OVERVIEW

1.1 INTRODUCTION

The vast majority of research articles and essays in this book deal with one or more aspects of what has been called the art and science of modern hotel management. It should be noted that the word *modern* can be loaded with the potential of much misunderstanding. Hotels are changing and will continue to change. As a result, the techniques of management of modern hotels must adapt to changing circumstances. Subsequent sections of this book are designed to help the student and practitioner discover information, methods, and techniques for dealing with these changing circumstances.

► INFLUENCES

Like many other American businesses, hotels have been affected by shifts in emphasis among the country's living patterns. People and industry have moved from the so-called rust belt to the sun belt. The hotel business has been active in reborn and reconstructed central cities. The explosion of technology and information-based companies has concentrated human endeavor in technological corridors in California, Massachusetts, Washington, Texas, and North Carolina, to name a few such places. It can be safely said that where jobs are and major concentrations of economic activity occur, hotels will follow.

Among other current and ongoing influencers of hotel design, construction, marketing, and operation are the following. *Note:* This list is neither exhaustive nor exclusive.

- *Demographics* play a major role and will continue to be influential in the foreseeable future. As the baby boom generation

and its children mature, the population of the country will for many years be older, healthier, and better educated than previous generations. These facts will present new challenges and opportunities to all business managers.

- *Technology*—in the form of computers, communication, personal devices, and laborsaving mechanical equipment—has had and will have a major effect on the way in which hotels are managed and operated. The speed with which information is accumulated, stored, manipulated, and transferred is such that today most travelers expect that the hotel rooms they rent will allow them to be as productive as they are in the office or at home. Increasingly, with portable computing, personal data assistants (PDAs), wireless communication, and virtually everything somehow connected to the Internet, hotels must provide services and access that allow guests seamless transition from the business, travel, or home environment to that of the hotel. Increasingly, entertainment must be fused with communication and productive processes.

- The concept of *market segmentation,* or ever-increasingly finely tuned market definitions, will dictate hotel structures and organizations, and management tactics designed to address those market segments have become even more important to the management of hospitality service businesses. With the increased power in the information and data manipulation realm, hotels have available to them ever-expanding databases about guests and are creating new products to attract those markets.

- One of the effects of the aging demographic is the emergence of *vacation re-sorts*—a modern incarnation of the time-share properties of several decades ago. Because these are being developed and operated by name hotel companies and are marketed to the affluent, healthy, well-educated population segment, resort managers have had to absorb new managerial realities.

- The well-documented change in the complexion of the *national economy* from one that emphasizes goods and, to a lesser extent, natural resources to one that emphasizes services has kindled new ideas about the way in which we manage the design and delivery of these services. Hotels, restaurants, and travel services are now seen as unique entities that dictate special kinds of managerial techniques and strategies.

- Changes in people's *travel patterns* have altered the way we manage our hotel properties. Deregulation of the airlines has driven a change in the way millions of people travel each year, given the hub-and-spoke design of airline services. Many hotel companies are now locating major hotel properties adjacent to hub air transport facilities, taking advantage of the fact that business travelers may not need to travel to a central business district (CBD) to accomplish their purpose in a given area. Meetings and conferences can now be scheduled within a five-minute limousine ride from the air terminal, and the business traveler can be headed for his or her next destination before the day is over without having to stay overnight in a CBD hotel.

- New *patterns of investment* in hotel facilities have emerged in the last two decades, and more attention is now paid to achieving optimum return on investment. Be-

cause people from outside the hotel industry are now participating in its financial structuring, hotel operations are no longer dependent on the vision of a single entrepreneur. Managers now must design tactics and strategies to achieve heretofore unanticipated financial goals. The same trend has also altered the complexion of management and organization of the modern hotel. This is especially true of publicly owned hotel firms, where Wall Street stock analysts heavily influence stock prices through expectations of quarterly revenues and profits. This puts pressure on hotel companies and their operations managers to perform, on a quarterly basis, in a way contrary to many managers' instincts.

Most of the foregoing issues and influences still operate (to a greater or lesser extent) on the organizational structures and strategies of the modern hotel. Since the last edition of this book, however, other phenomena of an economic, cultural, and social nature have come to the fore, complicating our view of hotel management. This furthers the argument that the hotel industry is a part of the greater economy and at the mercy of elements often completely out of its control.

The cyclical nature of the U.S. and international economies has recently affected significantly hotels' ability to respond to changing circumstances. In early 1993, for instance, employment growth was stagnant; corporate profits were low; the expansion of the gross national product (GNP) was only a marginal percentage above previous years; and travel in most segments was down due to corporate restructuring, downsizing, or reorganizing. Vast layoffs in the hundreds of thousands had been announced every month. While fuel prices continued to be relatively

stable, consumer spending patterns and high employment growth had not materialized, particularly in light of corporate layoffs and the ongoing nervousness of consumers about whether or not their financial wherewithal was safe.

Now consider late 2000, when the third edition of this book was being written. Unemployment was at an all-time low; the Dow Jones Industrial Average was between 10,000 and 11,000; hotel occupancies had stabilized nationally in excess of 70 percent; and the federal government was running a surplus for the first time in the memory of most.

Then what happened? The terrorist attacks in New York and Washington, D.C., in 2001 changed the face of all business and travel, immediately and probably for the foreseeable future as well. Major airlines are in bankruptcy; hotels are struggling to achieve profitable occupancies; business travel is down; the high-tech stock market bubble burst; the country is at war in a number of locations; security has made travel more difficult, if not actually annoying; and people are nervous. Join this with an imbalance of trade, the outsourcing of jobs, and the largest federal deficits in history, and the face of the economy is challenging. This translates directly not only to business travel but personal and recreational travel as well. Finding ways to operate profitably in such an environment is the job of the next generation of hotel operators.

Among the predictions I made in the preceding edition was that cultural diversity will play a role in the management and organizational structure of the modern hotel in the United States. As surely as living patterns, economic cycles, and market segmentation have influenced the hotel industry, so will the change in ethnicity of the workforce. The cultural backgrounds that an increasingly diversified workforce will bring to hotel operations

may be seen as a problem or a challenge—or both. To most operators, it will be seen as an opportunity to demonstrate to an increasingly diverse clientele that hotel companies are committed to hiring and training a workforce structure that mirrors society. I see no reason to change that prediction now; if anything, acculturation of the hospitality business will accelerate.

The legal and regulatory environments are increasingly important to all business managers, and hotel operators are no exception. Increasingly, operators must be aware of and alert to realms of risk that can engender lawsuits against them. Several articles and essays in this edition highlight these threats to hotels and their guests. It should be noted that present-day security concerns also have significantly affected the ways in which hotels are operated. Awareness of the risk environment and the regulatory realm are factors that affect a hotel's ability to compete in the early part of the twenty-first century. Essays and articles in the security section and the human resources section address this issue.

▶ INTRODUCTORY READINGS

I have attempted in this edition to present new and (sometimes) different takes on the hotel business. This section is also used to explore ideas that are new to the management process, and that—who knows?—may never completely catch on. Rather than focus exclusively on the operations of the major chains, the readings here are from the perspectives of operators, leaders, and experts such as regional operators, major industry consultants, and independent branded hotels.

John Dew, formerly president of Inn Ventures, a regional hotel management and development company that has built and operated many Marriott products, in addition to a proprietary hotel product, provides an insider's view of the steps needed to bring a hotel from conception to construction and operation. This unique view of hotel operations connects the concept of hotel development with the realities of day-to-day operation. It should help aspiring managers understand how the intricacies of the development process may influence the marketing and management of the hotel.

Peter Cass offers the reader insights, heretofore unavailable in books of this nature, into independently branded hotels that associate to provide market strength. He makes the case that the future success of independent hotels is linked to their ability to find ways to maintain their independence while sustaining competitive advantage in the luxury segment.

Because new construction of hotels diminished greatly after 9/11 but firms still needed to grow, rebranding existing properties generated a lot of growth activity. Rebranding is a complicated process that must be accomplished within critical time frames to coincide with marketing, financial, and operational variables. Tom Dupar is a seasoned veteran at this fascinating and important activity and has participated in rebranding operations around the world. His essay on the intricacies of rebranding was a mainstay in the previous edition of this book. Today's economic circumstances are different, and Dupar's business has changed its focus to opening new major projects. His piece serves as a useful companion to that of John Dew, and the two should be read together, with an eye toward comparing Dew's smaller project focus and Dupar's large projects.
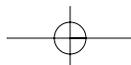
Perhaps proving the axiom that "everything old is new again," the concept of health and wellness spas as a hotel and resort product has enjoyed a resurgence. Once the province of high-end hotels and resorts, the idea of being pampered in a spa has been added to the service mix in many more modest hotels and resorts. While the big-name spas at five-star properties still set the standard for pampering and pricing, the comfort of personal service in less lavish spas seems to appeal to the modern traveler as well. Peter Anderson's overview of the spa industry provides insights into this fascinating service product.

In addition to products, building, and rebranding, I have also chosen to include in the section two recently reviewed and studied ideas that may or may not be adopted across the industry.

At the end of this section are a number of suggested readings for the student who would like to gain more in-depth knowledge about the hospitality industry as a whole and specific historical antecedents. In particular, the books by Hilton and Jarman look closely at the intermachinations of the establishment by two early pioneers of the industry, one of whom, Conrad Hilton, lives on in an international, publicly traded company operated by one of his sons. E.M. Statler's contributions to the modern hotel business are legendary in that he is generally credited with founding and operating the first commercial hotel concept that recognized the realities of the early business traveler at the beginning of the twentieth century. The suggested articles are drawn from recently published historic overviews of the hotel side of the hospitality industry in the United States. They also highlight other major forces in the development of the modern hotel business.

1.2 THE HOTEL DEVELOPMENT PROCESS

John Dew

▶ INTRODUCTION

The bulldozers are working and a construction crane is being erected on that vacant lot you pass each day going to and from home. The sign on the fence states that a new hotel is being built with a planned opening date of spring 2007. If you have ever wondered just how that hotel was created, you may have wondered about some or all of the following questions:

- How did someone select that particular vacant lot?
- Who actually creates a new hotel?
- Who owns it?
- Where did they get the money to build it?
- How long does the process take from idea to grand opening day?
- Who selects the architect, the engineers, and the interior designer?
- Who manages the myriad details that go into the development of a new hotel?
- Who will manage the hotel once it's open?

We hope to address these and other questions you may have in this chapter.
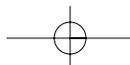
▶ THE DEVELOPMENT COMPANY

The developer is the entrepreneur, the risk taker, who originates the idea for the hotel. Depending on the business structure selected, the developer often puts his or her personal wealth at risk when engaging in a hotel project. The developer, along with a small staff of people, networks with commercial real estate agents on the lookout for a suitable hotel site. Depending on the type of hotel to be developed, a site of at least two to four acres is required (for comparison, an acre is roughly the size of a football field). This property must be zoned by the city for a hotel, be visible from a freeway or major street arterial, and have city approval for such construction activities as curb cuts, left-hand turn lanes, and delivery truck access. Commercial realtors offer sites for the developer's consideration that include maps, aerial photos, and proof of hotel zoning.

Sometimes the developer views potential sites by driving around the neighborhood within five miles of the site or touring multiple sites by helicopter, noting where the potential guests live and work and where potential competing hotels are located.

The price per square foot of the land is considered. The higher the cost of land, the higher the rates the hotel will need to charge. Is the price too high for the average daily rate (ADR) in this particular market? Is it too low? Or is it acceptable? This is determined when the hotel financial pro forma budget document is created.

▶ THE FEASIBILITY STUDY

When the developer selects a site, a feasibility study is often commissioned to obtain an analysis of the site by an objective third party. Companies offer hotel feasibility studies for a fee and are experts in a particular market, or developers may use the consulting group of one of the major public accounting firms.

The company retained to do the feasibility study can spend up to several months gathering detailed data to see if, in their opinion, it makes economic sense to build the hotel. Their conclusion offers an objective third-party opinion as to whether the project is feasible, hence the term *feasibility study*. Generally, the feasibility study considers, evaluates, and makes recommendations about the project based on the following variables:

The Site
- Proper zoning
- Size in square feet/acres
- Visibility from arterials/freeways
- Traffic counts/patterns
- Accessibility from streets, freeways, airports, train stations, etc.
- Proximity to where potential guests live, travel, or work
- Barriers that discourage competition coming into the market, if any
- How adjacent property and businesses are utilized
- Master area development plans
- Local permitting process and the degree of difficulty for that particular city
- Impact fees charged by the city

The Economy of the Area
- Major employers, government agencies
- Business trends for each employer/agency
- Hotel needs and the demand for each
- Leisure travel demand in the area
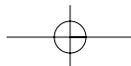
- Nearby tourist attractions
- Visitor counts
- Conventions, trade shows, and meetings history

The Hotel Market
- The competitors, both existing and planned
- Historical occupancy of hotels in the area
- Historical average rate
- Proprietary data on area travel

Identification of Which Hotel Market Segment to Serve
- Full service
- Limited service
- Extended stay
- Luxury
- Midprice
- Economy
- Budget

Selection of Appropriate Hotel Design
- High-rise
- Midrise
- Garden apartment style
- Hybrid design

Selection of Appropriate Hotel Brand
- Franchised (Marriott, Sheraton, Hyatt, etc.)
- Licensed (Best Western, Guest Suites, etc.)
- Independent
- Independent with strategic market affiliation (Luxury Hotels of America, Historic Hotels of America, etc.)

Ten-year Projection
- Occupancy projection by year
- ADR by year
- Estimated cash generated for debt
- Estimated cash generated for distribution to investors
- Estimated cash-on-cash return (after-tax income divided by equity invested)
- Overall projected yield
- Projected internal rate of return
- Net present value of the project over each of the next ten years

Once the feasibility study is completed, the developer is prepared to move forward with the project. Often, at this stage of the process, the developer purchases an option on the land to tie it up until the remaining development steps can be completed—and to prevent the competition from purchasing it.

► CREATION OF THE OWNERSHIP ENTITY

An ownership entity (note that this is different than and separate from the development company) must be created to hold title to the land—and the hotel, once it's built. Considering the limitation of liability to the investors, tax consequences, estate implications for the investors, and potential requirements of the mortgage lender, a business structure is selected, normally in one of the following forms:

- Limited liability company (LLC)
- Limited partnership (LP)
- S corporation (formerly known as a *Sub-S corporation*)
- C corporation
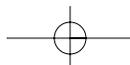
▶ THE DEVELOPMENT AGREEMENT

The newly formed entity now enters into a development contract with the development company to take the project to completion. The development company charges a fee, approximately 3 percent of the total project cost, for this service. The agreement generally covers such variables as:

- Selection of architect/engineers
- Selection and supervision of a general contractor
- Processing all building and occupancy permits
- Raising all the equity money from investors
- Securing a construction mortgage loan
- Selecting a franchise company
- Securing the franchise
- Selecting an interior designer that meets franchise company requirements
- Purchasing all opening furniture, fixtures, equipment
- Selecting a management company to operate the hotel
- Liability for cost overruns

▶ SELECTING A FRANCHISE

Depending on the type of hotel to be built (based on the feasibility study), the developer recommends a franchise company to the hotel owner. A major consideration is the best franchise brand for the market segment to be served. Each franchise company has different franchise fees, royalty fees, and marketing/miscellaneous fees as part of its agreement structure with the operating company. Consideration must also be given to the brands already represented in the target market that may be available for franchise. The franchise company is approached and a franchise is requested, with the feasibility study offered as backup for the request.

