42 million sq. ft. in 1995, 50 million in 1996 and 60 million in 1997) remain well below historic levels of "over-building" that the industry has experienced. For example, the industry put over 80 million sq. ft. of hotels into construction for three straight years from 1984 to 1986. Over the 1970-1990 period (a long span of time that would encompass both periods of excess new construction and low levels of new starts), a "normal" year averaged 56.7 million square feet, or about 90,715 new rooms. Moreover, the rooms that are being built now are most frequently in limited-service properties, where current demand levels do justify construction. New construction still seems to be far off for full-service hotels, which should continue to enjoy "pricing power" as the supply/demand balance remains favorable for many years to come. Figure 3 plots trends in new hotel construction.

Figure 3. Hotel Construction

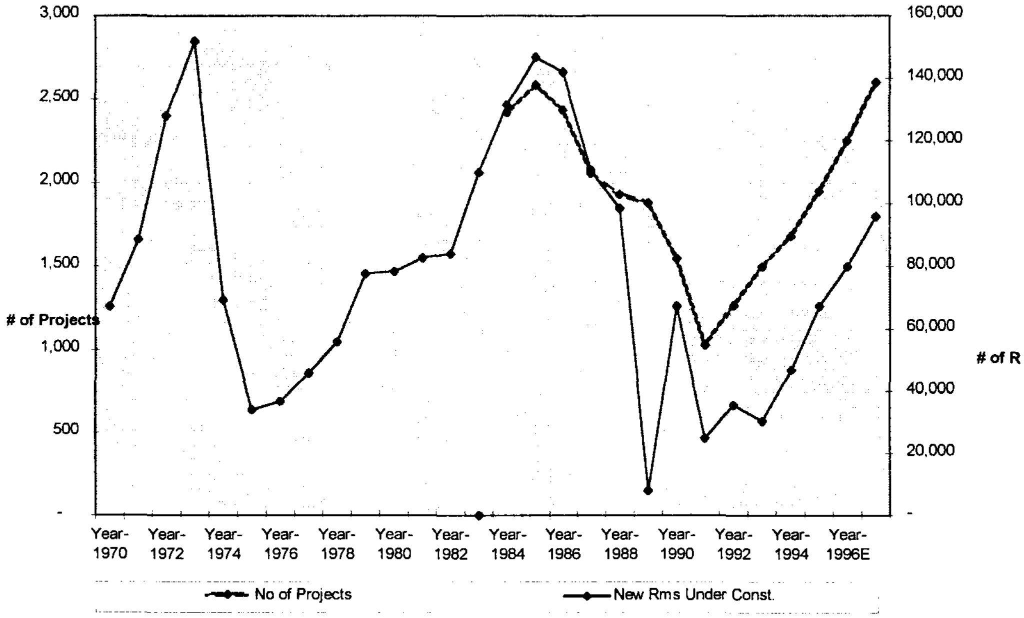


Table 2- (1) New Hotel Construction Contracts (Actual through 2Q '95)

Period	Total SQ. FT (MM) This Yr.	Total SQ. FT (MM) Yr. Ago	Percent Change From Yr. Ago	Percent Change Versus 1973 Peak	No of Projects	New Rooms Under Const.
Year-1970	41.98	48.31	-13.1%	-55.7%		67,168
Year-1971	55.42	46.17	20.0%	-41.6%		88,672
Year-1972	80.02	54.7	46.3%	-15.7%		128,032
Year-1973	94.87	78.34	21.1%	0.0%		151,792
Year-1974	43.44	92.39	-53.0%	-54.2%		69,328
Year-1975	21.27	41.12	-48.3%	-77.6%		34,032
Year-1976	22.96	20.33	12.9%	-75.8%		36,736
Year-1977	28.63	22.88	25.1%	-69.8%		45,808
Year-1978	34.92	29.48	18.5%	-63.2%		55,872
Year-1979	48.48	35.61	36.1%	-48.9%		77,568
Year-1980	49.01	48.13	1.8%	-48.3%		78,416
Year-1981	51.68	48.72	6.1%	-45.5%		82,688
Year-1982	52.52	51.83	1.3%	-44.6%		84,032
Year-1983	68.74	52.82	30.1%	-27.5%	N/A	109,984
Year-1984	82.31	67.08	22.7%	-13.2%	2,421	131,696
Year-1985	91.7	81.98	11.9%	-3.3%	2,584	146,720
Year-1986	88.75	89.84	-1.2%	-6.5%	2,437	142,000
Year-1987	69.2	88.34	-21.7%	-27.1%	2,058	110,720
Year-1988	61.63	72.12	-14.5%	-35.0%	1,929	98,608
Year-1989	61.18	61.98	-1.3%	-35.5%	1,880	7,888
Year-1990	42.04	62.46	-32.7%	-55.7%	1,546	67,264
1Q-1991	3.9	10.7	-63.6%	-95.9%	239	6,240
2Q-1991	3.55	11.8	-69.9%	-96.3%	261	5,680
3Q-1991	4.36	10.55	-58.7%	-95.4%	253	6,976
4Q-1991	3.68	90.1	-95.9%	-96.1%	275	5,888
Year-1991	15.49	42.06	-63.2%	-83.7%	1,028	24,784
1Q-1992	6.66	3.98	67.3%	-93.0%	339	10,656
2Q-1992	5.89	3.85	53.0%	-93.8%	290	9,424
3Q-1992	3.68	4.58	-19.7%	-96.1%	286	5,888
4Q-1992	5.97	4.33	37.9%	-93.7%	352	9,552
Year-1992	22.2	16.74	32.6%	-76.6%	1,267	35,520
1Q-1993	3.44	6.66	-48.3%	-96.4%	312	5,504
2Q-1993	3.42	6.46	-47.1%	-96.4%	291	5,472
3Q-1993	5	5.68	-12.0%	-94.7%	428	8,000
4Q-1993	7.08	4.41	60.5%	-92.5%	468	11,328
Year-1993	18.94	23.21	-18.4%	-80.0%	1,499	30,304
1Q-1994	6.49	3.5	85.4%	-93.2%	409	10,381
2Q-1994	6.66	3.59	85.5%	-93.0%	404	10,653
3Q-1994	7.92	5.22	51.7%	-91.7%	400	12,670
4Q-1994	8.14	6.56	24.1%	-91.4%	468	13,027
Year-1994	29.21	18.88	54.7%	-69.2%	1,681	46,731
1Q-1995	8.63	7.85	9.9%	-90.9%	442	13,802
2Q-1995	11.61	6.23	86.4%	-87.8%	513	18,573
3Q-1995	11.41	9.46	20.6%	-88.0%	504	18,248
3E-1995E	10.36	8.14	27.3%	-89.1%	491	16,578
Year-1995E	42	29.21	43.8%	-55.7%	1,950	67,200
Year-1996E	50	42	19.0%	-47.3%	2,250	80,000
Year-1997E	60	50	20.0%	-36.8%	2,600	96,000
Avg.1970-90	56.7	56.88	-0.3%			90,715

