

The confused world of hotel categorisation



It is time to take a systematic approach to categorising hotels, argue Paul Slattery and Ian Gamse from Otus & Co



Introduction

"When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean – neither more nor less."¹ So it is with the categorisation of hotels. Too many systems invent definitions just for themselves.

The Italian government requires 4* hotels to have a bidet in each en-suite bathroom. After more than a century, the French government has created a separate "5*" category for luxury hotels, while its structure also includes a no star category. The British Government-funded Visit Britain separates limited-feature and rooms-only economy and budget hotel brands from all other hotels and classifies them separately. Indeed, most governments have developed their own national categorisation of hotels.

Management consultants are equally idiosyncratic about their categorisations of hotels. STR entangles market level and hotel configuration categories into their linear structure of the hotel market. TRI classifies British hotels into two categories: budget – which is a market level category – and full service, which relates to the configuration of facilities.

There are also companies that try to enhance the perception of their hotels by categorising them as 3½*, others that have invented a sixth star and still others that talk about "4* hotels at 3* prices". A Humpty Dumpty world of hotels has evolved in which descriptions have become too detached from objective reality for, as Alice reminds us, "The question is... whether you can make words mean so many different things."

At a time when the UNWTO estimates that international arrivals reached 924 million in 2008,

up by a factor of three since 1980, and hotel chains account for seven million hotel rooms, 43% of the global total, we need categorisation of hotels that is systematic and consistent rather than idiosyncratic and variable.

As both the volume of international arrivals and hotel chain penetration of the market are expected to expand fast in the medium to long term future, the need for a more systematic and consistent approach will only increase, but as Humpty Dumpty replied to Alice, "The question is... which is to be master." We present here an approach, which unlike the others, is based on the objective reality of hotel chains wherever they are.

A systematic approach

We are of the view that the economic significance of the hotel business is such that it is necessary to be systematic and consistent in the categorisations of hotels to provide an effective basis to assess hotels relatively, to ask questions such as: why in any country or city do we have the hotel supply profile that we do? And how congruent is the hotel supply profile with the patterns of demand? What has been the historic trend? And what future developments can be expected? (The fact that a systematic approach might also be of some benefit to consumers is a welcome side-effect.)

As many of our regular readers will know, Otus approaches hotel chain supply systematically by classifying each hotel in terms of a global market level structure that differentiates hotels in terms

of their bedroom facilities and size as well as the bedroom services that are provided. In parallel, we classify each hotel systematically on a global hotel configuration structure that differentiates hotels in terms of their non-room facilities.

These two variables, market level and hotel configuration, are independent and apply to every hotel enabling us to create a market level and hotel configuration matrix that is applied to each hotel, to each hotel brand or each country or conurbation to compare with others systematically and consistently. The matrix specifies the diversity of supply more effectively than any other approach and guides more effective interpretations of trends and developments in the market.

The matrix approach is particularly useful, for example, in analysing brand profiles – taking Accor, say, where the unidimensional approach would classify Sofitel as 4* or 5* depending on the country, or Ibis as 2* or 3*, the Otus methodology enables a far greater degree of clarity. See table 1.

Of the 25 possible categories, Accor operates in 17 – the shaded categories contain the largest volume of rooms. Moreover, with the exception of Etap and F1, each brand operates in several categories because the pattern of non-rooms demand is different in different locations. This practice is the way in which brands seek to be flexible to the realities of locational demand and it is ignored by the Humpty Dumpty approaches.

However, the chains have played down the diversity of their brands. Assertions that their brands are consistent invariably relate to the

Table 1: Accor Hotel Brand Portfolio Matrix: Europe 2008

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only
Deluxe	Sofitel	Sofitel	Sofitel		
Up-Market	Pullman	Pullman	Pullman		Mercurie
Mid-Market	Mercurie, Novotel	Mercurie, Novotel	Mercurie, Novotel	Suitehotel	Mercurie
Economy		Ibis	All Seasons, Ibis, Mercurie	All Seasons, Ibis, Mercurie	All Seasons, Ibis
Budget					Etap, F1

Source: Otus & Co Advisory Ltd

Table 2: 2008 Replacement Value/Room €m

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only
Deluxe	0.750	0.700	0.650	0.600	0.550
Up-Market	0.280	0.260	0.240	0.220	0.200
Mid-Market	0.175	0.160	0.145	0.130	0.115
Economy	0.100	0.090	0.080	0.070	0.060
Budget	0.050	0.045	0.040	0.035	0.030