The next step is for the franchise company to conduct an impact study of the market. This considers such matters as possible negative impact on existing hotels that carry the franchiser's flag. If the impact is judged to be insignificant, a franchise is usually granted to the ownership entity for a one-time fee of about $400 per room, depending on the franchise selected, with continuing royalty and marketing, usually based on a percentage of hotel revenue.

▶ SELECTING AN ARCHITECT

Because the final product of this process is a building the operator has to run as a hotel, the architect's experience in designing hotels, his or her experience with the prototypical drawings of the franchise selected, the fee, and his or her on-time record must be considered. Architect fees can run up to 5 percent of the total project cost but are often negotiated down, if the project is big enough. The firm's experience and record on similar projects are critical. The architect does not have to operate the hotel when it is completed. The developer wants the architect to design a hotel that will be easy to operate and maintain.
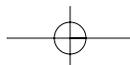
▶ SELECTING A GENERAL CONTRACTOR

Major consideration are the quality and reliability record of the general contractor and the firm's use of and relationships with the many subcontractors needed for a project as complex as a hotel. Again, experience in building the hotel type is important. It is hoped that the general contractor has learned from any mistakes made in building similar hotels. The general contractor and architect often bid the project as a team; this helps the developer determine the final cost. Often, up to a 10 percent contingency cost that allows for unforeseen circumstances is built into the project bidding process.

▶ FINANCING THE PROJECT

The following variables must be determined to qualify for financing:

- The cost of the land
- Design and construction cost of the building
- The cost of furniture, fixtures, equipment, and opening supplies
- Pre-opening marketing and labor costs
- A six-month operating capital cash reserve

The sum of these constitutes the total cost of the project for purposes of securing financing.

With this information, the ten-year operating pro forma budget is updated to reflect actual costs. It's now time to go to the money markets for construction financing. The terms and conditions of a construction loan can vary widely depending on the individual lender. Important terms that can affect the cost of the loan include:

- Personal guarantees by developers and/or equity partners/investors
- Loan origination fees
- Interest rate
- Required loan-to-value ratio
- Terms of repayment
- A requirement that interest/taxes be held in reserve
- Required debt service coverage ratios
- Length of the construction loan; length and costs of extensions

These are only a few of the considerations that must be analyzed when selecting a lender. The developer, on behalf of the owning entity, then approaches a number of lending institutions. The lending institutions analyze the deal and offer a proposed term sheet that answers all of the borrowers' questions. This allows the borrowers to select the lending institution with which they wish to work. The lender then commissions an appraisal of the project by an independent appraisal company such as Hospitality Valuation Services (HVS). Based on the appraisal, the lender issues a loan commitment for the project that usually offers up to 60 percent of the project cost. The balance must be raised as equity from investors.

▶ RAISING THE EQUITY INVESTMENT FUNDS

With the bank committed to about 60 percent of the cost, the remaining 40 percent

must be raised in equity commitments by investors. To pursue these, the developer prepares an offering solicitation document that meets current securities and exchange law. The nature of this document depends on the type of business entity that was formed. For limited partnerships or limited liability companies, a private placement offering circular and project description is prepared. For S or C corporations, stock offerings are prepared for sale consistent with applicable federal and state securities laws.

The developer now contacts money sources that have risk capital available to invest. These can include:

- Individual investors
- Private asset managers
- Opportunity fund managers
- Venture capital fund managers

These potential investment sources are offered the opportunity to invest in the hotel. Based on their study and evaluation of the reports, documents, and studies detailed above, they decide whether or not to offer funding to the developer.

Once the loan is secured, the equity raised, and the building permit issued by the city, the land purchase option is exercised and the purchase is completed. Then the 12–16-month construction process begins. If the architect's plans work as intended, if the general contractor has no problems with subcontractors, unions, or permits, if all the furnishings, fixtures, and equipment arrive on time, if the weather cooperates, and if the employment market is such that human resources are sufficient to open a hotel, then congratulations! The hotel will open on time.

▶ SELECTING THE MANAGEMENT COMPANY

Often even before the construction activity commences, the owning entity selects an appropriate management company to manage the pre-opening, marketing and sales, selection and training of the opening staff, preparation of the operating budget, and day-to-day operations once the hotel is opened. Management companies charge 3–5 percent of revenue for this service. In recent years, management companies have charged 3–4 percent of revenue and 2–3 percent of gross operating profit so they can be measured and evaluated on both sales and profitability.

The franchise company may offer to provide management services to franchisees. Marriott International, Inc., for example, manages about 50 percent of all hotels that carry the Marriott flag under 20-year contracts. Independent management companies manage the remaining hotels under long-term management contracts of up to ten years' duration, often with several five-year renewal options.

▶ CONCLUSION

This is a largely linear explanation of the complicated process that a developer goes through in order to create a hotel. It has been described in a step-by-step process, but in reality, many of the steps are carried out concurrently to save time (and money). Nevertheless, the hotel development process takes about three years from original concep-

tion to first guest. It is important to remember that during the initial stages of the process, the developer can have as much as $1 million (U.S.) or more at risk in the process before a final go/no-go decision is reached. Only after the project is approved and all financing is in place can the developer start to recover up-front costs and collect development fees.
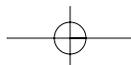
Hotel development with its component parts of hotel feasibility studies, hotel appraisal, hotel real estate finance, and hotel management are all among the career opportunities available to hotel and restaurant administration graduates.

▶ PUTTING IT ALL TOGETHER—THE STORY OF AN EXTENDED-STAY HOTEL DEVELOPMENT PROJECT

The City Development Commission in a Pacific Northwest community purchased a 1.55-acre parcel of riverfront land in the downtown area. The land was previously contaminated with industrial pollutants that made the parcel unsafe for habitation and construction. The City Development Commission used state, local, and federal grants to have the land decontaminated, created a master plan for the area, and then offered the parcel for sale and development.

The City Development Commission issued a request for proposal (RFP) that outlined the asking price of $2,076,240 ($30/sq. ft.) for the land and the design requirements set down by the Commission for a building that would fit the intended look and feel of the area. The RFP was sent to many major hotel companies and commercial real estate brokers, asking prospective buyers to submit a purchase price bid along with a statement of the buyer's development history and ability to develop a hotel of the type envisioned by the Commission. It listed a closing date by which all bids had to be submitted.

An area commercial real estate broker contacted a hotel development and management company with a long history of developing and managing extended-stay hotels in the Pacific Northwest, including a property located in a similar setting to that being offered for sale. The commercial realtor offered to represent the developer in negotiations with the City Development Commission, which would be paying the real estate commission on the sale. An agreement was reached with the commercial real estate broker to represent the buyer to the seller, and the developer went to work in preparing a proposal.

The developer conducted a feasibility study to see all of the conditions in the marketplace that would be encouraging or discouraging to this development project. Studies were conducted to estimate how many room-nights were being sold within a five-mile radius, how many extended-stay room-nights were available in the market, how many hotel rooms existed, and how many were being planned over the following five years. From this, the developer was able to estimate the number of extended-stay room-nights available needed to produce an 82 percent occupancy with an average daily room rate of $141 when the hotel achieved stabilization three years after opening. That provided the basis for a ten-year revenue estimate.
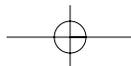
The developer proposed a nine-floor, 258-suite extended-stay hotel with an indoor pool, spa, and exercise facility, a guest laundry, offices, meeting facilities, and a three-floor parking garage with parking for 193 automobiles, all at a total cost of $38 million, or $147,286 per suite.

The $38 million construction budget was broken down as follows:

Land	6.0%
Construction	66.0%
Office Equipment	1.4%
Furniture, Fixtures, Equipment	7.4%
Architecture/Engineering	2.8%
Permits/Fees/Environmental	2.8%
Appraisal/Legal/Tax/Insurance	1.3%
Pre-Opening Expenses	1.3%
Construction Loan Fee	1.1%
Developer Fee	2.8%
Construction Interest	2.8%
Working Capital	2.1%
Contingency	2.2%
Total	100%

The opening date for the hotel was projected at 27 months from the date of proposal acceptance.

The City Development Commission awarded the project to the developer, and work began.

First, an ownership limited liability company (LLC) was formed as the ownership entity that would hold title to the hotel.

The LLC, in turn, entered into a development and construction management agreement with the development company to manage the arrangements for financing and construction of the hotel.

The developer, as agent for the ownership LLC, also entered into a hotel management contract with a management company to manage the pre-opening marketing, pre-opening hiring and training, and the day-to-day operation of the hotel once it was opened. The arrangements called for the management company to be paid 3 percent of revenue and 2 percent of the net operating income for management services.

The ownership LLC then contacted a major hotel company and applied for a franchise to allow the development and operation of an extended-stay hotel. A 20-year franchise was granted with a fee of $400 per suite or, $102,800. This was to be followed by a 5 percent royalty and a 3 percent advertising fee once the hotel was open and operating.

The developer, acting as agent for the owner, prepared a private placement memorandum document seeking investments from accredited investors. These investors were primarily defined as people with a net worth of $1 million, or those with an income in excess of $200,000 over the previous two years and expecting an income in excess of $200,000 in the current year. (*Note:* Additional entities may also be defined as accredited investors by the Securities and Exchange Commission.)

The private placement memorandum offered $100,000 units of ownership to accredited investors, guaranteeing a 9 percent priority return on the investment and a combined 50 percent ownership in the hotel. A group of initial investors retained the other 50 percent in exchange for putting the project together. This effort was successful in raising 40 percent of the total cost of the hotel in anticipation that a lender would provide the remaining 60 percent in the form of a construction loan. In addition to the priority return, investors could expect to participate in any future capital gain realized should the hotel be sold.

The development company, continuing to function as agent for the owner, then sought a commercial bank to provide three-year construction financing for the project.
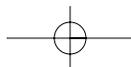
As $22,800,000, or 60 percent, of the $38 million development cost was to be borrowed, only major banks were considered as prospective lenders. The size of the construction loan was above the lending limits of most small regional banks. After a preconstruction appraisal by a third-party appraisal firm chosen by the lender confirmed the value at $38 million upon completion of construction, and for an origination fee of $400,000, a three-year construction loan was secured. The terms allowed the developer, as agent for the owner, to draw down the loan every 30 days after providing proof that funds had been properly disbursed in the construction process. The loan documents set an interest rate and also required that the ownership LLC seek a permanent mortgage prior to the three-year expiration date on the construction loan.

The development company then negotiated with and selected a general contractor with significant hotel construction experience who acted on behalf of the developer, as agent for the owner. The general contractor then selected design-build subcontractors and an interior designer to select colors, fabrics, furniture, fixtures, and equipment to meet the hotel franchise design requirements.

Building permits were applied for, and the building design was presented to the City Development Commission for its approval, along with other groups with a stake in the appearance of the finished building in relation to the area and neighborhood. With all of these approvals in place, construction commenced, and the hotel opened two years later.

▶ POSTSCRIPT

Three years after the hotel opened, the ownership LLC had the obligation to secure permanent financing on the hotel to replace the construction loan. The September 11, 2001, terrorist attacks on the World Trade Center and the Pentagon slowed travel throughout the United States. As a result, the hotel did not achieve the projected occupancy or average daily rate during the three-year construction loan period. An appraisal that was primarily based on the hotel's trailing 12-month net operating income produced a value about $2 million below the original construction cost. The bank that had provided the construction loan notified the owners that they did not wish to provide permanent financing under these circumstances. The owners were forced to conduct a search for a new mortgage bank. They were able to find a mortgage, but only after buying down the loan by $2 million to bring the loan-to-value ratio back to 40 percent equity and a loan at 60 percent of the appraised. This illustrates the risk that developers face when entering into a hotel project.

However, as hotel values historically peak and decline on about a ten-year cycle, the owners look forward to the option of selling the hotel on the next peak, which will allow them to capture the original projected return through capital appreciation. Hotel development and ownership is a high-risk, high-reward enterprise.
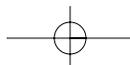
1.3 HOW WELL DOES THE BRANDED DISTRIBUTION COMPANY ALLOW INDEPENDENT HOTELS TO COMPETE WITH THE CHAINS?

Peter Cass

Dramatic changes have affected the hotel industry over the past 30 years. These changes have had a disproportionately high bearing on the independent hotel owner, who, in the face of increasing pressure from large, well-funded chains, struggles to maintain independence and to compete on the basis of distinctive hospitality and character.

Several organizations provide independent hotels and resorts with reservations and sales services. As competition has evolved and intensified, some of these organizations have modified their structure and enhanced their services to meet the changing needs of independent hotels and competitive market dynamics. Today, independent hotels may choose from among more than 20 such organizations delivering varying degrees of competitive advantage and ownership independence.

▶ A NEW MARKET MODEL

In the new millennium, the face of the global hospitality market continues to change at a rate never before seen. Four factors contribute to this rapidly changing environment:

- *The broadening and diversification of the global consumer market.* Both the demographic and psychographic characteristics of the global consumer market are growing and changing radically.

- *The rapid advancement and availability of technology.* This includes internal hotel operating systems, revenue management, direct-to-consumer communications and booking technology (Internet), marketing technology (customer databases), and telecommunications and automated sales systems that enable central sales offices to become revenue producers.

- *The growth and importance of global brands.* Recognized brand names and brand attributes are important in reaching diverse customer segments and in creating customer loyalty.

- *Consolidation of multiple brands under a single global management.* The management and leveraging of multiple brands use similar technology platforms and shared sales and marketing infrastructures to consolidate and direct consumer demand.

Some established ways of doing business—long-term, high-fee management contracts and franchises, a focus on traditional distribution channels, and traditional hospitality industry marketing techniques—are no longer effective in the new consumer-focused market. More and more hospitality marketing budgets are being directed toward technology-enabled customer booking and communication; this shift away from traditional hospitality marketing techniques is expected to evolve
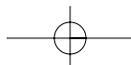
over several years and involve millions of U.S. dollars in telecommunication, e-commerce, data warehousing, and one-to-one marketing investment. The independent hotel or resort and many small branded management companies may not be able to fund this requirement.

However, this shift will not affect all independent hotels and resorts simultaneously. The first wave of change will hit the global business and city hotel market. This is primarily because of brand competition and the fact that the business travel distribution network is more structured and driven by multinational corporations desiring lower and more predictable costs. The second wave will affect the leisure market, and the changes could follow quickly. Leisure travel content, including packaging on the Internet, will increase rapidly as the presently fragmented leisure travel distribution network becomes more unified and efficient through consolidation.

The emergence of e-commerce modes in the hospitality industry is not eliminating the intermediary and empowering the individual property, as once thought; instead, it is creating new, more powerful intermediaries. Some of these evolve from the hospitality industry, while others are opportunistic e-commerce companies.

► MANAGEMENT COMPANIES AND FRANCHISES

In the 1970s, hotel chains continued to evolve as the need for capital to invest in additional properties restricted growth opportunities. This pressure bolstered the proliferation of the *management contract,* whereby the chain offers the hotel owner the rights to use its brand name and established facility and service standards as well as trained operations management and reservation and marketing services—for a significant fee, usually a percentage of gross sales. The pressure to grow also fostered the development of the franchise concept and franchise system in North America. The franchise differs from the management contract in that the owner is responsible for operations, including meeting the franchise standards.

The growth of management and franchise contracts has been remarkable, and today, according to a recent study, 75 percent of the hotel rooms in North America are covered by some form of branded franchise or professional management agreement (Travel Research International, 1999).

These new business structures continued to threaten the traditional independent owner by accelerating the growth of the chains' share of the lodging market. In response, the marketing/referral organizations formed in the 1960s began to offer a wider range of services. While these additional offerings leveraged linkages to the global distribution systems and led to strong relationships with travel agents, the consumer was largely ignored, and the organizations did little to generate consumer brand awareness.

