Hotel supply in the United Kingdom: assessments of size, structure and growth

Paul Slattery and Ian Gamse from Otus & Co review recent studies on the UK budget hotel market

Introduction

Industry wide analyses of the hotel business are rare and few are inspiring, but still we get excited when new ones emerge. Recently, two analyses of the hotel market in the UK have been published – *Quantification of Serviced Accommodation Supply in the United Kingdom and Consideration of Related Issues*, Melvin Gold Consulting Limited (MGCL) and *Budget Hotels 2008 UK*, TRI and BDRC. Both analyses make claims about the size, structure and growth prospects of the hotel market in the UK and in this note we will contrast their conclusions with our own approach.

The size of the UK hotel market

MGCL reviews the haphazard, inconsistent and infrequent measurement of the total supply of serviced accommodation in the UK. It lists the range of "venues" as bed and breakfasts, farmhouses, guesthouses, hotels, inns, motor lodges, motels and youth hostels. Otus separates these venues into two broad groups, which are legally and commercially distinct. First, are the bed and breakfasts, farmhouses and guesthouses, which are the most haphazard, most inconsistent and least successful venues. They are classified in law as private hotels in which renting bedrooms is at the discretion of the owner and historically they have been regarded as an extension of the home of the owner. These quasi-hotels, also known as commercial home enterprises, are part-time businesses and entirely fragmented. Almost invariably, they open for only part of the year, typically during the summer tourist season, they are predominantly located in rural and coastal resort areas and in larger conurbations they are in rapid decline. Three further characteristics of quasi-hotels are their very small size – rarely does any have more than ten rooms; their narrow range of in-room facilities – most do not provide en-suite bathrooms; and their narrow range of non-room facilities, providing little more than limited access to the family dining room or sitting room. At best these venues are utilitarian. At worst they are run by amateurs for whom even the operating fundamentals of safe, clean and green are a challenge. Thankfully, they are also economically weak and in long-term decline. The current MGCL estimate of 202,000 rooms in these venues is perfectly credible, but we would note that owing to their closure for significant parts of the year, the annualised availability is likely to be less than 100,000 rooms.

The hotels, inns, motor lodges and motels which form the second broad group are not well-defined distinct categories. However, as a group they are "inns at law" under the 1956 Innkeepers Liability Act and are thus distinct from the first group of venues. They are open to the public and, explicitly, they are businesses. It is among this group that the professionalisation of hotel-keeping has grown and it is among this group that hotel portfolios have emerged and grown. MGCL estimates the current volume of UK room stock in this group to be 514,000, an estimate with which we broadly agree. TRI/BDRC puts the total hotel room stock in the UK at 708,412. This number tallies roughly with MGCL's estimate if we assume that TRI/BDRC are including everything from the farmhouses to the Ritz; if that is not their intention then we have a remarkable discrepancy between the two reports.

What is immediately clear, however, is that there is no systematic, on-going census of serviced accommodation in the UK – outside the branded sector which is covered by the Otus Hotel Brand Database. Like MGCL, we believe that such a project would be of immense value.

The structure of the UK hotel market

MGCL divides the second group of venues – what we have described as "inns at law" – into two sections:

MGCL hotel classification	
Independent hotels	Hotel brands
Identified venues	Full service
Unidentified venues	Mid-market
	Budget

Source: Otus & Co. Advisory Ltd. 2008

TRI/BDRC does not attempt any general analysis of the structure of the UK market, distinguishing merely between the "branded budget sector" which is the subject of its report and the rest. MGCL's analysis, funded by Travelodge in order to justify its future growth ambitions, also focuses on the budget sector. Yet neither author provides a clear and consistent definition of what it means by "budget".