Table 2 - (2) New Hotel Room Under Construction (Actual through 2Q '95)

Period	Total Rooms In Industry (000) (A)	Percent Change From Yr. Ago	New Room Openings	As % of Total
Year-1970	1,935.0	1.6%	77.3	4.0%
Year-1971	1,954.5	1.0%	67.2	3.4%
Year-1972	1,995.6	2.1%	88.7	4.4%
Year-1973	2,081.2	4.3%	128	6.2%
Year-1974	2,190.6	5.3%	151.8	6.9%
Year-1975	2,217.5	1.2%	69.3	3.1%
Year-1976	2,209.1	-0.4%	34	1.5%
Year-1977	2,203.2	-0.3%	36.7	1.7%
Year-1978	2,209.5	0.3%	45.8	2.1%
Year-1979	2,225.9	0.7%	55.9	2.5%
Year-1980	2,263.9	1.7%	77.6	3.4%
Year-1981	2,302.7	1.7%	78.4	3.4%
Year-1982	2,345.8	1.9%	82.7	3.5%
Year-1983	2,412.2	2.8%	84	3.5%
Year-1984	2,504.6	3.8%	110	4.4%
Year-1985	2,618.7	4.6%	131.7	5.0%
Year-1986	2,747.8	4.9%	146.7	5.3%
Year-1987	2,872.3	4.5%	142	4.9%
Year-1988	2,961.8	3.1%	110.7	3.7%
Year-1989	3,035.5	2.5%	98.6	3.2%
Year-1990	3,104.9	2.3%	97.9	3.2%
Year-1991	3,140.2	1.1%	67.3	2.1%
Year-1992	3,129.0	-0.4%	24.8	0.8%
Year-1993	3,131.5	0.1%	35.5	1.1%
Year-1994	3,131.8	0.0%	30.3	1.0%
Year-1995E	3,148.5	0.5%	46.7	1.5%
Year-1996E	3,185.7	1.2%	67.2	2.1%
Year-1997E	3,235.7	1.6%	80	2.5%
Average of				
1970-1990	2,399.6	2.4%	91.2	3.8%

Note: (A) Total industry room count based on DOC's 5-Year Census of Service Industries, 1967-1987. Rooms are at establishments with payroll, which totaled 44,903 in 1967 and steadily declined to 40,837 in 1972, 37,154 in 1977, and 35,030 in 1982, but rose to 40,424 in 1987.

(B) New room openings in year 2 are the implied number of rooms (@ assumed 1 room = 625 sq.ft.) let into construction in year 1.