In the United States, strong consumer branded operators are attracting increasing amounts of capital to fund their growth at the expense of unbranded operators (PricewaterhouseCoopers, 2000).

► BRAND DEVELOPMENT

As the consumer market became more diverse and the hospitality product more
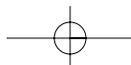
segmented, branding became increasingly important. By the late 1980s, without a recognized brand affiliation or a close relationship with the lending community, owners/developers found it difficult to obtain permanent financing on a new hotel or resort. Lenders, believing that an established brand provided greater economies of scale and established infrastructure, opted for the lower-risk alternative. In this brand-driven environment, the independent hotels' distinctive style and character became a competitive advantage, but only if they were able to meet recognized standards. As a result, the need for independent hotels to be associated with a clearly defined, trusted brand became more critical than ever.

In the late 1990s, independent hotels, particularly those in Europe, began to face the daunting costs of upgrading their technological infrastructure and facilities to accommodate changing consumer needs. Such upgrades as new property management systems, high-speed Internet access, two-line phones, in-room faxes, and leisure and health facilities became critical to maintaining competitiveness. When coupled with ever-increasing costs of consumer marketing, these costs put unprecedented strains on independent hotels' finances. As a result, these hotels became increasingly focused on leveraging greater returns from their reservation affiliation.

▶ RESERVATION AFFILIATIONS—A CHALLENGE TO EFFECTIVENESS

The relationship of independent hotels and resorts to reservation affiliations has been long and generally successful. These relationships operated best in a market environment that was stable, somewhat homogeneous in terms of demographic market segmentation, and where travel influencers played a dominant role in transient business, group, and leisure travel. Reservation affiliations are most effective in regional hospitality markets that do not have multiple brand competition and when the goals and objectives of the reservation organization are in alignment with the goals of the independent hotel owners. A contributing element to the attractiveness of reservation affiliations has always been the networking and camaraderie opportunities for the professional management at independent hotels.

Reservation affiliations focus on traditional channels of distribution. Access to the Global Distribution Systems (GDS) is no longer a competitive advantage; the GDS is a universal pipeline. The new competitive playing field is proprietary distribution channels leveraged by consumer segmentation, e-commerce technology and partners, and innovative customer management programs.

In the new technology-driven and consumer-empowered global market, the strength and effectiveness of reservation affiliations are challenged by new market and operating imperatives. The cost to compete against chains will grow exponentially. As competition intensifies, it is probable that local and regional market share at independent hotels and resorts will be drawn off by local and regional licensees of strong global brands. Independent hotels, therefore, need to draw more national and international business to fill occupancy gaps. This requirement runs counter to the established business model and capabilities of reservation affiliations.

The average room-night contribution of reservations companies to affiliated inde-

pendent hotels is less than 5 percent of available rooms (Preferred Research).
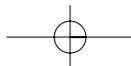
At least four emerging factors are challenging the effectiveness of traditional reservation organizations:

1. The growing demographic and psychographic complexity of the global consumer market requires significant new expertise and resources in the area of segmentation and analysis.

2. The emergence of consumer direct-booking Internet technology requires significant new and ongoing investment.

3. The new marketplace requires innovative global brand management together with resources to establish and maintain a brand in the face of intense competition. To be competitive, a brand must attract new development and must therefore be strong enough to convince lenders to commit to permanent financing. Brand management also includes loyalty program management and the development of regional and global partners to strengthen and extend the effectiveness of the brand.

4. The corporate objectives and governance policies of traditional reservation organizations are influenced by the need to grow and meet shareholder profit requirements. These goals for growth can be at odds with the goals and expectations of independent hotel and resort members.

The traditional reservation affiliations must change not only their focus but also their structure if they want to succeed in this new competitive world.

The traditional reservation organization must be prepared to respond to competitive challenges by expanding resources and skills necessary to increase average room-night contribution to affiliated independent hotels to 15 percent—an average growth per member hotel of at least 200 percent over present performance levels (Preferred Research).

In response to this competitive environment and the need for more cooperative and focused business relationships, a new hospitality business structure is evolving for all scales of hotels: the branded distribution company.

► CHARACTERISTICS OF A BRANDED DISTRIBUTION COMPANY

The ideal branded distribution organization is a conventional equity company with ownership shared (in some cases) by the individual hotel owners, who have direct input into the corporation through an elected board of directors. This ownership structure creates a true operating partnership and a sharing of energies toward the common goal of creating value through increased brand awareness and room sales. Corporate profits must be adequate to maintain technical and managerial leadership and to support the shareholders' investment.

Unlike a reservations and representation company, a branded distribution corporation owns and builds a branded distribution network asset that, in turn, provides services as set out in the diagram below. The sole focus is performance for the affiliated independent hotels and resorts.

Joining such an organization is appropriate for independently owned and managed hotels and resorts that want to keep owner control but require effective and low-cost
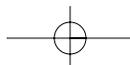
Table 1.1 Hospitality Structures and Corresponding Brands

Types of Business Structure	Representation Firms (Group Meetings Only)	Reservation Services Only	Reservation/ Sales Affiliations	Branded Distribution Companies	Flagged and Franchise Management Companies
General Attributes	• Primarily Trade-Focused • Primary Reservation Technology • Disparate range of abilities in: —Management Expertise and Depth —Marketing, Sales, and Reservation Support			• Consumer & Trade-Focused • Performance Focused • Brand Management • Quality Standards and Assurance • Multiple Technologies • Integrated Marketing and Technology Solutions • Customer Recognition and Loyalty Programs • Full-Service Provider —Purchasing, Technology —Recruitment, Training —Consultative & Design Services • Management Expertise and Depth	
Examples of Organizations, Brands, and Management Companies	ALHI David Green Helms Briscoe Hinton/Grusich Krisam	Utell Flag Int'l Lexington Pegasus/ Rezsolutions Supranational TRUST	Concorde Golden Tulip Historic Hotels Leading Hotels of the World Relais and Chateaux Small Luxury Hotels Sterling SRS Hotels Steigenberger	Preferred Hotels and Resorts Worldwide (for profit) Best Western (not for profit) Summit	Accor brands Bass brands Carlson brands Cendant brands Choice brands Four Seasons Hilton brands Hyatt Mandarin Marriott brands Starwood brands Wyndham
Relationship of Hotel Owner to Structure	Client	Client	Member (some are Owners)	Member-Owner	Licensee
Owner Control	High	High	High	High	Low
Room-Night Production	Low	Low	Low-Medium	High	High
Consumer Focus	Low	Low	Low	High	High
Overall Fees	Low	Low	Low	Low	High

distribution, global consumer brand awareness, and group purchasing benefits without the encumbrances and costs of a traditional hotel chain franchise or management contract. Above all, it promises the independent hotel awareness of, and access to, their target consumer and rapidly emerging technology through cooperative ownership.

Table 1.1 shows a summary of the key characteristics of the various marketing business structures and suggests examples of corresponding brands.

▶ THE BENEFITS OF A BRANDED DISTRIBUTION COMPANY

This new business structure is attractive from an owner's or a developer's standpoint for a number of reasons, including:

- **Costs:** First, it requires less up-front cash; second, ongoing fees and reservation commissions are significantly lower than with either a pure franchise or management agreement. For example, a 9 or 10 percent franchise fee in many cases equals 50 percent of gross profits.

- **Contract terms:** The terms are typically shorter, easier to negotiate, and allow for substantial owner control over the operation, style, and character of the hotel. As a result, conflicts can be avoided, and the branded distribution contract can be completed and signed in as few as 45 days.

- **Marketing:** It frees hotel management from the daunting and increasingly expensive task of acquiring profitable new customers and allows them to focus their attention and operating skills on the delivery of an exceptional hospitality experience.

- **Common objectives:** Both the owner and the branded distribution company enter into the agreement with the same primary objective: revenue. The branded distribution company receives no revenue if it does not deliver to the hotel or resort. This shared goal strengthens and energizes the relationship between the two partners.

From a branded distribution company's standpoint, this structure allows the brand to expand faster because capital is not used to subsidize additional construction or to support an older business model. Instead, funds are used to build and maintain an up-to-date global distribution network and infrastructure composed of telecommunications, e-commerce functions, reservations software, data warehousing capability, and sales and marketing. The efficiency of the operation is assured by a focus that is almost entirely on the most important part of this business relationship—the generation of brand awareness and measurable room-night revenue for each affiliated hotel or resort.

Unlike hard flags, which focus primarily on hotel operations and asset management such as the Marriott or the Westin, and reservation affiliations, which focus on professional camaraderie and traditional distribution channels such as the Best Western, the branded distribution company is primarily market-focused; its full attention is on customer and travel influencer communication, relationship technology, and revenue streams. (*Note:* Travel influencers are the intermediaries between consumers and the travel product and include travel agents, etc.)
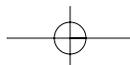
In contrast, asset management, profitability, and operating efficiency are the major concerns of management companies, which tend to be public companies with stockholder expectations that must be met. It is often the case that strategic asset management concerns conflict with day-to-day tactical operating needs. This is evident in Marriott's recent move to separate its ownership and operating divisions, to the benefit of both.

The same conflict can arise between the independent owners of a hotel property, who are focused on real estate concerns, and the management company they hire. Such misunderstandings can sour what should be a mutually supportive relationship. The fact that management contract fees are charged and collected, even when the cash flow is negative, does not create owner confidence in the partner. A franchise relationship can cause a similar conflict and put a financial and operating burden on an owner.

In contrast, participation of independent owner/operators as shareholders in a branded distribution company enables them to move beyond these concerns and focus on their operation and the consumer—the source of their revenue and the basis of their success.

▶ ARE THERE ANY DRAWBACKS TO A BRANDED DISTRIBUTION COMPANY?

The owners of property within a branded distribution company must relinquish a minimal amount of control and decision making, mainly in the areas of branding and quality assurance. In certain cases, member proper-ties may have to adopt and maintain specific quality standards. In addition, they may also be required to demonstrate their affiliation with the branded distribution company through using its logo on marketing materials as well as participating in e-commerce and inventory management initiatives.

However, these drawbacks can actually enhance a hotel's operations and market positioning while allowing the hotel to maintain independent ownership and management.

▶ ENSURING COMPETITIVE ADVANTAGE

Independent hotels face significant risk in today's marketplace. Given the advances in technology and the profitability pressures put upon chain hotels by shareholders, competition for customers is intensifying. Keeping in step with competitive chain hotels presents a significant challenge to independent owners. To address this, they currently have several options outside of the branded distribution company, including representation firms, reservations services, flagged chains, and franchise management companies. However, given the economic, societal, and technological trends that are dramatically changing the hospitality industry, several of which are analyzed in this book, many of these old-economy options can offer only short-term solutions to long-term competitive pressures.

A branded distribution company has an inherent advantage going into this new competitive arena. Its sole focus is on customer acquisition and management, achieved through the development of new technologies. This competitive advantage extends to the independent hotel aligned with a branded
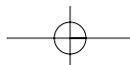
distribution company. By providing the independent owner with a global brand and the technology and expertise to acquire profitable new customers, the branded distribution company enables the hotel management to focus its attention on the delivery of exceptional service and profits to the owners. This separation of skills, expertise, resources, and operating cultures in a cooperative business relationship provides a model and formula for success.

Independent hotels and resorts that align themselves with a branded distribution company will not only continue to operate profitably in the new global marketplace, but will also flourish.

1.4 THE ART AND SCIENCE OF OPENING A HOTEL

Tom Dupar

If you ever have the chance to be involved with opening a hotel, jump at the opportunity. Opening a hotel is one of the most rewarding jobs in the hospitality industry despite its frustrating and exhausting aspects.

Walk into any hotel, anywhere, and look around. Everything you see, hear, and feel, every detail, involved many people and countless decisions. I have been an operations project manager (OPM) since 1989 and have opened over 40 three-, four- and five-star hotels around the world. From Guam to Malta, Berlin to St. Louis, each project has been unique, each project has been the same, and each has been professionally rewarding.

The OPM is the third person hired, after the general manager and the director of marketing. The role of an OPM is to pull together the visions of the architect, interior designer, owner, operator, and others. When these visions are successfully melded, the hotel guest is satisfied, the owner makes money, and the architect and interior designer can add the project to their list of successful accomplishments.

The OPM oversees the following aspects of a project:

- Reviewing blueprints and specifications for the entire building
- Assisting with the creation of a model room
- Developing the pre-opening staff plan
- Developing and managing the pre-opening budget
- Developing the operational supplies and equipment budget (OS&E)
- Overseeing the purchasing, warehousing, delivery, and installation of the OS&E
- Developing the interior graphics package
- Coordinating the installation of third-party vendors

▶ BLUEPRINTS

The OPM's responsibilities start with the architectural blueprints. The focus is to ensure a good flow for guests, staff, and goods.
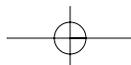
The bellperson bag storage room should be located between the porte cochere (entry) and the elevators and contain 1 square foot of space for each guest room.

If valet parking is offered, ensure that a convenient cashier's station is located near the porte cochere. Arrange for a key rack to hold the keys for each valet parking stall.

Given a 10,000-square-foot ballroom, the catering department can sell functions for 800+ for dinner. This requires 80 6-foot round tables, 800 chairs, a dais for the head table, a dance floor, and staging for the band. If sold for a 700-guest all-day meeting, the classroom setup requires 1,400 linear feet of narrow tables and 700 chairs. A short theater meeting setup for 1,000 requires 1,000 chairs, a podium, staging, and audio visual equipment. The same space accommodates a cocktail reception for 1,400 guests; this requires cocktail tables, portable bars, buffet stations, and so on. This all boils down to ensuring ample storage space for equipment not being used—at least 1,500 square feet.

Moving goods from the back of the house to the front requires careful planning to ensure that precious labor dollars are used efficiently. Are the rollaway beds, cribs, and high chairs stored near an elevator for quick delivery? The housekeeper closets should be centrally located on guest room floors to cut down on access time. A 6-foot, 2-cubic-yard garbage cart will not work if the elevator is only 5 feet deep.

If ice machines are offered for guest self-service, they must produce an ample supply (10 pounds per room per 24-hour period) for the number of guest rooms on that floor or floors. The ice machine room requires the proper utilities, including electricity, plumbing, lighting, and HVAC. Don't forget the sign on the outside of the room, which must meet ADA standards!

▶ MODEL ROOM

Build a typical king and double/double guest room close to the site so you can review every single item in them. Are ample electrical and telecom outlets placed exactly where the TV, lamps, clock radio, mini-bar, coffeemaker, hair dryer, Internet access, and telephones are located so the cords are hidden? Are spare outlets offered for guest use (computer, iron, etc.)? Is the closet rod hung so the ironing board organizer and iron board fit in the closet? Is the thermostat location convenient for guest access?

Are the case goods (dresser, nightstands, headboards, chairs, etc.), designed for commercial heavy-duty use? Will they hold up to abusive use? Do they have sharp corners that will snag guest clothing? Does the bedskirt hang ½ inch off the floor? Do the bedside lamps give off enough lumens so guests can read in bed? Does the room meet or exceed every operator brand standard?

These model rooms serve as sales tools for the sales and marketing staff selling group rooms up to three years before opening.

▶ PRE-OPENING STAFF PLAN

The pre-opening staffing begins with an organizational chart with all positions. Once the titles and staff counts by position are finalized, then spreadsheets are created to include the position titles, start dates, pay rates, bonus, transfer allowances, and number of full-time equivalents (FTEs) for all positions.
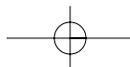
The pre-opening staff plan is a comprehensive document that states who is hired, when they start, how much they are paid, and whether or not they are allocated a relocation allowance and benefit costs. Each of these pieces is used to build the pre-opening staff plan budget. If hiring has already begun and the opening date changes, the budget must be amended. Hiring a position that does not conform to the plan, such as bringing on a renowned chef one month earlier than planned, also requires the budget be modified.