In fact, we have no idea what is included in MGCL's definition of "budget" since it proclaims that, "our approach is somewhat notional and we have deliberately not described the way in which we have treated specific hotels or portfolios". TRI/BDRC is more explicit and purports to produce, "a clear and widely accepted definition of budget status" to "define where the UK budget sector stops and the midscale sector begins". To achieve this they produce "four cut-off points" – bedroom size, construction cost, room tariff and rooms sales as a percentage of hotel turnover. There are two flaws in this approach. First, in three of the cut-offs the range is so wide as to be of limited value in defining a market segment. They classify "budget" room size from 7 square metres to 22 square metres, overlapping with the mid-market Park Inn and not far off the 28 square metre minimum for up-market Hiltons and Marriotts. "Budget" construction costs per room range from £16,000 for easyHotel to more than three times that amount for Express and others. "Budget" room tariffs range from £28.00 to £170.00. Second, the final cut-off used by TRI/BDRC, room sales amounting to more than 70% of hotel turnover, confuses what we believe should be two different elements of hotel supply classification: market level, an indication of the size and cost of rooms, and hotel configuration, a measure of the non-rooms facilities offered by a hotel. As we survey the hotel world we find plenty of cheap branded hotels with small rooms that nevertheless make more than 50% of their revenues from non-rooms facilities; equally, there are many very expensive branded hotels that offer nothing more than rooms and breakfast. And these should be further distinguished from measures of service level – e.g. whether a hotel offers room service or night porterage – which are generally related to the brand or local market demand rather than the intrinsic nature of the building and can be turned on or off more or less at will. Yet when we arrive at the page of TRI/BDRC that actually matters, the supply forecasts, we discover that the market segmentation presented there is actually "Branded Budget" against "Branded Full-Service": this implies that the distinction between the two categories is entirely due to service level.

Why do definitions matter?

Without clear and consistent categorisation of hotel supply that enables us to capture the complexity of the market, we have little hope of understanding or even tracking its growth patterns, of determining the factors that have produced those patterns and then of modelling future growth and decline.

As our regular readers will know, in contrast to the MGCL and TRI/BDRC approaches, our Otus Hotel Brand Database is systematic in its classification of the chain hotel market. Otus tracks all hotels that are affiliated to a portfolio of four or more hotels through ownership, leasing, management contracting or franchising. We do not regard consortia as brands because almost all consortium members are independent hotels with minimal control of members by the consortium and membership that can be as short as annual, though we do recognise that some small portfolio operators brand some or all of their hotels through Best Western and others. MGCL appears confused, including with branded hotels "hotels that are part of larger marketing consortia" while presumably excluding smaller consortia from the branded sector. The confusion is further compounded by its note that "many small portfolios of hotels are reflected within the independent sector". TRI/BDRC offers no basis on which brands are differentiated from independent hotels, though counting nine budget "brands" that have only one or two hotels.

We have already noted the importance of treating market level and hotel configuration as independent variables in the analysis of hotels and hotel markets. Otus classifies every chain hotel into five market levels – deluxe, up market, mid-market, economy and budget – based on the investment in bedrooms, the range of facilities and the in-room services at each market level and it uses a wide range of brands from around the world to act as benchmarks for each market level. In parallel, Otus also classifies each chain hotel in terms of hotel configuration, that is, the range of its non-room facilities. Again, this is done at five levels, ranging from what we term rooms-only through limited- basic- and full-feature to resort hotels. Each level is objectively defined in terms of the facilities that form the fabric of the site. Hotel configuration is also a good indicator of the proportion of turnover derived from rooms, ranging from 100% for rooms-only hotels down to 30% or less for resort hotels. Otus is thus able to produce a matrix of market level and hotel configuration to illustrate 25 categories of hotel and the representation of chain hotels in each category. The table presents the position for the UK at the end of 2007. Viewed in historic series it provides essential insight into the trends across the market which cannot be grasped from a superficial view.

The economy category, which is broadly the top half of the range of TRI/BDRC cut-offs, includes brands such as Premier Inn, Travelodge, Express, Old English Inns and a host of equivalents from around the world. Currently, this segment in Europe accounts for 250 brands with 3,900 hotels and 336k rooms. The budget category is broadly the bottom half of the range of TRI/BDRC cut-off points and includes Etap, Formule 1, Premiere Classe and Walkabout as well as a range of equivalents throughout Europe. The table shows the stubborn reluctance of the UK market to demand budget brands, though the picture is different across Europe as a whole where 46 budget brands account for 1,300 hotels and 91k rooms – most of them in France.

Economy brands in the United Kingdom span all but one of the hotel configuration categories. According to their own definition, TRI/BDRC should exclude the economy basic feature and economy full feature hotels from the "budget" category because they generate less than 70% of turnover from rooms – this would remove 227 hotels and 14.5k rooms. The problem is that brands are more complex than TRI/BDRC admits and this also produces inconsistencies in their analysis. For example, included within its list of "budget" room stock is Innkeeper's Lodge, 45% of whose rooms are in 53 basic feature hotels, which should exclude them from the TRI/BDRC definition of "budget".