Table 2 - (3) Total Hotel Rooms, After Opening Less Inferred Closings & Value of construction

	Total Rooms In	Implied Room Closing		Net New Rooms		Dollar Value of construction	
Period	Industry (000) (A)	(000) (C)	As % of Total	(000).	As % of Total	Total in Million	Per Sq. Foot
Year-1970	1,935.0	47.6	2.5%	29.7	1.53%	842.2	20.06
Year-1971	1,954.5	47.6	2.4%	19.6	1.00%	1,157.8	20.89
Year-1972	1,995.6	47.6	2.4%	41.1	2.06%	1,752.3	21.9
Year-1973	2,081.2	42.4	2.0%	85.6	4.11%	2,142.2	22.62
Year-1974	2,190.6	42.4	1.9%	109.4	4.99%	1,194.4	27.57
Year-1975	2,217.5	42.4	1.9%	26.9	1.21%	605.9	28.49
Year-1976	2,209.1	42.4	1.9%	-8.4	-0.38%	718.9	31.31
Year-1977	2,203.2	42.6	1.9%	-5.9	-0.27%	966.1	33.74
Year-1978	2,209.5	39.5	1.8%	6.3	0.29%	1,399.6	40.08
Year-1979	2,225.9	39.5	1.8%	16.4	0.74%	2,231.2	46.02
Year-1980	2,263.9	39.6	1.7%	38	1.68%	2,611.0	53.27
Year-1981	2,302.7	39.6	1.7%	38.8	1.68%	3,212.8	61.17
Year-1982	2,345.8	39.6	1.7%	43.1	1.84%	3,611.0	68.75
Year-1983	2,412.2	17.6	0.7%	66.4	2.75%	4,700.3	68.38
Year-1984	2,504.6	17.6	0.7%	92.4	3.69%	5,581.5	37.81
Year-1985	2,618.7	17.6	0.7%	114.1	4.36%	6,099.4	66.51
Year-1986	2,747.8	17.6	0.6%	129.1	4.70%	6,176.3	69.59
Year-1987	2,872.3	17.5	0.6%	124.5	4.33%	5,219.2	75.42
Year-1988	2,961.8	21.2	0.7%	89.5	3.02%	4,764.7	77.31
Year-1989	3,035.5	24.9	0.8%	73.7	2.43%	5,129.6	83.84
Year-1990	3,104.9	28.5	0.9%	69.4	2.24%	3,634.0	86.44
Year-1991	3140.2	32	1.0%	35.3	1.12%	1,683.0	108.65
Year-1992	3129	36	1.2%	-11.2	-0.36%	2,324.0	104.68
Year-1993	3,131.5	33	1.1%	2.5	0.08%	1,918.0	102.27
Year-1994	3,131.8	30	1.0%	0.3	0.01%	2,537.0	86.86
Year-1995E	3,148.5	30	1.0%	16.7	0.53%	3,700.0	88.1
Year-1996E	3,185.7	30	0.9%	37.2	1.17%	4,500.0	90
Year-1997E	3,235.7	30	0.9%	50	1.55%	5,500.0	91.67
Average of							
1970-1990	2,399.6	34.1	1.4%	57.1	2.38%		

Note: (C) Room closings are inferred based on new room additions over 5-year intervals compared with Census totals in 1967.'72,'77,'82. and '87. Closings for the post-1987 period are assumed to steadily rise to 36,000 rooms annually by 1992 (average rate over 1969-87) from 1987's figure of 17,500.

Expansion and the Equity Markets

The industry continues to attract investment capital, as shown by the rising level of funds going into hotel construction (see Table 2). One important determinant of the future pace of rooms' growth will be the equity markets. Table 3 shows the amount of capital raised from 1991 through November 1995 in public debt and equity offerings. The figures include both C-corps. and REITs. It is believed that a substantial amount of the money raised in 1992 and 1993 represented funding of existing hotels that were changing hands, as opposed to the financing of new hotels. Moreover, with industry economics still shaky at the time, the recipient of the funds (probably a financial institution that foreclosed) was unlikely to reinvest in the hotel business immediately, and even less likely to do so in a new property without a cash flow track record.

Table 3 Public Funds Raised, 1991-1995

	1991	1992	1993	1994	through 11/95
Debt	$800	$900	$420	$481	$795
REIT Equity	0	0	85	612	1,554
C-corps. Eq.	289	103	490	389	962
Total Equity	$289	$103	$575	$1,001	$2,516
Total Capital	$1,089	$1,003	$995	$1,482	$3,311

Source: Coopers & Lybrand

In 1994 and 1995, however, a greater and greater shares of the funds come from new equity, and in many cases from IPOs or secondary offerings of recently public companies. Hospitality REITs alone accounted for over 60% of both the 1994 and 1995 equity capital raised. An obvious question is how much of the equity capital is going "into the ground" to fund new construction (a potential near- to intermediate-term concern for investors), versus financing the purchase and rehabing of existing facilities (which suggests a longer life to the current upcycle). This is relevant since, for example, if all the new capital (debt + equity) were funding new construction, it could finance 50,000-60,000 new rooms (much more if the equities were leveraged to a more normal 60%-75% ratio), or about a 1.8% increase in supply. It is believed that the vast majority of the money raised (probably 80%+) is initially going to the purchase and refurbishment of existing properties. Because it is highly likely that an increasing proportion of the capital will eventually be recycled back into developing new properties.

As existing hotel purchase prices rise (e.g., full-service hotels now sell for about 75% of replacement value, versus around 65% a year ago) and as industry profitability continues to climb rapidly, the economic justification for new construction will combine with ever-optimistic developers to revive new building.