▶ PRE-OPENING BUDGET

The OPM develops and manages the pre-opening budget. This budget typically consists of three major categories; labor cost (40 percent), sales and marketing efforts (40 percent), and miscellaneous (20 percent).

The labor cost is taken directly from the pre-opening staff plan.

Sales and marketing activities comprise advertising, collateral, public relations, and travel to see clients.

Rounding out the budget are all of the miscellaneous items. These include office space rental before moving into the hotel, utilities (power, water, Internet, and telephone), human resources recruitment (ads, headhunters, drug testing, etc.), training materials, association dues, and licenses and permits (business, liquor, sales tax collection, etc.).

If the hotel opening date is delayed for any reason, the pre-opening budget is affected. Additional costs include labor, office rent, utilities, and marketing efforts. If the opening date changes within three weeks of the original plan, major costs are encountered, as most of the staff is already hired.

▶ OPERATIONAL SUPPLIES AND EQUIPMENT (OS&E)

The largest and most complex aspect of the OPM's responsibility is specifying, quantifying, and budgeting for the operational supplies and equipment (OS&E) list. This budget typically pencils out to $8,000 to $10,000 per guest room for a typical four-star property. The list of goods typically exceeds 2,500 line items. Add a little more for a full-service resort; deduct a little for an in-city business hotel.

The OS&E comprises all of the items that are not nailed down, with the exception of the furniture, fixtures, and equipment (FF&E). The FF&E is typically specified and ordered by the interior designer.

Typical guest room items include bedding (frames, box springs, mattresses, mattress pads, sheets, pillows, pillowcases, towels, etc.), clock radios, hangers, laundry bags, laundry tickets, iron, ironing board, ironing board organizer, luggage rack, guest amenities (soap, shampoo, lotion, etc.), hair dryer, shower curtains, and shower curtain hooks.

Housekeeping equipment includes vacuums (guest room and wide-area units), carpet shampooers, carpet extractors, housekeeper carts, laundry bins, garbage trucks, valet delivery carts, and shelving, to name a few of many items. Housekeeping must also keep an inventory of guest request items including humidifiers, dehumidifiers, cribs, high chairs, rollaway beds, bedboards, spare pillows, towels, amenities, refrigerators, laundry soap, and so on.

Food and beverage front-of-the-house items include flatware (knives, forks, and spoons), hollowware (serving trays, serving utensils, chafing dishes, sugar bowls and sauce
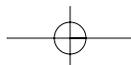
boats, punch bowls), glassware, table linen, napkins, skirting, salt and pepper shakers, china, plate covers, espresso machines, menu covers and the list goes on and on.

Banquet items include all of the above plus tables, chairs, staging, staging steps and railings, dance floors, carts, carving boards, ice carving trays, flags, podiums, portable bars, ice bins, pianos, and tray jack stands.

The largest purchase order—typically over 100 pages long—is for a full-service kitchen and includes everything a chef needs to produce the menus being sold at the hotel. Every utensil, pot, pan, dish, and glass rack, warewashing chemicals, mops and buckets, specialty items (roller-docker, anyone?) must be reviewed by the chef, purchased, and delivered the day before the chef starts burning in the kitchen.

On the hotel administration side, the OPM specifies the office desks, chairs, cork and dry-erase boards, conference tables, filing cabinets, safes, bullet-proof window for the general cashier's office, fax machines, copiers, currency and coin trays, and a set of flags for the exterior flagpoles.

One of the largest and most complicated purchase orders is for staff uniforms. My recent Kona, Hawaii, project uniform purchase order was 68 pages long. The invoices covered over 100 pages!

Before quantifying uniform needs, many questions are asked. Do we need summer and winter uniforms? Will the uniforms be laundered by the hotel or the hotel associates? How many extra servers are needed for a capacity dinner function in the ballrooms? Is the intent to have a large percentage of part-time staff? Which uniforms need custom embroidery (restaurants, culinary, engineering, etc.)? What percentage of spare uniforms are needed in reserve?

Once these questions are answered, then the selection process begins. Operations and the interior designer review the look and feel the options available. Each position (housekeeper, bellperson, etc.) or similar position (front desk clerk/concierge) has different requirements. Housekeepers and bellpersons require durable uniforms that breathe and can handle lots of bending and stretching. The uniforms of the culinary and engineering staffs are often stained and must hold up to numerous launderings.

The uniform order is placed 90 to 120 days *before the first uniformed staff is hired.* To quantify the sizes required, a typical bell chart sizing curve is used for the particular country or region of the hotel. The uniforms are delivered and sorted prior to the individual fitting process. On the line staff's second day on the job, each individual is measured for uniforms. An army of seamstresses then takes the pants, jackets, and dresses and alters each piece for each associate. The fitted uniforms are issued a few days before opening day.

► PURCHASING, WAREHOUSING, DELIVERY, AND INSTALLATION OF THE OS&E

In an ideal process, the 500 purchase orders are issued beginning six months prior to opening. Each order is tracked to ensure it is delivered to the proper location on the desired date. Most goods are delivered to a local warehouse and pulled for delivery to the site as the general contractor completes construc-

tion and turns over areas. Some goods are shipped directly to the site to eliminate double handling. These large orders include bed sets (21 40-foot shipping containers for the Kona project), televisions (3 containers), banquet chairs (2 containers), banquet tables (3 containers), and guest room safes (1 container). The linen order for guest rooms and F&B are shipped to an off-site laundry facility for initial washing.
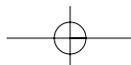
Once the goods are on site, they are typically staged in the largest ballroom for unpacking and distribution. The unpacking process requires a plethora of workers. For example, each clock radio must be unpacked, the electrical twist tie removed, the 9-volt battery installed, and the time set. Then the unit is placed in a guest room on the nightstand. For the 525-room Kona project, this task required two people for three eight-hour days. Once they completed this task, they spent the next five working days installing the 7,000+ shower curtain hooks, 525 shower curtains, and 525 shower liners. Then they unboxed 30,000 glasses and placed them in glass racks for washing. These kinds of tasks must be carried out for each of the 2,500 line items.

Once receiving and distribution begins on site, another element comes to the forefront: garbage. During the five-week Kona installation process, over 3 tons of packing material were generated *every day!* Making friends with the local waste-hauling service is a priority.

▶ INTERIOR GRAPHICS PACKAGE

The project manager reviews the interior graphics package for errors and omissions. This package includes every sign needed to direct guests and staff in front and back of the house areas. The recent Kona project included 1,600 signs, 98 percent of which were one of a kind. The text must be correct, the directional arrows must point the correct way, and most are required to include raised Braille text, per the ADA.

The OPM works with the marketing department to develop the identity for the unique areas within a property. These include the restaurants, bars, pools, spa, and retail areas. These logos are incorporated into the signage package, collateral (cocktail napkins, menus, check presenters, etc.), and uniforms.

▶ THIRD-PARTY VENDORS

Many third-party vendors must have access to the property prior to opening. The project manager schedules and directs all of these vendors, including the soft-drink vendor (who installs soda guns for the bars and vending machines for the guest floors), the coffee company (which must install and test equipment), the pay-per-view TV vendor (who must connect every television in the building and test the signal strength), the warewashing chemical vendor (who must install and calibrate the dishwashing machines), and the office furniture installer (who must assemble all office equipment). Among the other vendors are those dealing in copier services, postage machines, telephones, fitness center equipment, security systems, and first aid supplies.

These vendors are constantly informed when they can install their equipment based on the general contractor's completion dates. When the construction schedule changes, vendors must be updated so they show up when the area they need access to is ready.
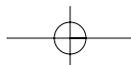
► HUMAN RESOURCES

The OPM assists the human resources personnel during the last two months of pre-opening so that they have all of the tools they need to recruit and hire the staff. On average, the HR department interviews at least five applicants for every position. This works out to over 1,000 applicants for a typical 300-room four-star hotel. This process is referred to as the *mass hire*.

The mass hire is typically conducted over a two- or three-day period six weeks before opening. To interview this many job seekers, HR requires office space, reception space for up to 200 at one time, rest rooms, and break rooms for the interviewers. The OPM coordinates all of these details so that the operations team can focus on the recruitment.

Once the offer letters are accepted, all line associates start work about three weeks out. The first few days on the job are dedicated to group training, operational philosophies, code of conduct, and other general policies. On day three, divisional training takes place. In the second week of training, the staff is broken out into departmental or job-specific duties.

Departmental training includes teaching staff to make beds, clean a room, cook every menu item, the most efficient route to each guest room, and what to tell the guest en route to the room.

► OPENING DAY

The activity during the last 72 hours before the opening ceremonies is chaotic. This is the time that all hands are on deck. Sixteen-hour days are the norm. Rooms are cleaned. Housekeeping closets are stocked. Liquor and food storerooms are filled. The general contractor completes all small details such as paint touch-ups. Artwork and furnishings are installed in the public areas. Rehearsals are conducted for all aspects of the operation, including serving test meals and cocktails, guest check-ins and check-outs, and even such easy-to-overlook activities as valet parking and vacuuming the pool.

As soon as the general manger cuts the ceremonial ribbon, the OPM knows what kind of job has been done. The next step is to find the next project and do it all again!

1.5 ON-LINE PRICING: AN ANALYSIS OF HOTEL COMPANY PRACTICES

Peter O'Connor

The importance of electronic hotel-distribution routes has grown substantially in recent years. According to statistics quoted in the Horwath Worldwide Hotel Industry Studies, direct reservations fell from approximately 39 percent in 1995 to 33 percent in 1999, with the shift in sales going almost exclusively to electronic channels (O'Connor, 2001, 70–93). While hotels continue to make extensive use of travel-agent-oriented global distribution systems (GDSs), consumer adoption of the Internet as a reliable and secure commerce
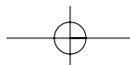
medium has prompted a change in the way in which hotel rooms are being distributed.

The Internet has dramatically changed the way people communicate, research information, and buy goods and services. Travel products in particular have proven to be suitable for sale on line. The typical Internet user—an affluent, frequent traveler who spends more than the average on leisure and entertainment—is an attractive market for travel suppliers (NFO Plog Research, 2000). Furthermore, from a consumer's perspective purchasing travel products on line has, in many instances, become faster, easier, and more convenient than contacting a travel agent or telephoning a supplier directly. As a result, on-line travel-related revenues are forecast to grow sharply. For example, according to a recent report by Jupiter Media Metrix, on-line travel sales will more than triple in the next five years—from US$18 billion in 2002 to US$64 billion in 2007 (Jupiter Media Metrix, 2001).

Booking volumes are also forecast to climb. The Travel Industry Association of America (TIAA) estimated that by the end of 2002 between 6 percent and 10 percent of all travel reservations would originate on the web (TIAA, 1998). If Jupiter's 2007 prediction comes true, travel will be the biggest selling on-line product, with a volume nearly double that of the current leading product, PC hardware (Forrester Research).

Price is key to selling successfully on line. Studies by Internet analysts Gomez and PhoCusWright, and also a study by TIAA, all identified price as being one of the key motivating factors that encourages consumers to purchase travel on line (Gomez.com, 2000; PhoCuSWright, 2001; TIAA, 2001). For example, the PhoCusWright study found that competitive pricing is the best way to attract customers (Pastore, 2001). When travelers who haven't bought on line were asked what would encourage them to do so, 64 percent said that saving money would make them more interested. No other benefit—whether saving time, getting bonus loyalty-club points, more control, or obtaining better information—came close to this level of response.

► HOTEL PRICING ON THE WEB

Yesawich, Pepperdine, and Brown found in a 2000 study that almost six out of ten leisure travelers now actively seek the "lowest possible price" for travel services (Yesawich, Pepperdine, and Brown, 2000). Similarly, a 2001 Forrester Research study found that 66 percent of all buyers had used an on-line discount in the previous 12 months to buy travel on line (Forrester Research, 2001), and a study by the Joint Hospitality Industry Congress found a real expectation among consumers that Internet prices would be lower than those available in the "bricks and mortar" world (Joint Hospitality Industry Congress, 2000).

Such a perception has developed for several reasons. First, many of the best-known Internet retailers (such as, for example, Amazon.com) initially competed with traditional outlets based, to a large extent, on price. Second, savvy consumers are aware that web-based distribution costs are lower than those of other channels (Nua, 1998). As Jack Geddes, Radisson Hotels Worldwide's managing director, sales and marketing Asia, has pointed out: "Consumers now understand that suppliers are cutting costs through this channel and expect savings to be passed on to them, as well as being rewarded for making the booking themselves" (Muqbil, 1998). Such expectations

are being reinforced by the budget-airline sector, which offers substantial discounts for on-line bookings. Companies such as EasyJet, RyanAir, and Buzz estimate that by avoiding telesales and travel agents, they can achieve savings of up to 30 percent—which they pass on to customers in the form of lower fares (Cooke, 2000). Similar or even greater levels of savings can be made by hotel companies, as can be seen from the internal Accor figures in Table 1.2, which show how an 80- to 90-percent savings in transaction charges can be achieved by selling directly to the consumer on line. Finally, many hotels (and airlines) use the web to sell last-minute deals—packages at relatively low prices but with short lead times. While such promotions can help dispose of unsold inventory, they have also resulted in the public's associating rooms sold over the Internet with lower prices.

These factors have combined to make consumers associate on-line booking with good value, which in the consumer's mind translates into low prices. However, in the case of hotel brands' own web sites, industry practice frequently seems to be the opposite of theory. In a 1999 survey, for instance, a colleague and I found that rates obtained from the web site were usually substantially higher than those obtained by contacting the central reservations office (O'Connor and Horan, 1999). That study was limited, however, in that it focused only on direct sales over hotel chains' own branded web sites. Electronic distribution is rapidly evolving for hotels, and a large number of other on-line consumer-focused channels are now available, with most chains using multiple routes to reach the consumer (Castleberry *et al.,* 1998, 19–24).

Table 1.2 Reservation Cost by Distribution Channel

Route	Transaction Fee						Total Cost
	Customer	Traditional travel agent	GDS	Switch	CRS	Hotel	
Traditional route		$5.90	$3.20	$0.20	$4.20		$13.50
	Customer	Online travel agent	GDS	Switch	CRS	Hotel	
Online intermediary route		$3.00	$3.20	$0.20	$4.20		$10.50
	Customer	Hotel company website				Hotel	
Direct online route		$1.50					$1.50

Source: Dresdner Kleinwort Benson/Accor, quoted in *Travel and Tourism Intelligence, The International Hotel Industry: Corporate Strategies and Global Opportunities* (London: Economic Intelligence Unit, 2001).
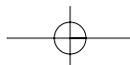
The availability of numerous points of sale poses some interesting questions. Foremost among these is: Is there consistency between the room availability and prices being offered over each of the channels? Unlike in the physical world, where a potential customer would have to telephone or visit several suppliers, comparison shopping on the web can generally be accomplished relatively quickly. Research has shown that consumers shopping for travel on line almost always check more than one site before purchasing. According to Jupiter Media Metrix (2001), just 10 percent of would-be guests visit only one site to book a hotel room, another 43 percent visit two or three sites, and 22 percent visit four or more sites. Because they check prices in several places, on-line purchasers have become increasingly intolerant of inconsistent information, and may react unfavorably to a firm's disparate rates by booking with the company's competitor. Two related questions, then, are:

1. If rates are not consistent across channels, is any one route consistently cheaper?

2. Is the company's approach to pricing logical from both the consumer's and the hotel's perspective?

In this paper, I seek to answer those questions.