The value of our insistence on maintaining both the economy and budget market levels as separate categories becomes clear when we compare the hotel markets in the UK and France.

Hotel configuration and market level, UK chain rooms December 2007

Rooms (thousands)	Deluxe	Up-market	Mid-market	Economy	Budget	Total by configuration
Resort	0.6	10.1	1.5			12.1
Full feature	3.9	60.0	42.1	2.2		108.3
Basic feature	0.5	16.1	40.6	12.3	0.0	69.7
Limited feature		0.2	2.7	37.9	0.4	41.3
Room only	0.1	0.5	1.3	41.2	2.1	45.1
Total by market level	5.1	86.9	88.3	93.7	2.5	276.5

Source: Otus & Co. Advisory Ltd. 2008

UK and France chain rooms by market level, December 2007

	United Kingdom			France		
	Hotels	Rooms (k)	Percentage	Hotels	Rooms (k)	Percentage
Deluxe	55	5.1	2%	17	2.3	1%
Up-market	539	86.9	31%	191	29.2	11%
Mid-market	900	88.3	32%	664	67.9	26%
Economy	1,388	93.2	34%	1,285	89.5	34%
Budget	25	2.5	1%	1,120	74.6	28%
Total	2,907	276.0		3,277	263.6	

Source: Otus & Co. Advisory Ltd. 2008

At the end of 2007 the number of chain rooms in France was within five per cent of that in the UK, yet the structure and history of the two markets was radically different. While the UK now has 3,500 more chain economy rooms than France, it had been 20,000 rooms behind in 2003. The up-market category was also notable, accounting for 31% of chain rooms in the UK against only 11% in France. But the biggest difference is in the budget sector – the likes of Etap, Formule 1 and Premiere Classe – where France had 74,600 branded rooms against only 2,500 in the UK.

The point is simple: every country has its own supply and demand fingerprint and unless the analysis of each is systematic, consistent and continuous there is no hope of effective interpretation of the market. Without such effective interpretation, the chance of achieving superior returns on investment becomes more remote. The example of the UK and France captures the differences in the structures and patterns of development of their chain hotels. By collapsing the economy and budget segment into one, MGCL and TRI/BDRC have not captured these differences and this has implications for their pronouncements on market growth.

Growth prospects for the UK hotel market

Projecting medium to long-term growth in the hotel market is difficult. It involves addressing large-scale economic and investment issues that demand and deserve systematic analyses. It requires detailed, systematic and complex methodologies as well as insights.

TRI/BDRC announces its room stock projections based on the extent to which brands "had met their stated development targets" historically and the "increasingly limited availability of suitable development sites". It predicts that by 2017 the branded "budget" segment will have added 55,800 rooms, a CAGR of 4.8%. In parallel, it predicts that the full service segment will grow by a CAGR of only 1% adding 38,400 rooms. The MGCL methodology for projecting growth is to start from current supply and an inclination of historic developments then to assume that the UK will grow its economy lodging to the proportions already achieved in France and the US. MGCL proclaims that its "budget" segment will add 140,000 rooms over the 20 years to 2027 and that it will add around 110,000 rooms by 2017. Broadly, MGCL predicts that over the next 10 years, the "budget" segment in the UK will add twice as many rooms as predicted by TRI/BDRC.

But neither number can be meaningful as there are two gaping holes in the methodology applied in both reports. First, as we have already argued, an approach of projecting growth in hotel supply by only examining supply is flawed, particularly without a systematic analysis of market structure. The Otus approach to projecting hotel supply in the medium to long-term starts from a systematic, consistent and continuous analysis of supply. It also analyses hotel demand and the economic conditions that generate that demand before we begin to contemplate future changes in economies and the impact that these will have on hotel demand. Only then can we start to be authoritative on the changes to supply that they will require.

The second hole is in the attempts to make comparisons with the French and the US markets. No justification is offered for the implied claim that the UK market is destined to follow the growth patterns of these other two – indeed, no attempt is made to show that the French and US markets have developed along similar lines, much less for similar reasons. We have already noted how the category in which chain supply in the UK lags France is the Otus budget category that includes brands such as Etap and Premiere Classe – not the economy category that includes brands such as Premier Inn, Travelodge, Ibis and Express. We do not believe that MGCL and TRI/BDRC intended to illustrate that the growth in the "budget" segment that they predict referred to hyper long-term supply growth in the UK for Etap and Premiere Classe, but that is what their models point to.

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