Stock Performance

Considering how strong fundamentals have been in 1995 and their continued promise for 1996, lodging stocks as a group has not been particularly strong performers, at least relative to the booming overall market. Indeed, the group has trailed the S&P Industrials by 1 p.p. year-to-date, and would be 10 p.p. behind was it not for the spectacular gain by HFS. At the two extremes, HFS is up 193% year-to-date and JQ Hammons is down 41%. Even excluding these two "outliers" leaves the manager/franchiser (M/F) group up an average of 16% and the owner/operators (O/O) ahead an identical average of 16%, not especially impressive versus the market's 32% climb through mid-December. Ex HFS, the only stocks to beat the market for the full year are MAR, up 34% year-to-date, and Host Marriott, up 33%. It is believed that the lodging industry can generally outperform the market over the next several years

Recovery in Asset Values

With the improvement in US hotel fundamentals starting in 1992 there has been a recovery in hotel asset values, and capitalization rates are moving down. It is a seller's market for economy and midprice hotel assets, reflecting the robust fundamentals of this segment. It is a buyers' market for full service and luxury hotels, however, as some properties are still offered below replacement value. Table 4 provides current hotel valuation data.

Table 4 Hotel Valuation Tools

Category	Capitalization Rates	EBITDA Multiples
Stabilized Properties	10-12%	8x to 10x
Turnaround Properties	8-10%	10x to 12x
Trophy Properties or Cities	6-9%	11x to 17x

Section Conclusion

As it has been discussed above, the hotel industry is presently in a much better position as compared to a few years ago. The hotel industry was able to report large increases in revenue in 1995 with total profits reportedly reaching $2.62 billion. The increase in profitability was attributed to a high occupancy rate as well as growing demand that had outpaced the rate of development. The pace of new hotel construction is beginning to pick up, but remains well below the historical peaks experienced in the early 1970s and mid-1980s. Thus, it is projected to have a favorable supply/demand balance for the industry as a whole for at least the next several years. The "under-building" situation will last longer especially in the luxurious segment of the industry. The rooms that are being built now are most frequently in limited-service properties, where current demand levels do justify construction. The luxurious segment will continue to enjoy "pricing power" as the supply/demand balance remains favorable for many years to come. However, the balance can be broken easily by government monetary and fiscal policies as it happened in the 1980s. As it has been shown in the previous tables and figures, the hotel industry already began to construct new rooms. Especially the number of projects has almost reached to the point of the peak year in the 1980s. Thus, the possibility of the overbuilding is in the market with a great potential.

In the next section the analysis for the market segmentation in the hotel industry is conducted. The analysis focus on the luxury segment of the industry. The overall performance and issues in the segment are analyzed and discussed.

Market Segmentation

Occupancy Percent and Room Rate

Concerning room rate growth is the bottom line in determining profitability trends, its solid gains were recorded in May 1995. Room rates rose soundly in every region, location and service sector, and the average room rate in the United States rose 4.4% in May 1995. The Mountain region posted the largest room rate increase by a wide margin, with an 8.1% gain for the period. Economy and budget-priced hotels posted the highest increase in room rates among the service sectors, each with price hikes of more than 5%. Airport hotels raised room rates 5.7% during the month for the lead among property locations. Most sectors posted solid occupancy gains as well, and the national average rose 3.5%. The West South Central region led the regional pack in occupancy gain, with a 5.8% improvement. Among the different service types, economy properties showed the largest improvements in occupancy rates with a 4.3% increase. Hotels located on the highways posted the best occupancy gains among the different locations for the quarter, with a 3.8% rise.

Supply and Demand

Among the service sectors, currently, the midprice and economy segments are experiencing strong demand which continues to outpace supply growth. However, barriers to entry are low in these categories and it is possible that, over the course of the decade, additional new supply may pressure on rates and occupancies in the mid-price and economy segments. The luxury and full service segments are the best positioned for improving fundamentals over the next several years. These segments are protected by high barriers to entry and the likelihood of little new supply.

Luxury Hotel Industry

Introduction

Luxury is very difficult to define, but it's very easy to recognize. In this study, the luxury hotels are defined as the deluxe properties at the highest market level. The classification of the hotels into the luxury hotels were based on six criteria: tariff, size of the hotel, location, facilities, services, and declared target markets. See the International Hotel Group directory 1992 for more detail. The complete list of the luxury hotels in U.S. is presented in the Table 5.

Cautions aside, the condition of luxury hotels is good and the outlook is even better. Business and leisure travelers who secured luxury bargain during the recent recession are staying with the opulent hotels they patronized at those lower rates. In addition, luxury hotels are beginning to yoke greater business efficiency to their traditional personalized atmosphere and service. Another is the increasingly personalized nature of business communication. Clearly luxury hotels base their market penetration on loyalty. Most of luxury hotels have a sophisticated guest-history system, butlers on every floor and an obsession with detail. The secret is to be perceived as luxurious, not extravagant.