▶ METHODOLOGY AND LIMITATIONS OF THE STUDY

Previous studies of hotels' Internet use have been limited. Murphy *et al.* (1996, 70–82) focused on rating the content of hotel web sites, while Van Hoof and Combrink (1998, 46–54) attempted to measure managers' perceptions of and attitudes toward the Internet. Web-reservations facilities were investigated in detail in the co-authored paper that I mentioned above (O'Connor and Horan, 1999). However, the issue of pricing over several distribution channels does not appear to have been the subject of extensive systematic research to date. The objective of this study, therefore, was to analyze the room rates being offered to consumers over multiple electronic distribution channels.

An exhaustive analysis of the rates being offered by all hotels would be virtually impossible. Those rates are constantly in flux, as hoteliers project occupancy rates and open or close rate classes accordingly (according to yield-management principles). I believe, however, that major international hotel chains' electronic-distribution activities are indicative of industry patterns, because recent research has shown that large companies are most active on the web—perhaps because their size often gives them an advantage in terms of technical expertise and financial resources. As a result, I decided to focus this study on the behavior of the top-50 international hotel brands. While this strategy means that the findings are not representative of the industry as a whole (and, therefore, not generally applicable), it does allow establishment of an accurate benchmark of trends as they currently stand. The companies were chosen based on the ranking of the top-50 hotel brands published in *Hotels* magazine in July 2000. Two of those companies (Disney and Club Med) were removed from the listing because they operate resorts and distribute their rooms largely as part of packages, which means that their products are not directly comparable to the rest of the industry. Furthermore, another three companies neither offered on-line reservations on their own web site nor were they listed on any of the other channels studied. Thus, the results

discussed below reflect the findings from the 45 hotel brands for which consistent data could be found.

Five major types of electronic business-to-consumer distribution channels were identified from the literature, and leading examples of each category were selected for inclusion in the study. In addition to a chain's own web site (e.g., www.marriott.com), these comprised channels that draw their data and reservations engine from the GDS (i.e., Expedia and Travelocity); those that are based on the databases and reservation engine of the switch companies (namely, Travelweb); and pure web-based channels with an inventory and reservations database that is maintained on line (i.e., WorldRes). While not collectively exhaustive, these represent the majority of hotel-reservation sites. Omitted from the study were the auction-style web sites, such as Priceline.com, which are not comparable to typical booking approaches.

As another point of comparison, I incorporated voice channels into the study by analyzing the rates offered by the toll-free number to the central reservations service (CRS). Data were collected by repeatedly offering to reserve a standard double room for specified dates in a selected property from each of the brands using each of the distribution channels discussed above. Where the product requested was available on the system, both the number of rates displayed and the lowest rate available were recorded for analysis. To help ensure consistency, I ignored rates not available to the general public (e.g., corporate, military, AARP, and AAA), and analyzed only those rates that could be booked by a "normal" customer. After checking the web sites, I telephoned the hotel company's CRS to request the same booking. In that case, I recorded only the first rate quoted

by the agent, and I did not ask for a lower rate (nor did I record any subsequent offers after I demurred from making a reservation). Although better rates could probably be achieved by haggling, I decided that negotiating would leave no systematic way of consistently determining the lowest rate, depending as it does on the caller's persistence. The above process was repeated for five sets of alternative dates to reduce the possibility of error due to system malfunctions or other exceptional circumstances.

▶ SUMMARY OF RESEARCH FINDINGS

As can be seen from Table 1.3, each of the major hotel brands uses multiple simultaneous distribution channels. The most commonly available channels were voice (via the company's CRS) and electronic (through the company's corporate web site). The company that did not make a CRS number available was in the economy sector. Offering hotel rooms via the company web site is almost universal, all but one of the brands surveyed offering on-line reservations in this manner. It is interesting to note that this represents a considerable advancement when compared to surveys made only a few years ago, which found that only approximately 50 percent of the major hotel companies provided on-line reservations (O'Connor and Horan; Hensdill, 1998).

As shown in Table 1.3, hotel companies make less use of the other channels investigated. Approximately four-fifths of the major brands used the GDS-based intermediaries Expedia and Travelocity, three-quarters used Travelweb, and barely one-third used World-
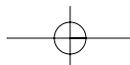
Table 1.3 Channels Used by Major Hotel Brands (*n* = 45)

Channel	Number (*n*)	Percentage
Hotel company website	444	97%
Expedia	38	84%
Travelocity.com	35	78%
Travelweb	34	76%
WorldRes	14	31%
Voice (CRS)	44	97%

Res. These findings are not in themselves surprising. Both Expedia and Travelocity draw their data from the GDSs, where the majority of the hotel brands represented in this study (being major hotel companies) can reasonably expect to be represented. Similarly, Travelweb draws its data from THISCO (The Hotel Industry Switching Company), and thus any of the hotel brands that use this as their switch service could be expected to make inventory available for sale via Travelweb.

I found the chains' low usage of World-Res surprising. With the exception of a company's own web site, using WorldRes has the lowest potential transaction cost and thus would appear to be an attractive channel for use by hotel companies. Examination of its property database reveals a large percentage of independent hotels, bed-and-breakfast inns, and small hotel chains. An unresolved question is why the major brands do not exploit this distribution channel.

▶ RATES AVAILABLE

Each of the electronic channels offered multiple rates. As can be seen from Table 1.4, each channel presented an average of five rates in response to the request, with more being offered to the customer by Travelocity than by the other channels surveyed.

Presenting a variety of rates to the customer has both positive and negative implications. From a positive perspective, it offers choices to potential customers, allowing them to match their needs with the products being sold. On the other hand, presenting a large number of rates without adequate differentiation between products can confuse customers regarding what they are getting for their money. This is best demonstrated by an example encountered in the study, where a property offered 17 different rates for a particular date on Travelweb, with few (if any) discernible differences in the room descriptions. Clearly such a scenario would be confusing and frustrating for any customer wishing to book that property.

Mean prices. It was difficult to make a general observation about which of the several channels is consistently least expensive on average, although Expedia's rates were marginally lower than those offered by other channels and WorldRes seemed to offer consistently higher rates than did the others (see Table 1.5). Indeed, all things considered, prices across each of the channels were comparable—with the average price for the
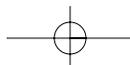
Table 1.4   Number of Rates Offered to the Customer

Channel	Mean	Standard Deviation
Hotel company website	4.27	3.6
Expedia	3.66	1.4
Travelocity.com	6.07	3.3
Travelweb	5.62	3.6
WorldRes	4.58	3.8
Voice (CRS)	1.00	—

requested room being in the range of US$163. It was interesting that Expedia's mean rates were lower, because as an on-line travel agency, it has a high distribution cost, and it would be logical to assume that rates offered over this channel would reflect the higher costs. By the same token, since WorldRes's transaction costs are relatively low in comparison with those offered by the other channels surveyed, hotels could potentially offer cheaper rates over this channel. In other words, what I found is that when selling hotel products on line, there does not appear to be a relationship between the cost of using the distribution channel and the rate offered. Illogically, the electronic channels with the highest transaction costs for the hotel seem to regularly offer the best value to the customer.

As will be discussed below, hoteliers need to rethink their current practices and take action if they are to benefit from the increasing market for on-line hotel-room sales.

Segment breakout. The foregoing discussion was based on an overall look at hotel-room sales distribution. If the brands studied are subdivided into classifications based on their targeted market segment, a different picture emerges. As can be seen from Table 1.6, hotels at the low end of the market are far more likely to offer consistent rates across all channels used. While it could be speculated that the reason for this might be that economy properties are more likely to have a single fixed price for their product irrespective of demand, it could also be due to a more consistent pricing strategy on the part of the ho-

Table 1.5   Average Rates Offered to the Customer

Channel	Mean	Standard Deviation
Hotel company website	$159	112
Expedia	$152	116
Travelocity.com	$166	134
Travelweb	$162	115
WorldRes	$181	168
Voice (CRS)	$163	117
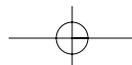
Table 1.6 Market Sector Analysis (Lowest Rates)

Channel	Percentage of cases where a channel offered the lowest rates			
	Economy	Midprice	Luxury	Chi-squared
All rates equal	46%	21%	28%	0.016*
Hotel company website	26%	47%	14%	0.036*
Expedia	14%	11%	41%	0.030*
Travelocity.com	3%	5%	7%	0.750
Travelweb	9%	5%	7%	0.900
WorldRes	0%	0%	0%	—
Voice (CRS)	3%	11%	3%	0.600

*Indicates that the association is significant at the 95-percent confidence level.

tel companies involved when addressing a relatively price-sensitive market. Furthermore it can be seen that consumers at the low ends of the market are far more likely to obtain low rates through direct (company-owned) channels. For economy brands, direct sales over the company's own web site were lowest 26 percent of the time. When coupled with the 46 percent of cases where the same rate is offered irrespective of the channel used, that means that a consumer reserving an economy room will find the cheapest rate on the hotel company's web site nearly three times out of four. With mid-price products, the chain's web site is even more likely to give the best rate, offering the lowest rate nearly half of the time.

The situation is different at the upper end of the market. Luxury-hotel companies' web sites gave the cheapest rate in less than 10 percent of cases. Furthermore, Table 1.7 shows that the company's web site quoted the highest rate in over one-third of cases. Overall, the evidence seems to indicate that if you want to stay in up-market hotels, you should avoid booking on these hotels' web sites if you are searching for good value. Instead, the on-line intermediaries (in particular, Expedia) offer the highest probability of finding the best rate available for high-end properties, with an average savings of 5 percent available by booking through Expedia rather than on the company's own site.

Haggling required. It is also clear from the data that a hotel company's CRS is not the place to obtain the best rates, at least if one takes the first offer as I did for this study. Irrespective of the market segment, there is a higher probability of being quoted the highest rate through this channel, and bookings through this route were almost never the cheapest available. This finding, however, is to a large extent driven by my methodology. Indeed, in many cases, as soon as I indicated that I did not plan to make a booking at the quoted rate, the CRS associate quoted another, lower rate. This anecdotal finding suggests that negotiation might have resulted in lower prices. (This is a longstanding CRS practice; see Lewis and Roan, 1986).
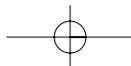
Table 1.7   Market Sector Analysis (Highest Rates)

Channel	Percentage of cases where a channel offered the highest rates			
	Economy	**Midprice**	**Luxury**	**Chi-squared**
All rates equal	46%	21%	28%	0.016*
Hotel company website	14%	16%	34%	0.011*
Expedia	0%	21%	7%	0.017*
Travelocity.com	3%	5%	10%	0.450
Travelweb	0%	0%	0%	—
WorldRes	6%	0%	0%	0.240
Voice (CRS)	31%	37%	21%	0.440

*Indicates that the association is significant at the 95-percent confidence level.

▶ DAWN OF A NEW WAY

From the above discussion, it can be seen that both the range of channels through which hotels can be booked and the complexity of such channels have grown. This study represents a first attempt at documenting hotel companies' pricing practices over electronic routes. The study revealed that the majority of hotel brands now use simultaneous, multiple electronic channels of distribution, making their rooms available to a relatively wide audience. While the use of CRS-based reservations has fallen slightly, there has been a growth in the availability of hotel companies' own web sites, and a vast majority of companies that I studied now make their rooms available for sale in this manner. The differences between this study's findings and earlier published research indicate a major expansion in hotel chains' use of the web as a direct-sales medium, perhaps accompanied by a realization of the web's benefits in comparison with other, more traditional, electronic channels of distribution.

Most companies offer multiple rates to customers over each channel. It is interesting to note, however, the large number of companies that now offer consistent pricing across all channels. Previous research found less than 10 percent of companies had consistent pricing and cited the lack of integration among the various inventory databases used to manage inventory as a possible cause. Yet over one-third of the brands I studied now offer consistent pricing across multiple channels, indicating progress in the industry's management of electronic distribution.

Although no single channel consistently offers the lowest prices, in-depth analysis does reveal a link between pricing and the market being targeted. First, the lowest prices can rarely be obtained from the CRS (absent negotiation), irrespective of market segment. As compared to the first-offered CRS price, a would-be customer can save at least 5 percent by booking over any of the electronic channels I examined. From the data it can be seen that consumers are more likely to find the lowest prices on the hotel chains' own web sites in the economy and mid-price segments than will be found from those companies'
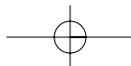
CRS or third-party web sites. So-called up-market hotel brands are, on the other hand, more likely to quote higher prices on their own web site than what they offer on other channels. Economy brands seem to be the only ones in the industry as a whole displaying a logical on-line pricing strategy (in terms of the relationship between the cost of using a channel and the rates offered there) and also in terms of actively managing their channels of distribution.

Implications. First, it is clear that for those with a taste for upscale products, the hotel brand's own web site is not the place to shop, as better value can be obtained in most cases through other channels. More interesting, however, is the fact that, in general, prices have become more or less equal across many of the channels investigated, and by implication, across many other electronic distribution channels as well. It is well established that time is a valuable commodity in today's society. Since the number and variety of ways that a consumer can book a hotel room has become undeniably manifold, the cost associated with searching through even a small number of the many consumer-focused channels currently available in the marketplace in an attempt to find a low price has increased. Given that this study has found that many of the rates being offered over alternative channels are more or less the same for many hotels, customers should reconsider whether all that time and energy searching for the lowest rate is actually worthwhile.

The implications for the hotelier are more pressing. My findings suggest that many hotel chains are not actively managing the room rates being offered in their portfolio of electronic distribution channels. Most companies offer multiple rates on each channel, which, as discussed earlier, can be beneficial as it gives a choice to the customer. Displaying too many rates, though, can be counterproductive, if the customer becomes overwhelmed. Presenting a small number of tightly defined rates would be the most appropriate solution. However, most companies currently display about five rates in response to a customer inquiry, with others showing significantly more, usually with little or no apparent product differentiation. In addition, there appears to be inconsistency in terms of the rates being offered over electronic channels. In many cases, no clear or logical pricing strategy is apparent. The lowest prices are offered on channels with the highest transaction costs, and vice versa. A small number of companies offer consistent pricing irrespective of the channel being used to make the booking. Informal follow up with those companies revealed that they follow this strategy as they believe in the principle of one "correct" price for each customer. In this way, they do not have to address the issue of customer dissatisfaction as a result of a person's being quoted a lower price for a room on a different channel after having already made a booking. However, such an approach ignores the issue of the cost of processing a booking over a particular channel. As was discussed earlier, such costs vary greatly depending to a large extent on the number of intermediaries between the supplier and the customer. The greater the number of intermediaries, the greater the transaction cost and processing fees—and therefore the greater the distribution cost. This would seem to argue for having high rates on the channels that have high-cost structures and low prices on those with low-cost structures. Coupled with this matter is the fact that customers have become more knowledgeable about and comfortable with e-commerce issues in general, are more aware that distribution costs are lower in the virtual world than the bricks-and-mortar one, and
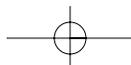
thus increasingly expect to find the cheapest prices over electronic, and particularly direct electronic, routes. Put simply, when they go to a hotel company's web site, they expect to find the best value there. This study has shown that in many cases this is simply not the case, given that luxury hotels in particular tend to offer their highest rates over direct channels—and (ironically) their cheapest rates over the most expensive on-line intermediaries. Informal follow up to the study revealed that this may be due to the proactive approach of the on-line companies in contacting hotel companies on practically a daily basis and encouraging them to reduce their rates in return for better positioning on their search listings. In contrast, the rates on hotel companies' web sites go largely unmanaged, in many cases being set far in advance and not adjusted to reflect changing supply and demand.