Source: Otus & Co Advisory Ltd

¹Through the Looking Glass and What Alice Found There, Lewis Carroll, Macmillan, 1871

Table 3: Chain Market Level/Hotel Configuration Matrix: Spain 2008 % Share

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only	Total
Deluxe	1%	1%	0%			1%
Up-Market	6%	7%	5%	0%	0%	19%
Mid-Market	13%	12%	30%	3%	1%	59%
Economy	2%	0%	13%	4%	1%	20%
Budget			0%	0%	0%	1%
Total	22%	20%	48%	8%	2%	100%

Source: Otus & Co Advisory Ltd

Table 4: Chain Hotel Replacement Value €m: Spain 2008

	Resort	Full Feature	Basic Feature	Limited Feature	Room Only	Total
Deluxe	1,390	1,660	130			3,180
Up-Market	6,175	6,850	4,235	325	50	17,635
Mid-Market	8,515	6,755	16,040	1,480	335	33,125
Economy	910	95	3,705	1,070	120	5,900
Budget			35		35	70
Total	16,990	15,360	24,145	2,875	540	59,910

Source: Otus & Co Advisory Ltd

Table 5: Chain Market Level/Hotel Configuration Matrix: UK 2008 % Share

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only	Total
Deluxe	0%	1%	0%		0%	2%
Up-Market	3%	22%	6%	0%	0%	31%
Mid-Market	1%	15%	14%	1%	0%	31%
Economy		1%	4%	14%	15%	35%
Budget			0%	0%	1%	1%
Total	4%	39%	25%	16%	17%	100%

Source: Otus & Co Advisory Ltd

Table 6: Chain Hotel Replacement Value €m: UK 2008

	Resort	Full Feature	Basic Feature	Limited Feature	Room Only	Total
Deluxe	585	2,740	410		35	3,770
Up-Market	2,845	16,320	3,985	30	100	23,280
Mid-Market	280	6,940	6,115	415	160	13,910
Economy		195	1,045	2,950	2,590	6,780
Budget				15	90	105
Total	3,710	26,195	11,555	3,410	2,975	47,845

Source: Otus & Co Advisory Ltd

market level of the hotels and only rarely to hotel configuration. The systematic categorisation of chain hotels is also important because each category entails different construction and replacement costs. For the purpose of analysis we have applied the following replacement cost structure to all chain hotels in Spain, UK, France and Germany, the four largest hotel chain markets in Europe with a total of 1.1 million rooms and a replacement cost of €172 billion. See table 2.

Hotel categories in Spain

Spain is the largest hotel chain market in Europe with 364k rooms and it is also the most complex

since it has two distinct markets. The Costas account for 65% of the chain rooms for which the demand is overwhelmingly foreign holiday makers. The Costas hotel supply is essentially decoupled from the structure and state of the Spanish economy and from the patterns and volume of domestic hotel demand it generates.

The other market is the interior Spanish market, which is tied to the Spanish economy and accounts for only 35% of the chain rooms. Chains in Spain are represented in 21 of the 25 hotel categories. See table 3

Given its reliance on holidaymakers it is no surprise that there is a very heavy incidence, 75%

of total chain room stock, on non-rooms heavy hotels – resorts, full feature and basic feature hotels at deluxe, up-market and mid-market levels – and 63% of these hotels are in the Costas whose demand is generated by the major tour operators.

Package holidays require a major provision of hotels with full life support facilities and services. The issue is that, as the demand for package holidays is declining, the hotel demand is shifting away from the non-rooms heavy hotels, which is producing increasingly redundant hotel facilities. The global major chains account for only 2% of Costas chain rooms. In no other significant hotel market have the chains failed so miserably to generate demand and grow their supply.

The high volume of chain room stock relative to other European countries as well as their heavy exposure to the categories with high market levels and high non rooms facilities means that the replacement costs are high at €60 billion, 30% higher than the UK, two thirds higher than Germany and 114% higher than France. See table 4.

Hotel categories in the UK

Chains account for 291k hotel rooms in the UK and are represented in 21 of the 25 hotel categories. Domestic demand accounts for the majority of hotel demand. The strong secular growth in the economy limited-feature and the economy rooms-only categories over the past 20 years has been a central feature of supply development. See tables 5 and 6.

This development has been about the decline in packaged conference and packaged leisure demand into non-rooms heavy hotels and simultaneously about the growth in transient demand into non-rooms light hotels. It has been about hotel configuration switch more than it has been about market level switch.