The major players and the leading firms in the luxury hotel industry are highlighted in the Table 5. Those firms include: *Bel-Air Hotel Company, Four Seasons Hotels & Resorts , Mandarin Oriental Hotel Group , New Ontani Group of Hotels , Nikko Hotels International , Orient-Express Hotels , Park Lane Hotels International , Princess Hotels International , Ritz Carton Hotel Company , The Peninsula Group.*

Table 5. Luxury Hotels in U.S. (Deluxe properties at the highest market level)*

Name	Number of Hotels	Name	Number of Hotels
Bel-Air Hotel Company	2	Orient-Express Hotels	5
Four Seasons Hotels & Resorts	**10**	Park Lane Hotels International	3
Mandarin Oriental Hotel Group	8	Princess Hotels International	7
New Ontani Group of Hotels	1	**Ritz Carton Hotel Company**	**20**
Nikko Hotels International	9	The Peninsula Group	4

* Data were derived from the International Hotel Groups Directory 1992 by Linda Harrison and Keith Johnson.

Worldwide overall industry performance by service

Since luxury hotels are widely scattered in the world, it is worth to look at the overall performances of the luxury segments worldwide and compare the performances by each region and segments to get the better analysis. This can improve the understanding regarding the overall picture of the luxury segment.

As it shown in Table 6, the first-class segment and Africa/Middle East regions were the most profitable for hotels in 1994, according to Horwath International's Worldwide Hotel Study. Pre-tax per available room averaged 4.8

information was available-luxury (15.4 percent) mid-price (10.9 and economy (4.7). North America registered the highest occupancy figures in all but the mid-price segment, where it trailed Asia/Australia.

U.S. Hotel Performance by Services

Many luxury hotels in U.S. are being faced with several issues. The segment of the hotel industry is now suffering from the rising costs of staffing and upkeep, the intense competition, the high price of finding financing, and the cost-cutting measures of once free-spending corporations and financial institutions. Furthermore, occupancy percentage is still low so the hotels in the segment are trying to discount their room rates. Table 7 shows the figures for the occupancy percentage and average daily rate classified by service level. These factors make their business worse. Several financially troubled deluxe hotels recently

Table 6 Worldwide Hotel Performance by Services

North America	Luxury	1st Class	Mid-Price	Economy
Occupancy	72.5%	70.5	68.6	69.0
ADR	$105.37	79.57	63.03	50.62
REVPAR	$46001	31777	23189	20209
GOP/Available Room	$13221	9226	6314	4766
Pretax Income/Available Room (% of REVPAR)	$1905 (4.1%)	1694 (5.3%)	610 (2.6%)	-549 (2.7%)
Africa/Middle East	Luxury	1st Class	Mid-Price	Economy
Occupancy	59.8%	63.6	58.9	61.7
ADR	$138.48	82.61	54.50	24.05
REVPAR	$63779	44265	21795	10936
GOP/Available Room	$21816	17845	6523	2305
Pretax Income/Available Room (% of REVPAR)	$9821 (15.4%)	N/A	2381(10.9%)	512 (4.7%)
Asia/Australia	Luxury	1st Class	Mid-Price	Economy
Occupancy	72%	70.3	73.6	65.2
ADR	$136.76	89.34	70.03	44.83
REVPAR	$77524	43944	33858	19220
GOP/Available Room	$23034	10924	10081	3983
Pretax Income/Available Room (% of REVPAR)	$1792 (2.3%)	2311 (5.3%)	3615 (10.7%)	-246 (1.3%)
Europe	Luxury	1st Class	Mid-Price	Economy
Occupancy	63.3%	61.8	63.3	60.3
ADR	$150.90	90.85	69.78	48.16
REVPAR	$62776	39692	33574	27881
GOP/Available Room	$16794	9301	9442	6636
Pretax Income/Available Room (% of REVPAR)	$589(0.9%)	796 (3.1%)	344 (1%)	947 (3.4%)
Latin America/Caribbean	Luxury	1st Class	Mid-Price	Economy
Occupancy	63.9%	55.9	59.6	61.6
ADR	$119.21	70.03	49.61	25.28
REVPAR	$49317	25006	17478	12482
GOP/Available Room	$48188	5821	3388	1512
Pretax Income/Available Room (% of REVPAR)	-$2909 (5.9%)	771 (3.1%)	662 (3.8%)	-737 (5.9%)
Worldwide Average	Luxury	1st Class	Mid-Price	Economy
Occupancy	68.8 %	66.7	66.2	63.2
ADR	$124.37	82.53	63.83	42.56
REVPAR	$55843	34723	26915	21005
GOP/Available Room	$15457	9374	7148	4238
Pretax Income/Available Room (% of REVPAR)	$1440 (2.6%)	1631 (4.8%)	984 (3.6%)	-256 (1.2%)

Source: Lodging Trends, Lodging, January 1996, the International Hotel Association and Smith Travel Research.

went up for sale, including the Aga Khan's Ciga hotel chain, the Four Seasons Hotel chain, and several Ritz-Carlton hotels. Many hotels are in a precarious position because they have overcapitalized and overbuilt in the 1980s. To assure their survival, hoteliers must learn to avoid extravagance and overstaffing.[1] The hotels in this segment are using serveral managements to overcome these issues. The new managements include discounting, going international, and offering new services.