Irrespective of its root cause, the behavior of hotel companies is driving Internet shoppers into the arms of the waiting on-line intermediaries, where in addition to consistently low prices, they also find wide product choice. Because of this, it's likely that many hotels are losing potential bookings to competitors as a result of consumers' migration toward the on-line travel sites that offer relatively low rates from many different hotel chains. Instead of being presented with a list of a chain's properties on a company's web site, prospective guests see a much wider variety of options from the on-line intermediary and may be tempted to book a competitor's room (especially if price becomes an issue). Once consumers conclude that they will usually find better prices on a third-party channel, they will make Expedia or Travelocity, for example, their first port of call for future bookings—threatening brand loyalty, driving up transaction fees, increasing reservation leakage, and strengthening the third parties' power to demand "special rates" or commission overrides for a company to gain premium positioning (or even inclusion) in their search listings. Hotel companies need to take urgent action if they are not to lose control over the sale of their own product. At the very least, this means offering consistent prices over all channels, but more probably means providing customers the lowest rate over their own web site. This would decrease guests' motivation to book on alternative electronic channels, would help build web-site traffic, and should help to decrease distribution costs.

1.6 CUSTOMER RELATIONSHIP MANAGEMENT—A DRIVER FOR CHANGE IN THE STRUCTURE OF THE U.S. LODGING INDUSTRY

Gabriele Piccoli, Peter O'Connor, Claudio Capaccioli, and Roy Alvarez

Note: Over the past two years, we have engaged in significant formal and informal discussion with senior executives from top hotel chains, management companies, and ownership groups. The propositions presented here are the fruit of these discussions as well as in-

depth case studies of two of the largest U.S.–based hotel chains.
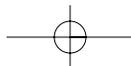
Customer Relationship Management (CRM)—a managerial philosophy that enables a firm to become intimately familiar with its customers—is currently gaining widespread popularity in many industries. Firms that embrace CRM strive to provide consistent and personal customer service over time and across multiple touch points. At first glance, the lodging sector, with its emphasis on customer service and multiplicity of customer touch points, seems ideally positioned to take advantage of CRM initiatives. We believe, however, that the current structure of the lodging industry gives rise to a "data-ownership dilemma," which appears to be limiting the adoption of a comprehensive CRM approach.[10] The three parties typically involved in running a hotel—the owner, the management company, and the brand (*Brand* refers to the franchiser that flags a given property (e.g., Hilton, Marriott, Six Continents)—have partially misaligned interests and, as a result, often resist sharing customer data, a prerequisite for successful CRM. (The recent slew of lawsuits between brands and ownership groups that allege data misuse confirms the often conflicted relationship between the entities; see Billing, 2002, for example.)

This paper highlights the data-ownership dilemma and outlines several possible future scenarios leading to its resolution. The first section introduces the CRM concept and discusses the potential benefits and risks it engenders. The second section examines the current structure of the U.S. lodging industry and outlines the complementary role of the three major industry players—owners, management companies, and brands. The following section demonstrates why the current structure of the lodging industry creates a barrier to successful CRM adoption by hotel companies. The effect of the "data-ownership dilemma" is discussed. The final section of the article presents alternative scenarios as to how the dilemma may be resolved.

► CUSTOMER RELATIONSHIP MANAGEMENT

Customer Relationship Management (CRM) is currently one of the hottest topics in the fields of business strategy, information technology, and marketing management (Hall, 2001, 24–27). Put simply, CRM is a management philosophy that calls for the reconfiguration of the firm's activities around the customer. CRM differs from traditional marketing initiatives (see Table 1.8) in that, while the latter take predominately a short-term, transaction approach, CRM focuses on maximizing revenue from each customer over the lifetime of the relationship by getting to know each one intimately (Wilson, Daniel, and McDonald, 2002, 193–219). CRM is also, by definition, a crossfunctional philosophy that calls for substantial business integration (Markus, 2000). Thus, to implement CRM successfully, a very different mindset is needed: The firm no longer markets to customers, but it fosters a relationship with them through programs that span marketing, operations, information systems, accounting, and other organizational functions.

One of the questions most often asked about CRM is, "why bother?" Changing an organization's philosophy and methods of operation is troublesome; developing and maintaining in-depth customer databases is expensive and the benefits of the approach are not guaranteed. Day, Dean, and Reynolds neatly summarize the benefits of using CRM
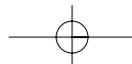
Table 1.8   Traditional Marketing Versus CRM Approach

Traditional Marketing		Customer Relationship Management
Transaction focus	←——————→	Customer focus
Short-term focus	←——————→	Lifetime focus
One transaction	←——————→	Multiple transactions
Broadcast approach	←——————→	Sniper approach
One-way, one-time communications	←——————→	Two-way, continuous dialog
Segment of many	←——————→	Segment of one

(Day, Dean and Reynolds, 1998, 828–837) First, by developing a closer relationship with customers, the firm may gain a competitive advantage and, through increased switching costs, may be able to defend it. Over time individual customers typically educate a company about their individual needs, wants, and preferences—a costly process that they are reluctant to repeat with a rival (Peppers and Rodgers, 1994, 6). Thus, getting to know customers intimately creates a barrier to imitation of the leader's strategy.

Second, effective CRM can lead to increased customer satisfaction. Properly implemented, the customer-company dialogue facilitates the tailoring of products and services closely to individual needs, and the development of new products and services to meet changing needs or even anticipate future needs (Palmer, 1994).

Third, using CRM techniques contributes to decreasing overall marketing expenditure. Acquiring new customers is estimated to be more expensive than keeping existing ones (Blattberg and Deighton, 1996, 136–144). Figures of between five and seven times as much have been quoted (Kotler, 1997). And, last,

developing a closer relationship with customers is thought to increase customer loyalty, and loyal customers are thought to stay with the firm longer, buy more from it, and buy more often (Dowling, 2002, 87–104). An oft-quoted statistic is that companies can improve profitability by between 25 and 85 percent by reducing customer defections by 5 percent (Reichheld and Sassre, 1990, 301–307). While the value of loyalty is currently being debated (Reinartz and Kumar, 2002, 4–12), for some time now lodging firms have been fostering loyalty through frequent-traveler programs and CRM may be seen as the logical next step.

The above arguments offered by CRM proponents suggest that CRM leads to higher profitability due to increased sales, declining customer acquisition costs, and increasing profitability of customers willing to pay a premium for "better" service. Figure 1.1 presents a graphical representation of how CRM is thought to work. The top row of effects leads to building relationships with customers and thus establishing customer loyalty. The bottom row lists well-accepted outcomes of data-mining activities. Together those two sets of

Figure 1.1	**CRM Model**

Loyal customers

CRM program

Customer
database

Data mining

- Better responsiveness to
customer needs
- Increased customer
satisfaction

Relationship

- Increased ARPU*
- Stronger brand attitude
- Less price sensitivity
- Reduced customer churning

Cross-selling

- Increased ARPU*

Better target marketing

- Cost reductions
- More-targeted communications

Market research

- New customer insights
- Early warning system

*ARPU=average revenue per user

outcomes have stimulated many companies to invest in creating a database-driven CRM system (Dowling, 2002).

Some authors warn that substantial investments in CRM are not right for everyone (Gronroos, 1990, 3–11). In a small or niche business, for example, it is relatively easy to keep in touch with customers' preferences. But because of the significant increase in the amount of information that must be managed as the firm's scale and scope increase, successful CRM requires significant investments in technology, process redesign, and people. An airline or a major international hotel chain must manage substantially larger amounts of data than does a small inn to achieve a similar relationship with its customers. However, information technology (IT)—used appropriately—can help mitigate the problem. Between 1990 and today, the world has seen enormous transformations in the extent to which organizations can deploy computer power. IT allows customer data to be collected, consolidated, manipulated, and analyzed on an unprecedented scale, and IT has been identified by many authors as one of the key success factors for CRM implementation (Hall, 2001). IT allows increased reach into new markets without high incremental entry costs, and facilitates specifically tailored customer marketing and increased responsiveness (Gamble, Stone, and Woodcock, 1999).

The role of IT in CRM efforts is so important that some writers (such as Copulshy and Wolf, 1990, 16–20), and many practicing managers and vendors, associate CRM with the technology that is used to support the approach. Many use the term in the highly specific sense of database marketing, where a range of demographic, lifestyle, and purchasing activities are recorded and tracked, and subsequently used as the basis of targeting
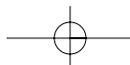
differentiated products to selected customer groups. In turn, their response to each marketing contact is tracked and used to further refine the approach. However, CRM is a broader concept than just technology. For example, CRM has been defined as "an enterprise-wide commitment to identify your named, individual customers and create a relationship between your company and these customers so long as that relationship is mutually beneficial" (Gamble *et al.,* 1999). This definition highlights several key CRM concepts—that the company will actively seek out the right customers (and, by implication, will not target those that will not do business with them), will develop a long-term, mutually beneficial relationship with each customer by starting and maintaining a two-way dialogue, will strive to satisfy customers' needs and solve customer problems, and will support customers throughout the life cycle of their interactions with the firm (Piccoli, Spalding, and Ives, 2001, 38–45).

This approach to CRM demands more than computer systems and information technology. The customer must become the focal point of the organization. All members of the organization must understand and support the shared values required for CRM, its philosophy must encompass not just marketing but the entire organization, and it must be used to manage all aspects of the customer relationship in a coordinated way.

Although limited research about the effectiveness of CRM has been published to date, most observers agree that successful CRM is predicated on the ability to effectively capture exhaustive data about existing and potential customers, profile them accurately, identify their individual needs and idiosyncratic expectations, and generate actionable customer knowledge that can be distributed for ad-hoc use at each point of contact (Newell, 2000). The objective is to achieve a comprehensive view of customers, and be able to consistently anticipate and react to their needs with targeted and effective activities at every customer touch point. CRM requires the firm to keep track of the information produced through each interaction so that it can "learn" on a continuous basis, get to know each guest better, and enrich its database of individual customer knowledge (Marsan, 2000, 91–94). Godin has likened CRM to "dating a customer," in that it is a long-term process that requires an investment of time, information, and resources by both parties (Godin, 1999). The result is an active, participatory, and interactive relationship between customer and supplier. Lastly, CRM is about customization, or the ability to consistently treat different customers differently (Newell, 2000). Relationships differ as they develop. We do not treat old friends in the same way as new friends or good friends in the same way as casual acquaintances (Gamble *et al.,* 1999). Such consistent personalized interaction requires integration and synchronization of many organizational functions, from marketing to accounting to operations and information systems. Failure to understand the scope, essence, and magnitude of CRM is likely to result in problems, rather than its promised benefits.

▶ THE POTENTIAL OF CRM IN THE LODGING INDUSTRY

Lodging-industry participants face an increasingly competitive market (Vialle, 1995). In addition, the basis of competition is changing.
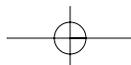
Location, a key driver of business, is fixed in the short and medium term, and attracting and retaining customers based on facilities and amenities is becoming increasingly difficult as they have become increasingly standardized across competing brands. Price competition is unattractive, even more so as consumers are able to easily find and compare prices over the Internet (O'Connor, 2002, 285–293). As a consequence consumers are increasingly displaying less brand loyalty (Gamble *et al.,* 1999), and CRM is becoming increasingly attractive as a way for hotel companies to differentiate themselves from their competitors (Francese and Renaghan, 1990, 60–63).

The lodging sector is ideally suited to applying the principles of CRM. In few other industries is there such potential to build up a comprehensive and accurate picture of the client. In few other industries do customers provide the significant amount of information hotel guests divulge when making a reservation and during their hotel stay. Every interaction between the guest and the customer is an opportunity to refine knowledge about her or him and to further build a relationship. By methodically collecting, consolidating, and analyzing both guest preferences and transactional data, hotel chains have the potential to develop a deep understanding of each customer's needs and preferences, provide substantially improved service levels, individually tailor the customer experience, and generally offer more personalized service. Providing outstanding personal service is certainly not a new concept in the hotel sector. Companies such as Ritz-Carlton and the Savoy group historically maintained extensive manual guest-history systems recording guest preferences in an effort to better serve their best customers. However, when oper-

ated manually, such systems are expensive to maintain, are frequently inaccurate, and can only be used to track a limited number of clients at individual properties (Main and O'Connor, 1998, 7–15). Developments in information and communications technologies have enabled automation and efficiencies in these processes, reducing costs, increasing accuracy, and allowing comprehensive knowledge about each customer to be shared on a global basis. As a result, many companies are turning to technology to improve customer service by implementing large-scale CRM programs.

Analysis of the lodging sector shows that, driven in most cases by pressure from the marketing function, many of the dominant hotel chains are in the process of deploying (or have already deployed) the technological infrastructure to support CRM. A recent study by Arthur Andersen and New York University found that over one-third of U.S. hotel chains had a data warehouse in 2000, with another 50 percent planning to install one in the near future (*Hospitality 2000,* 8). Many chains have introduced information systems to improve the targeting of marketing and sales efforts. Such systems can help the firm to assess the value of each customer as well as their propensity to respond to various offers, and to market to them individually.

As discussed earlier, while important, such initiatives do not imply that the company has adopted CRM. In most cases, such developments focus solely on marketing objectives and lack the integration among functional areas that characterizes a CRM initiative. Only where the company reconfigures its operations to deliver a comprehensive view of the customer and to support consistent, highly personalized service at every customer touch point could it truly be regarded as CRM. Few
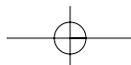
companies in the lodging sector appear to have progressed to such an advanced stage.

Given the geographic dispersion of hotel properties and the role of brands in marketing and distribution, large-scale CRM initiatives seem most justifiable at the brand level. Implementing CRM at this level would help to increase consistency and personal service throughout the chain and at each customer touch point. However, to achieve this, consistent and comprehensive information must be captured from all properties within the brand and then consolidated, analyzed, interpreted, and subsequently disseminated to each property in time to influence the next customer interaction.

Two barriers currently prevent that from happening—a lack of standardization and IT-system integration within each franchise, and the fact that at any one time there may be up to three parties holding a stake in the operations of a particular property (owner, management company, and brand). The two issues are largely interconnected as the industry's generally reactive attitude toward IT has been exacerbated by its structural characteristics. The technical challenge is subsiding due to recent developments in technology, including the emergence of the application service provider (ASP) model. (*Note:* When software applications are delivered using an ASP model, they are not installed on the computers at the property. Rather, they are accessed by remote users via the Web. Thus, IT resources under the ASP model are not bought but acquired as a service.) A discussion of these technologies is beyond the scope of this article. Note, however, that, even assuming away technological challenges, we believe that the structure of the lodging industry creates severe obstacles to successful CRM. The remainder of the paper focuses on these challenges.

▶ THE LODGING INDUSTRY'S STRUCTURE

Lodging is an important component of the tourism industry, providing accommodation (and associated ancillary services) to travelers while away from home. Lodging operations are diverse, ranging from small bed-and-breakfast properties in rural locations to large hotels with several thousand rooms in major cities. Table 1.9 provides an overview of geographical dispersion, showing that the majority of the world's hotel properties are concentrated in Europe (55 percent) and North America (22 percent). The exhibit also demonstrates that the average property size in North America is larger than that in Europe (56 versus 28 rooms), with chain-affiliated properties being more common in North America. Despite controlling only a minority of room stock (approximately 30 percent of total room supply) hotel chains dominate the lodging sector (Corporate 300, 1998, 51–77) and tend to exert a disproportionate influence on industry operations and performance (Cline and Rach, 1997, 35).