Despite the strong growth in economy lodging and the slow growth in non-rooms heavy up-market and mid-market hotels, up-market full feature hotels remain the dominant category and this is reflected in the replacement costs of chain room stock in the UK, where the non-rooms light categories account for only 13% of the total replacement value.

When it comes to the question about return on investment in hotels, the non-rooms light categories are by far the highest performers while the non-rooms heavy categories languish in declining returns as the pattern of rooms demand changes from packaged to transient. ►

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Hotel categories in France

Chains account for 266k hotel rooms in France and 20 out of 25 hotel categories. More than half the hotel demand in France is foreign holiday demand, but unlike Spain the demand is dominated by transient customers rather than package holidays and this is reflected in the pattern of hotel supply. Moreover, domestic short break packages into French hotels is a small market compared with the UK.

Business demand is also dominated by transient demand due to the high proportion of demand generated by the agricultural and industrial segments of the economy, which use hotels less

frequently for conferences and meetings than the citizen services and service business segments. Thus, France has a hotel chain matrix unlike any other European country. See tables 7 and 8.

The replacement value of hotel chains in France is lower than the other major economies, by far, because of the patterns of demand and supply.

Hotel categories in Germany

Germany accounts for 196k chain hotel rooms in 19 out of the 25 hotel categories. The three largest categories: up-market full feature, mid-market full feature and mid-market basic feature account for 73% of chain supply. Foreign demand

into Germany accounts for a lower proportion of hotel demand than in any of the other major European economies.

Domestic business demand is the main market, followed by foreign business attracted to the catalogue of industrial fairs held in German cities. These fairs cities have been the main impetus for the development of up-market full feature and mid-market full feature hotels, which account for 57% of total chain room supply. All of the non-rooms light categories account for only 16% of chain supply. See tables 9 and 10.

The high market level and high configuration categories account for 82% of chain supply and this is reflected in the replacement value where they account for 92%. The high density of high market level and high configuration hotels in a market with low domestic and foreign leisure packaged demand as well as low transient business demand puts a very heavy burden on conference demand to fill the hotels and deliver high returns. The German context indicates that the volume and pattern of hotels supply is too great for the volume and pattern of available demand.

Table 7: Chain Market Level/Hotel Configuration Matrix: France 2008 % Share

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only	Total
Deluxe	0%	1%	0%			1%
Up-Market	1%	7%	2%	0%	0%	11%
Mid-Market	1%	8%	9%	5%	3%	26%
Economy		1%	9%	18%	6%	34%
Budget			0%	2%	27%	29%
Total	3%	16%	20%	25%	36%	100%

Source: Otus & Co Advisory Ltd

Table 8: Chain Hotel Replacement Value €m: France 2008

	Resort	Full Feature	Basic Feature	Limited Feature	Room Only	Total
Deluxe	615	1,000	155			1,770
Up-Market	960	4,860	1,280	180	220	7,500
Mid-Market	500	3,490	3,560	1,635	910	10,095
Economy		200	1,780	3,375	1,000	6,355
Budget			5	165	2,145	2,315
Total	2,075	9,550	6,780	5,355	4,275	28,035

Source: Otus & Co Advisory Ltd

Table 9: Chain Market Level/Hotel Configuration Matrix: Germany 2008 % Share

	Resort	Full feature	Basic feature	Limited feature	Rooms only	Total
Deluxe	0%	2%	0%			2%
Up-market	2%	29%	3%	0%	0%	33%
Mid-market	1%	28%	16%	3%	1%	48%
Economy	0%	2%	2%	7%	1%	13%
Budget					3%	3%
Total	3%	60%	21%	11%	5%	100%

Source: Otus & Co Advisory Ltd

Table 10: Germany 2008 Chain Hotel Replacement Value €m

	Resort	Full Feature	Basic Feature	Limited Feature	Rooms Only	Total
Deluxe	70	2,890	140			3,100
Up-Market	1,120	14,495	1,240	25	40	16,920
Mid-Market	205	8,685	4,610	790	115	14,405
Economy	55	300	360	1,010	135	1,860
Budget					195	195
Total	1,450	26,370	6,350	1,825	485	36,480

Source: Otus & Co Advisory Ltd

Conclusion

Simply, for a business as economically significant and as diverse as hotels, there is no alternative to a systematic and consistent categorisation that enables realistic presentation of hotel supply that can be linked directly with the patterns of hotel demand and ultimately an effective valuation of the replacement value of the hotels. Without it, Humpty Dumpty rules, and we all know what happened to him.

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