Discounting

As it commented above, luxury hotels have declined with occupancy. To overcome this problem, hotel owners and managers have begun to cope with declining occupancy by reducing operating costs without affecting the quality of service associated with luxury hotels. Others have been providing discounts and encouraging repeat customers. However, the discounting is not an ultimate solution. As late as 1993, inflation was running about four percent while the annual increase in average rates was a paltry two percent. It was then that industry analyst Randy Smith of Smith Travel Research
cautioned that change was coming and that hoteliers should prepare to take advantage of a surge in consumer confidence and a greater willingness to travel and spend money. It was time to turn up the dial on rates, he suggested. As he predicted, the turnaround came in 1994. With inflation at just 2.7 percent, average rates increased by 4 percent. In 1995, rates rose another 4.2 percent. While there is plenty of opportunity for further rate expansion, many properties are still selling defensively. They are too willing to discount rooms, and too many reservation agents and sales people do not know how to sell today's justifiably higher rates. Sales strategies often focus on getting people through the door, at whatever price it takes. Discounting mentality, however, is a significant problem, particularly, for luxury properties.

Table 7 Occupancy Percent and Average Daily Rate by Service and Location

	US. Total		Luxury		Upscale		Mid-Price		Economy		Budget	
	Occ%	ADR	Occ%	ADR	Occ%	ADR	Occ%	ADR	Occ%	ADR	Occ%	ADR
Jan-93	51.5	60.48	61.6	103.09	54.5	69.42	51.8	53.3	49	40.04	49.2	30.94
Feb-93	59.8	63.13	69	109.02	63.8	72.62	60.1	54.89	56.5	42.09	56.3	31.99
Mar-93	63.5	62.13	72.9	109.20	68	72.64	64.9	55.06	61.3	42.09	60.5	32.17
Apr-93	63.9	61.08	71.5	108.30	68.3	71.07	65.4	54.18	62.4	41.95	62.2	32.22
May-93	64.5	61.34	72.8	106.92	69.1	71.31	65.8	54.65	61.8	42.23	61.5	32.25
Jun-93	69.1	60.13	72.7	101.45	72.8	71.26	70.5	54.84	67.8	43.14	67	33.13
Jul-93	73.3	60.44	71.5	97.09	75.9	72.99	74	55.5	72.8	44.67	73.4	34.01
Aug-93	72.2	61.3	73.2	99.20	76	73.34	73	55.97	71.1	44.43	71.4	33.92
Sep-93	66.6	60.77	72.7	103.94	70.6	71.3	66.8	54.94	63.3	42.84	63.1	32.83
Oct-93	67.6	62.4	77.7	110.82	72.1	71.91	68.2	55.37	64.3	42.7	62.6	32.8
Nov-93	57.5	60.55	68.2	107.62	60.8	69.75	58.4	54.15	54.6	41.65	54.2	31.52
Dec-93	48.9	59.75	53.5	103.22	50.1	70.34	48.7	53.41	48	41.55	49.5	31.67
Jan-94	52	61.97	61.8	109.76	55.2	74.33	52.8	55.38	48.7	41.79	49.1	32.7
Feb-94	61.6	64.58	72	114.38	65.9	76.7	62.8	57.85	57.7	43.54	56.7	33.68
Mar-94	65.7	65.23	74.9	117.09	70.3	77.91	67.4	57.91	62.2	43.97	61.3	33.79
Apr-94	65.8	64.05	75.1	115.24	70.5	76.31	67.6	57.18	62.4	43.79	60.7	33.8
May-94	65.1	63.61	73.6	113.48	69.3	76.49	66.7	57.42	62.3	44.27	61.3	34
Jun-94	71.7	62.66	75.6	107.76	74.6	74.27	72.3	57.26	69.4	45.31	68.1	34.64
Jul-94	74.9	63.13	75.2	103.22	76.9	75.68	75	57.72	73.5	46.47	72.7	35.61
Aug-94	74.2	63.26	75.5	103.11	76.9	75.5	74.2	57.69	71.5	46.04	70.8	35.37
Sep-94	68.8	63.18	74.3	108.80	72.1	73.8	68.4	57.2	65	44.6	64.6	34.36
Oct-94	69.6	64.86	79.9	115.54	73.1	74.68	69.7	57.52	65.1	44.52	63.9	34.31
Nov-94	60.4	62.91	70.6	111.39	62.5	72.15	60.5	56.23	57.1	43.85	57.2	33.07
Dec-94	50.9	62.37	55.1	107.12	51.3	73.09	50	55.87	49.5	43.76	51.4	33.23
Jan-95	53.8	64.65	64.6	113.69	56.8	76.82	54.7	57.84	49.8	44.16	50.7	34.45
Feb-95	62.3	68.04	72.4	119.90	66.2	80.02	63.1	60.44	57.8	45.72	57.2	35.33
Mar-95	66.6	68.46	76.6	122.26	71.3	80.43	68.2	60.37	63	45.9	61	35.47
Apr-95	66.6	66.67	74.2	120.37	69.8	78.88	68.1	59.67	63.9	45.99	62.4	35.49
May-95	67.4	66.42	75.9	118.79	71.2	79.30	68.8	60.17	65	46.56	63.2	35.97
Average	**63.99**	**63.09**	**71.19**	**109.72**	**67.44**	**74.29**	**64.76**	**56.55**	**61.27**	**43.78**	**60.80**	**33.61**