In addition to generally having higher occupancy and average daily rate (Worldwide Hotel Industry Study, 1998), chain properties tend to be more profitable, delivering trading profit per room seven times more than their independent counterparts (Slattery, 1992, 90–102). As a result, the industry is expected to continue to consolidate, with an increasing number of mergers and acquisitions resulting in a small number of large companies dominating the marketplace (Corporate 300, 1998).

A differentiation must be made between hotel ownership, hotel branding, and hotel operations. Historical developments with

Table 1.9   The International Hotel Industry

	Total Revenue (10⁹) US$	Number of Hotels	Percentage of Total Hotels	Total Number of Rooms	Average Size of Hotel (Rooms)
Africa	6.3	10,769	3.5	343,347	32
Caribbean	7.9	5,290	1.7	155,253	29
Central America	1.2	1,160	0.3	41,221	35
North America	62.1	66,943	21.7	3,738,977	56
South America	9.8	14,576	4.7	487,787	33
Northeast Asia	23.7	10,192	3.3	719,480	71
Southeast Asia	12.8	13,211	4.3	453,657	34
South Asia	3.1	3,663	1.1	159,417	44
Australia and Pacific Islands	6.6	10,082	3.2	229,319	23
Middle East	9.2	4,735	1.5	162,178	34
European Economic Area	87.5	151.945	49.4	4,242,193	28
Other Europe	22.5	19,178	6.2	676,631	35
Total	*247.8*	*307,683*	*100**	*11,333,199*	*37*

Source: World Travel and Tourism Council 1995
*Total does not add up to 100 due to rounding.

Real Estate Investment Trusts (REITs) in the United States gave rise to a situation where many owners could not operate their own hotels. Instead they must use a separate management company to oversee day-to-day operations (*The International Hotel Industry,* 2001, 85), resulting in a split between hotel ownership and hotel operations. The situation is further complicated by the widespread use of both franchises and marketing agreements that provide a consumer brand and require compliance with brand standards (Singh, 1997, 89–107).

At any one time there may be up to three parties holding a stake in the operations of a particular property: (1) the owner, who holds title to the assets, is responsible for mortgage payments and provides the capital for the operation; (2) the brand, which brands the property and provides standards, distribution services, marketing, technology, and other services; and (3) the management company, which provides management talent and operates the property on a day-to-day basis. Table 1.10 demonstrates how, with the exception of Wyndham International, the major brand companies own less than one-third of their branded properties, with various management companies operating the remainder on behalf of their owners. Furthermore, as Table 1.11 shows, within each management company the brand portfolio is quite mixed, with each company operating under a variety of competing flags in different geographical markets. The data lend support to our claim that in the U.S. lodging industry there are multiple stakeholders with, at times competing, interest in the operations of the property. In the remainder of
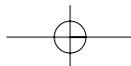
Table 1.10 Portfolio Composition of Major U.S. Brands[1]

Parent Company	U.S. Brands	Total Properties	Company Owned	Franchised, Licensed	Management Contract
Cendant Corp.	Days Inns	1,943	0	1,943	0
	Ramada	1,005	0	1,005	0
	Super 8	1,933	0	1,933	0
	Howard Johnson	425	0	425	0
	Travelodge	475	0	475	0
	Knights Inn	226	0	226	0
	Villager Lodge	118	0	118	0
	Total	*6,125*	*0*	*6,125*	*0*
Six Continents	Holiday Inn Hotels	1,056	5	1,004	47
	Holiday Inn Express	1,083	0	1,078	5
	Crowne Plaza	77	6	51	20
	Total	*2,216*	*11*	*2,133*	*72*
			3%	*98.6%*	*1.2%*
Hilton Hotels Corp.	Hampton Inns	1,094	1	1,081	27
	Hilton Inns/Hotels	230	40	171	15
	Doubletree	153	10	49	59
	Embassy Suites	155	6	75	57
	Homewood Suites	89	14	59	16
	Total	*1,721*	*71*	*1,435*	*174*
			4.4%	*81.3%*	*9.8%*
Marriott International	Marriott Hotels	277	4	39	234
	Courtyard	493	1	236	256
	Fairfield Inn	464	0	412	52
	Residence Inn	362	0	242	116
	Renaissance	53	0	22	31
	Total	*1,649*	*5*	*951*	*689*
			.5%	*60.8%*	*38.5%*
Starwood Hotels and Resorts Worldwide	Sheraton	189	40	105	44
	Westin	57	22	10	25
	Four Points	105	6	84	15
	Total	*351*	*68*	*199*	*84*
			18.9%	*58.8%*	*16.7%*
Hyatt Hotels Corp.[2]	Hyatt Hotels and Resorts	120	18–36	4	80–98
	Total		*15–30%*	*3%*	*67–82%*
Wyndham International	Wyndham Hotels and Resorts	114	81	13	20
	Wyndham Luxury Resorts	6	3	0	3
	Summerfield Suites by Wyndham	38	27	11	0
	Total	*158*	*111*	*24*	*23*
			70.2%	*15.2%*	*14.6%*

[1]Adapted from: The Brand Report, *Lodging Hospitality,* August 2000.
[2]Hyatt Hotels Corp. is privately owned, and a precise classification of ownership is not available.
Range estimates were provided directly by company representatives.
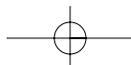
Table 1.11 Portfolio Composition of Major U.S. Management Companies

Management Company
Meristar Hospitality Corp. and Felcor Lodging Trust

Parent	U.S. Brands	Number of Properties
Six Continents	Holiday Inn and Crowne Plaza	21
Hilton	Embassy Suites	6
	Hilton Inns/Hotels	35
	Hampton Inns	6
	Doubletree	9
	Homewood Suites	6
Marriott	Courtyard	9
	Fairfield Inn	2
	Marriott Hotels	5
	Residence Inn	2
	Renaissance	0
Starwood	Sheraton	16
	Westin	3
Wyndham	Wyndham	4
Others	Multiple Brands	59
	Total	*183*

Management Company
Lodgian, Inc.

Parent	U.S. Brands	Number of Properties
Six Continents	Holiday Inn and Crowne Plaza	62
Hilton	Hilton Inns/Hotels	4
	Hampton Inns	2
	Doubletree	1
Marriott	Courtyard	8
	Fairfield Inn	5
	Marriott Hotels	1
	Residence Inn	2
Starwood	Four Points	3
Others	Multiple Brands	21
	Total	*109*

Management Company
Interstate Hotels Corp.

Parent	U.S. Brands	Number of Properties
Six Continents	Holiday Inn and Crowne Plaza	8
Hilton	Embassy Suites	1
	Hilton Inns/Hotels	4
	Hampton Inns	38
	Doubletree	0
	Homewood Suites	5
Marriott	Courtyard	10
	Fairfield Inn	6
	Marriott Hotels	14
	Residence Inn	13
	Renaissance	2
Starwood	Sheraton	2
	Westin	1
	Total	*138*

Management Company
Tharaldson Property Management, Inc.

Parent	U.S. Brands	Number of Properties
Six Continents	Holiday Inn and Crowne Plaza	16
Hilton	Hampton Inns	7
	Homewood Suites	36
Marriott	Courtyard	18
	Fairfield Inn	113
	Residence Inn	32
Others	Multiple Brands	112
	Total	*334*

the article we demonstrate how the structure of the industry can provide significant obstacles to the success of CRM initiatives.

▶ THE DATA-OWNERSHIP DILEMMA

As was discussed earlier, CRM's success is predicated on the ability to collect, analyze, and disseminate large amounts of timely and relevant information for customer-service operatives to act on to improve the experience at each point of customer contact. Thus, a CRM initiative cannot be successful without commitment among a critical mass of properties. Hotel chains cannot provide a consistently high level of personal service unless customer data can be garnered from most, if not all, of the affiliated properties, organized and synthesized in one central location, and subsequently redistributed to each property on an as-needed basis. However, we propose that (technological constraints aside) this apparently simple theoretical proposition is difficult to realize in the lodging industry due to an inherent data-ownership conflict between the major industry stakeholders. In the following sections we present the main issues facing the brand, the management company, and the owner.

The Brand. For brands, the development of an effective CRM initiative is deemed an important competitive move as it would facilitate the development of a deep understanding of customer needs and preferences, potentially resulting in a high level of personalization, thus helping to improve service levels across the brand as a whole. As a result guests would have a strong incentive to remain loyal to the brand and patronize affili-ated properties, thus increasing the value proposition for owners and operators through improvements in financial performance.

For the promised benefits of CRM to materialize, standardized information systems must be implemented throughout the franchise network to allow data to be obtained from all branded properties—a problem in the past, becoming less important as a result of recent technology improvements. Furthermore, the brand must be willing to share the customer knowledge generated by the consolidation of customer data chain-wide with the individuals that can take action based on it at each point of customer contact. Such data sharing presents the first dilemma. In some cases, the brand may be reticent to disseminate customer knowledge back to the property for fear that owners or operators might use it to poach high-value customers and divert them to competing brands within their own portfolios. For example, imagine a management company that operates a hotel flying one flag (Brand A) in a particular market, and a competing flag (Brand B) in others. This company might be tempted to steer high-value customers toward its Brand B hotels in markets where it does not operate Brand A hotels. Thus, Brand A is faced with a decision—either share the data it collects companywide to reap the benefits of large-scale CRM and risk the poaching of high-value customers by some of its partner management companies operating individual properties; or protect its customer knowledge from the interests of multi-flag owners and operators, thus forgoing the full benefits of CRM.

The Management Company. Management companies do not appear to have strong incentives to develop a CRM initiative for themselves. As was shown in Table 1.11, such companies tend to operate a varied
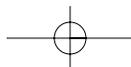
portfolio of properties, each flying different flags, on behalf of different owners. By definition a CRM initiative developed across flags is unlikely to generate brand loyalty and thus is of limited interest to most management companies.

The question arises, however, as to whether management companies should actively cooperate with the collection of operational guest data by brand-level CRM initiatives. As most companies operate a varied portfolio of flags, if the management company participates in a brand-based CRM initiative, it will stand to gain only in those properties that carry that particular brand. Conversely, participation will result in a competitive disadvantage in markets where it competes against the brand. As a result, management companies have little incentive to support brand-level CRM initiatives by contributing data about customers that stay at its properties. In fact, by doing so, they would in effect be undermining their own operations in markets where the brand operating the CRM initiative is a competitor rather than an ally. Moreover, while the management company may not be interested in detailed customer data for branding purposes, it certainly finds value in customer data that allows it to create customer-value models and better target high-value prospects, particularly with respect to group business. Consequently, management companies have in effect an incentive to limit data disclosure and not cooperate with brand-level CRM initiatives.

The Owner. While owners, like operators, typically have many flags in their portfolio of properties, they have a different focus in terms of profitability. Many primarily view hotel ownership as a real-estate investment, and have a marginal interest in the question, "Who owns the data?" Where their properties fly the flag of a successful CRM initiative, they may have an advantage over other competing properties; where their properties fly competing flags, they may be at a disadvantage. Thus, the same dilemma facing the management company seems to affect the owners—whether to participate in brand-level CRM initiatives, or to refuse to cooperate with the collection and consolidation of customer data. The owners may also have interests that go beyond the use of the data strictly for operational purposes. Customer data may be used by the other entities (the brand and the management company) for marketing purposes and analyses that run counter to the owner's own interests (e.g., studying the feasibility of building new properties in the same geographical area).

▶ CONCLUSIONS AND IMPLICATIONS

In this paper we have drawn attention to what we term the "data-ownership dilemma"—the inherent conflict that various entities in the lodging industry face as they embrace CRM. We propose that the data-ownership dilemma represents a significant, yet often unrecognized, challenge to the success of CRM initiatives. As was discussed, CRM strategies appear most applicable at the brand level, but their success is dependent on the active cooperation of both the operator and the owner of each property. For CRM to succeed at the brand level, operators must supply the brand with in-depth customer data—a requirement with which operators in particular, and owners to a lesser extent, have little incentive to comply. Brands also face challenges in terms of maintaining control over the resulting

customer knowledge and preventing its spread outside the brand network.

Because of this conflict, we believe that CRM in the lodging industry may never progress beyond its current, relatively limited, level of sophistication. While database-marketing techniques will continue to be used, we propose that few hotel companies will successfully implement large-scale, chain-wide, CRM initiatives. Only if significant change occurs in the structure or methods of operation of the sector are the full benefits of a CRM approach likely to be realized.

In closing, we speculate as to what changes will have to occur for successful implementation of CRM initiatives. We see three possible scenarios: there will be a fundamental change in the way in which hotel brands are organized; a change in the nature of franchise agreements and management contracts; or there will be more cooperation among brands to take advantage of CRM's promised benefits. These three scenarios are further developed in the remainder of this article.

The first scenario is that the need for adoption of a CRM approach will induce changes in the ownership and management structure of the lodging sector. If CRM truly provides compelling benefits, the large brands should begin to pressure the management companies and franchisees within their network to provide the data needed for successful CRM operations. Those brands that manage a relatively large number of their own hotels will be in a good position to take advantage of these initiatives quickly, should face little resistance as a result of the data-ownership dilemma, and should be able to easily reap the benefits of CRM. Wyndham International's ByRequest initiative demonstrates that highly integrated lodging brands

are moving quickly to embrace CRM (see sidebar). If these pioneers are successful in their effort and are able to attract and retain high-value customers, competing brands will have to follow suit and develop similar CRM capabilities. Such companies would have to resolve the data-ownership dilemma either by "integrating down" or by restricting the number of flags that the companies operating their hotels can fly. Integrating down implies that brands would move aggressively to take over the operational management of their branded properties. Such integrated companies should be able to standardize the IT infrastructure needed to support CRM, mandate the collection and consolidation of customer data, and provide each property with dynamic access to the central knowledge repository. Since all operations would effectively be managed by the brand, there would be no conflicts of interest and no danger of high-value customers being poached, freeing the brand to take full advantage of the CRM initiative.

Obviously, taking over operational control of their unit properties would be a dramatic and high-risk strategy. Thus, brands, particularly in the short term, may instead concentrate on restructuring their management and franchise agreements to minimize the barriers to success discussed earlier. Redevelopment should focus on two main areas—data collection and data use. While many franchise agreements require properties to feed its customer-folio data back to the central level, few specifically mention any other data collected about the guest. As CRM is dependent on building up a holistic picture of the guest's needs and behavior, this oversight may force brands to restructure contracts to force greater compliance with data needs. Such restructured contracts could spec-
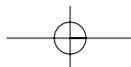
A CRM EXEMPLAR: WYNDHAM INTERNATIONAL

*A*s part of our research, we investigated the CRM initiatives of large hotel chains. One such chain, Wyndham International, has made CRM a cornerstone of its brand strategy. We briefly describe the key characteristics of Wyndham's CRM approach to aid the reader in understanding the principal characteristics of large-scale CRM initiatives.

Wyndham International is one of the five largest U.S.–based hotel chains, with a portfolio of over 160 branded properties. After converting from paired-share REIT status to a C corporation in 1999, Wyndham revised its corporate strategy in an effort to become a "world-class branded hotel operating company."[1] Wyndham's differentiation strategy is nicely captured in the words of Andrew Jordan, Wyndham's senior vice president of marketing: "We said, okay, we are going to reinvent the Wyndham brand. We are going to say: We are all about personalized service. We are going to say: We are the brand who really recognizes that guests are individuals, we know you have specific needs, quirks—you tell us about them one time and we are going to remember them."[2]

The cornerstone of Wyndham's strategy is its membership-based CRM initiative: Wyndham ByRequest. When a guest joins ByRequest, he or she completes a comprehensive profile including general and contact information, room preferences (e.g., room location, needed extra items, newspaper), credit card and express check-in/check-out preferences, airline frequent-flyer preferences, personal interests (e.g., activities, music, readings, spectator sports), and complimentary beverages and snacks (e.g., preferred wine, soft drinks, juice, snacks).