Going International

As an another solution for the problem, hotel owners can consider to develop new luxury hotels in Africa and Middle East where generate the highest pretax income per available room and have good potential in terms of demand in the near future (see Table 7). Asia and Australia regions are also good place to develop luxury hotels.. The region currently shows the highest GOP per available room and great demand (72 percent occupancy). Going international will give a solution for market risks because it can diversify the risks.

New Services

New services are the ultimate solution if the services are fit for the needs of target customers. Especially, the most remarkable asset of luxury hotels must be distinguished services from other segments. Really luxury hotel environment, facilities, amenities, and impressive services of the employees are their assets to sell. The hospitality industry should focus service quality to prevent heavy financial losses and the important role that senior management has to play to ensure the successful implementation of quality management programs. There is no doubt that the services coped with the images of the luxury hotels are the starting point for growth of this segment. As an example, Ritz-Carlton and Sofitel hotel chains have distinguished themselves for their quality service. Both chains have developed their quality programs and ensure their implementation by the staff. Ritz-Carlton and Sofitel employees proudly display their slogans to assure guests that they offer guests the best services. For its efforts, Ritz-Carlton garnered the 1992 Malcolm Baldridge National Quality Award. Meanwhile, Sofitel motivates its employees through its Quality-Challenge program which rates staff performance through guest evaluations.[2]

Challenges and Opportunities of the Future

Nowadays, the increasing nature of complexity and uncertainty in the business world is becoming the first and foremost problem to resolve. This section discusses issues just emerging but likely to impact the hotel industry. Detecting the major trends could be a first step for finding the possible solutions for the challenging environments. The aspects of economic, human resources, and technology are discussed. Based on all of the analysis and discussion in this study, the overall conclusions containing current and future investment strategies are followed.

Economic Trends

Economic prosperity-affluence, low interest rates, low inflation rate-will continue through the foreseeable future causing 1.8% annual growth in per capital personal income through the turn of the century. The intolerably high interest rates of the 1970s have led the Federal Reserve Board (FRB) to manage interest and inflation rates since 1981, which result the lowest interest and inflation rate in 20 years. They will remain low through the 1990s which will result the growth of investment in construction and housing. People have more disposable income today, especially in two-earner families. As the dollar declines against other currencies, the US exports and foreign tourists to the US will grow rapidly. The US economy is becoming integrated with the international economy due to the falling of tariffs and other trade barriers.

The tremendous economic growth of new international markets, such as China, India, and the countries located in the Pacific Rim has been possible with the movement of massive quantities of capital. More profitable investments in these territories have consequently caused a shortage of capital in the more industrialized territories. The capital shortage, in turn, has resulted in greater expectations for asset performance. In other words, capital rationing has significantly increased the demand for more profitable business performances. Hence, hotels and restaurants are required to maximize economic efficiency and managerial effectiveness in order to generate more than satisfactory returns on assets. Now investors look more closely to management strategies and tend to tie them to the assets value. Top management is evaluated based upon its skills to produce more at a lower cost. This capital shortage trend has forced many hospitality companies to downsize their organizations. Actually, the downsizing strategy adopted after the tax reform of 1986, continued during the subsequent international recession, which occurred between the 1980s and 1990s and is currently caused by heavy capital investments in developing countries. Downsizing has mostly affected middle management and employees working at corporate offices of the major hotel chains. For example, Sheraton, despite not being financially overleveraged, had 400 layoffs in its corporate headquarters and regional and divisional offices and Hyatt cut 700 mid-management positions.

Human Resource

Human resources management in the hospitality industry will face major challenges in the future. First, demographic and cultural changes within the workforce will demand a great deal of improvement in terms of effective communication skills to recognize diversity and build competitive strengths upon different cultural traditions. Second, the increasing market expectations for more asset productivity and customers satisfaction will further encourage the use of both sophisticated technological tools and skilled, well educated employees. Third, the increasing shortage of labor supply and participation of women in the workforce will decrease the bargaining power of hospitality employers, who will offer more flexible working hours, time away from home and nursing facilities.

However, the decreasing number of available skilled workers, coupled with the underpaid wages that characterize the hospitality industry will force hoteliers to hire unskilled and unmotivated workers. This practice will detract effectiveness of training, empowerment, recruitment and selection. Hoteliers should reassess their management priorities to include what should be the most important asset of the hospitality industry, namely, people. Good people-handling skills of hoteliers were learned from other good hoteliers. The industry must hold training sessions where hotel managers will be taught the rudiments of managing and leading people correctly.[3]

Technology

Technology is dramatically shaping the new way of offering hospitality worldwide. Workers at all levels in the hospitality industry are involved with technology. Managers depend on it in terms of "decision supporting systems" and "management control." Workers involved in the housekeeping, reception, and room service departments have to be acquainted with all the technologies related to the "smart room" and its complex automation. The marketing and the sales departments need to excel on telecommunication, reservation networks, database marketing, and yield management in order to bring business to the company. All the employees working within a hospitality company have to be familiar with the new technological instruments applied in the facility to provide a healthy and safe environment. The automation of most of the operational activities requires all employees, even those filling entry level positions, to have a solid educational background. Due to the speed of the process by which the technological innovations are implemented in the hospitality industry, the workforce is also expected to easily learn how to use new methodologies, systems, and technological advanced tools.

A variety of the latest technology is generally needed, but in itself is not sufficient. A service must be relevant and meet precise needs of customers. Hotel operators should be reminded that high-tech amenities are not always appropriate. To become effective navigators of innovations, hotels need a displined structure to identify the customer's actual needs and wants in term of technology.

Concluding Remarks

Visioning Now

It is always a good idea to reveiew hotel investing strategy to determine ways of enhancing the upside potential while monimizing downside risks. Since the hotel industry generally runs in cycles, it is important to look for trends that indicate impending changes that could impact investment decision.

The industry appears to be approaching the mid-point of a longer-term (five-to six-year) recovery that began in late 1992 and could last into 1998, at least. With room rate gains exceeding the rate of inflation for the first time in almost a decade and the favorable supply/demand dynamic intact, hotels have only begun to reap the rewards of the longer-term cycle. Coopers & Lybrand and Smith Travel Research, leading industry consultants, predict that current favorable supply/demand dynamics will persist through 1997, at least. Although new construction has picked up slightly during the past few months, it is not expected to increase at faster than a 1.5% a month pace for some time, nor should it offset ongoing growth in demand. That should mean that room rate gains, which typically trail supply and demand indicators, could grow at or above inflation for another two or two and a half years, at least.

As far as investment concern, now is the best time to sell the economy/limited-service properties. Prices in this segment have peaked, new development is under way and overbuilding is likely within two or three years. The midrate hotels that are more than 25 years old are also need to be sold now. Most of these properties suffer from massive functional obsolescence and require extensive work to maintain a top-quality franchise afiliation.

Every first-class and luxury hotels are recommended for investment where the selling price is below replacement cost. These properties still have strong upside potential, since very few are being built. Technological breakthrough will make many types of business travel totally unnecessary. Lodging facilities catering largely to individual business travelers will be affected the most. Resorts are at the least risk from the technological revoluation. Thus, it is also recommended to buy the resorts hotels.

It is recommended to develop first-class, full-service hotels, but small-150 to 300 rooms in areas where the supply grew slighly during the 1980s or where a number of hotels are older than 25 years. However, it is important to remember the hotel industry during the 1980s. The lodging industry has a very short memory. Based on the construction trends, it is most likely to be overbuilding situation again within few years. Thus, it is necessary to follow the trends and react quickly to the signs indicating the market peaks (times to sell) and troughs (time to buy or build).[4]

Visioning Future

A recent report by the World Travel & Tourism Council (WTTC) said that the global travel and tourism industry are set for strong mid- and long-term growth with gross output increasing by 55 % in real terms and $ 7.2 trillion by 2005. International tourist arrivals, 457 million in 1990, are expected to more than double by 2010 with the annual growth rate of 3.5% and the 50.8% world market share..

Demographics tell us of an ageing population throughout the Western World. The next generation of customers will be more knowledgeable than ever before. They will be better equipped through a wide experience of travel and hotels to make deliberated choices and differentiate between the competing value offerings. The new sophisticated consumer will demand specific hotel products for specific needs. Perceived value will be paramount. Price awareness will be critical. The hotel companies that will thrive will be those who can provide a targeted product at a highly competitive price. This will require a far higher quality of mangement than has been the standard in our industry to date.

The hotel firms built and operated inefficiently will come to an end. Witness Forte, which has 80 such hotels for sale and there are likely to be hundreds more controlled by banks who are waitng to off-load when the property market picks up in the next years or two. This is just the beginning. Rising central site values will lead to many hotels in such locations being demolished or put to alternative use yielding higher rents for landlords. Boom conditions for residential nursing homes will lead to even more conversions in the traditional coastal holiday towns.

Winners in the intensively competitive market of the future will have a culture based on four fundamental principles: (1) providing a product exactly suited to target customer groups, (2) rigorous cost discipline to eliminate waste in both capital cost and operational cost, (3) front line staff as the competitive edge, (4) a recognition that high levels of marketing expenditure are essential to build high brand awareness.

On the international scene, the globalisation of hotel chains will be the dominant theme. The increasing importance of the Asia Pacific region, and in particular China, will be paramount. The pace of change is now quickening. Travel is expected to grow by five percent on a global basis over the next two decades. Long before 2019 this means our market will have doubled in size, its position as the world's largest industry will be pre-eminent.

Endnotes

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