The above information is compiled at Wyndham's headquarters and a pledge is made to the guest that, irrespective of which property in the Wyndham chain the guest travels to in the future, he or she can expect a consistent level of personalized service. This includes a room that is located where desired and fitted with the required amenities, a welcome snack and drink that's of the guest's liking, and information that suits the traveler's interests (e.g., reading material, information about shows or sporting events).

Key to the initiative's success is the realization that, while important, the technology underlying Wyndham ByRequest—including the website, the preferences databases, and integrated operational systems (e.g., PMS)—does not in and of itself deliver the ByRequest promise. As a result, Wyndham has designated staff members to support ByRequest and created a property-level position—the Wyndham ByRequest manager—who has responsibility over property-level execution, and Wyndham has developed integrated processes for delivering the ByRequest promise.

[1]"Letter to Shareholders," Wyndham International 2000 Annual Report, 2001.

[2]For complete information about Wyndham ByRequest, see G. Piccoli and L. Applegate, "Wyndham International: Fostering High-Touch with High-Tech," Harvard Business School Case Study, 2003; # 9-803-092.
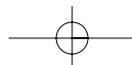
ify that all customer data generated at the property level be extracted and loaded to the brand's central data repository. Management contracts also need to be rewritten to offer protection to the brand as it disseminates customer knowledge back to the property level. Both of these measures mean that ties between brands and operators would be strengthened, which may ultimately result in further industry consolidation as owners and operators feel pressure to fly a limited number of flags. In an extreme scenario, each operator would effectively become aligned with one brand and fly only one flag.

The final potential scenario we envision is the emergence of an industry consortium that both develops and maintains the CRM infrastructure and standardizes customer-data collection and distribution. As it has happened historically with hotel e-commerce systems such as THISCo (The Hotel Industry Switching Company), HDS (Hotel Distribution Systems) and Avendra (an e-procurement marketplace), competing brands could cooperate to develop the standards and the infrastructure necessary to capture, store, organize, and distribute customer information. Such a scenario is attractive as joint development would mean that the infrastructure could be delivered and operated at a fraction of the cost of proprietary initiatives. Thereafter, rather than being used as a basis of competition, customer data would be shared and companies would compete on the analysis, interpretation, and use of such data. For example, competing brands could use the same data to market to their chosen customer bases. Competitive advantage would come from how well they could use the data to identify, target, and build a relationship with each individual.

We believe the latter scenario to be the least likely, even though it may optimize industry-wide performance. The likelihood of an industry consortium developing and managing customer information for the benefit of the industry as a whole is small, as the industry's belief in the proprietary value of customer data, the industry's structure, privacy issues, as well as a culture that precludes trust in this domain makes the cooperation necessary unlikely. We see a change in contractual agreements and in industry structure as far more probable. In any case, given the potential proposed for lodging-industry companies, careful consideration must be given to the data-ownership dilemma to avoid failure.

1.7 SPAS AND THE LODGING INDUSTRY

Peter C. Anderson

► OVERVIEW

Spas are becoming such a significant component of the service menu for resorts and full-service hotels that their absence, especially in amenity-rich resort environments, is glaringly obvious. Within the leisure industries in 2003, revenues related to spas ranked number four behind golf fees and dues ($19.7 million), cruise line revenues ($14.7 million), and health club revenues ($14.1 million). At $11.2 million, spa revenues outpaced amusement
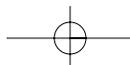
park revenues ($10.3 million), box office receipts ($9.5 million), and vacation ownership sales ($5.5 million) (Thacker, 2004; Audi and Wright, 2004). In this section, we first examine trends that support a sea change in North Americans' attitude toward spa use. After evaluating spa demand demographics, we discuss the types of spas currently popular in the industry, development and operational considerations, the components of a spa experience, compensation issues, and trends in the spa industry.

▶ SPA DEMAND

According to the International SPA Association research, between 2002 and 2003, 11 percent of the national population over the age of 16 made one or more spa visits. This statistic shows that one in ten Americans visited a spa during that period. Additionally, of these, 41 percent were visiting spas for the first time, indicating a larger population embracing spa usage. Age demographics show that 14 percent of clients are between the ages of 16 and 24, and over 50 percent are in the 25 to 44 age bracket.

An emerging national statistic is the number of male visits to spas. Twenty-three percent of spa visits and 29 percent of spa goers were men in 2003, trending toward special gender-oriented treatments and male-only spas being opened worldwide.

Spa selection criteria are determined by a number of factors. An established and known environment—for instance, as a part of an established resort, club, or destination spa—often influences the decision, as does atmosphere, quality of treatment, and friendliness of staff. Additionally, among spa goers, nine out of ten respondents report they would return for a similar experience.

Most spa customers believe they received good value for their spa dollar. On a 10-point scale, services were given an average of 8 for value, with massage generating 8.8 on the value-for-service scale.

Spa services demonstrated the highest and heaviest demand on weekends, followed by appointments after work on weekdays. Gender demographics also play a role in spa demand, as men are more likely to go for regular weekly visits after business hours or while traveling on business. Women, however, often visit spas during regular business hours (Thacker, 2004; Audi and Wright, 2004).

The International Hotel Resort Spa Association (IHRSA) reports that branded resort spas such as Canyon Ranch are opening in the day spa market, adding new competitive pressure on the independents. Nontraditional players are also adding product supply. For example, corporations are creating in-house spa environments, hospitals are adding wellness as part of their repertoire, and medi-spas, with a primary focus on cosmetic surgery, are adding spa business as an additional profit center. Health clubs are also trying to capture a piece of the pie by adding spa practices. The rationale in this market is that time-crunched patrons can benefit from the one-stop-shopping approach to fitness and wellness, but the health club operator also uses the spa as an enticement to join the fitness center.

As the day and destination spa markets become saturated, it will become imperative for survival that each operator differentiate from the competition. The necessity for market segmentation to ensure clear communication with consumers will be a key to success in the maturing spa market. Another component of success will be a branding strategy that the
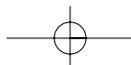
consumer can immediately identify with respect to spa performance and the consumer's personal comfort level.

▶ HEALTH ISSUES AND SPA DEMAND

Increasingly, spa goers are looking to create prolonged wellness that integrates and renews body, mind, and spirit. To that end, Eastern and Western lifestyle issues related to medicine, philosophy, and spirituality are becoming a mainstay of many spa/wellness experiences. To best deliver this, the wellness spa (located at day, destination, or resort environments) supports guest needs by creating an experience, not just a series of treatments. All the guest amenities, facilities, treatments, and programs must be seamlessly integrated into a personally tailored guest experience. These experiences should be targeted toward couples, parents with children, and teenagers. In the early 1990s, spas were considered a natural outgrowth of fitness facilities and focused primarily on treatments related to body wellness. As market sophistication evolved, the body-mind connection attracted consumer focus. In the beginning of the twenty-first century, spas and marketers are overtly addressing body, mind, and spirit connections in order to respond to emerging market sensibilities. Among the components one might find in a modern spa are services related to:

- Complementary and alternative medicine in mainstream lifestyles
- Traditional Western medical and Eastern lifestyle/wellness practices
- A proactive approach to overall health and the quality of one's life

Body

- Action spas are attracting a greater percentage of men who are looking for a way to unwind and keep active. Because of this trend, an aggressive array of activities—including cardio-circuit courses, squash, racketball and tennis, free and fixed weights, jogging, and bike paths, hikes, and water spots—is still a basic spa/wellness requirement.

- As part of the wellness experience, medical affiliations are sometimes available to provide information and to check blood pressure, heart conditions, bone density, and so on.

- Exceptional food can be tailored to virtually any dietary restriction or request.

- When examining which body treatments to include, note that salt glows and exfoliant treatments are approximately four times more popular than any other body treatment. These items are a mainstay in successful spa services.

- Guests must be able to upgrade their experience with add-ons such as eye-firming therapies and mineral-enhanced hydrotherapy soaks. Further, it is important to sell services in several time blocks so guests can select services that fit their schedule and financial budget.

Body, Mind

- Educational programs at many levels include classes and clinics. These programs personally empower the guest, expand the wellness center's demand base, and encourage repeat visits. Health and wellness issues encompass cardiovascular health, holistic childrearing, the integration of Eastern and Western medical practices, indigenous spiritual practices, aging, inti-

macy, transition/death, vitality, strength training, cooking programs (macrobiotic, vegan, vegetarian, indigenous), women's issues, and so on. Traditionally, educational programs at spas have focused primarily on personal health issues.
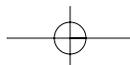
- Mind-body techniques may include spiritual and cultural instruction. Examples include tai chi, visualization, progressive muscle relaxation and biofeedback, labyrinth walking, meditating and chanting, sweat lodges, and storytelling.

- Extensive yoga programs should include Hatha yoga for body control, Ashtanga yoga for cardio workout, Iyengar yoga for balance and alignment, and Kundalini yoga for breath work.

Body, Mind, Spirit

- Comprehensive touch/alternative manual therapies including chiropractic treatment and deep tissue massage (rolfing, myofascial release, nueromuscular massage, acupressure/shiatsu, watsu, Trager massage, etc.) are a necessary component of any wellness clinic. This modality is an extension of the basic massage offered at all spas and wellness/healing centers. Practitioners who provide manual therapies should be cross-trained in the areas of subtle energy work such as reiki, chakra balancing, and chi gung. Offering alternative touch/energy therapy as a component of traditional massage has the potential to accelerate market acceptance.

- Ayurvedic treatments are popular and provide an additional link between the East-meets-West philosophy showcased in many day spas. Elements of ayurvedic treatments can be incorporated into most touch therapies.

As far back as 1993, a well-known study by David Eisenberg revealed that one-third of all patients had visited a practitioner of alternative health care in the past year, at a cost of $13.7 billion. This indicated to the medical community that the significant out-of-pocket expenses implied not only lost revenues to traditional (allopathic) doctors but also a broad dissatisfaction with mainstream medicine. A great number of people were taking the issues of health and well-being into their own control, thus setting the stage for the popularity of proactive wellness programs.

In 1997, Eisenberg updated his study. He estimated the total number of visits to alternative medical providers at 600 million, representing an expenditure of over $27.1 billion. The number of visits to alternative care physicians in 1997 was greater than the total number of visits to traditional primary care physicians in the same year. The increasing popularity of alternative wellness modalities, the aging of the population, and the strength of the economy are all factors that support the growth of this trend. As of this writing, it appears to continue to grow.

The use of at least 1 of 16 (alternative) therapies during the previous year increased from 33.8 percent in 1990 to 42.1 percent in 1997. The fastest-growing therapies were herbal medicine, message, megavitamins, self-help groups, folk remedies, energy healing, and homeopathy. The probability of users visiting an alternative medicine practitioner increased from 36.3 percent to 46.3 percent. In both 1990 and 1997, alternative therapies were used most frequently for chronic conditions, especially back problems, anxiety, depression, and headaches. In general, it can be concluded that alternative medicine expenditure increased substantially between 1990 and 1997, and this can be attributed primarily to

Table 1.12 Most Frequently Reported Principal Medical Conditions

Ailment	Alternative Therapy	
	Primary	Secondary
Back problems	Chiropractic	Massage
Allergies	Herbal	Relaxation
Fatigue	Relaxation	Massage
Arthritis	Relaxation	Chiropractic
Headaches	Relaxation	Chiropractic
Neck problems	Chiropractic	Massage
High blood pressure	Megavitamins	Relaxation
Sprains or strains	Chiropractic	Relaxation
Insomnia	Relaxation	Herbal
Lung problems	Relaxation	Spiritual healing/herbal
Skin problems	Imagery	Energy healing
Digestive problems	Relaxation	Herbal
Depression	Relaxation	Spiritual healing
Anxiety	Relaxation	Spiritual healing

an increase in the proportion of the population seeking alternative therapies rather than increased visits per patient.

The most frequently reported principal medical conditions for which alternative therapies were sought are summarized in Table 1.12.

▶ SPA CLASSIFICATION

Spa development and its attendant popularity have deep historical roots and vast potential for the hospitality industry. The term *spa* was once reserved for European destination resorts where guests went to "take the waters" and restore a healthy and balanced life. However, the term now is used to describe many types of facilities and amenities in the U.S. lodging industry. At one end of the spa spectrum are dedicated destination resort spas aimed primarily at those seeking a specialized combination regime of health, fitness, and pampering. Modalities and treatments include massages, unique treatments, custom dietary plans, lectures, and adventures that can include, but are not limited to, an array of activities ranging from nonsurgical facelifts to helicopter skiing.

Destination resorts, such as Miraval's Life-in-Balance and Canyon Ranch, with locations in the Berkshires in Massachusetts and the Arizona desert, draw demand because of their facilities and reputation. The primary reason for going to a destination resort spa is to enjoy the spa itself and its related activities. The destination itself is a demand generator.

Closely related to a destination resort spa is the amenity spa. Amenity spas provide
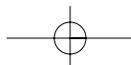
services to resorts and full-service hotels. The primary difference between an amenity spa and a destination spa is the scope and depth of spa services. Amenity spas, while sometimes quite extensive, *support* the resort environment, whereas destination spas are the *focus* of the resort environment. In situations where a full-service, high-end hotel is located in an urban environment and has a significantly large spa component, the spa can operate as both an amenity spa (to the hotel) and a day spa (to the local community). Later in this chapter, we study the case of the Westin Los Angeles Century City's 35,000-square-foot Spa Mystique. This spa supports the needs of the hotel's convention and individual travelers while experiencing heavy local day spa use.

Middle-market hotel properties now feel obliged to add a spa as an amenity; however, due to capital and real estate restraints, often they cannot provide a full-service location. As a result, this sector has seen an explosion in poorly conceived and executed spa additions that provide the owner the opportunity to add ". . . and spa" at the end of the business name. These are often no more than the result of subcontracting a massage therapist and converting the guest room closest to the swimming pool into an exercise room. These spas seldom surprise and delight their guests and often reflect poorly on the spa industry overall. Fortunately, the sophistication of the industry is making it harder and harder for the ". . . and spas" to succeed.

As the spa industry matures, certain development trends are emerging. In 2005, the spa industry was considered the fastest-growing segment of the travel, hospitality, and leisure market, showing 26 percent growth from 2002 to 2004. Spas are no longer considered a niche industry but rather an entity unto themselves.

The spa industry is made up of the following segments, each with its own characteristics and operational opportunities:

- Destination spas
- Resort hotel spas
- Day spas
- Medical spas
- Mineral springs
- Club spas

▶ Destination Spas

A destination spa is one whose sole purpose is to provide programs and facilities that support lifestyle improvements and enhance guest health. The services offered are professionally administered and include fitness, education, and lectures on lifestyle, nutrition, and disease prevention. Because of their healthful orientation, destination spas often provide programs that support postoperative conditions, address various addictions, and provide tools to cope with serious, prolonged illness.

The destination spa industry constitutes only 1.6 percent of the total spa industry, per the International Spa Association's Industry Study (Thacker, 2004). However, the growth in the development and use of destination spas reflects the market's trend toward wellness and health as a major component in spa menus.

▶ Resort Spas/Amenity Spas

Resort spas are located on the grounds of vacation resorts where treatments for mind, body, and spirit are offered to complement
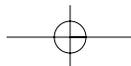
other resort activities such as golf, tennis, horseback riding, skiing, and water sports. Healthful spa cuisine is on the menu as an option, complementing traditional offerings. In the evenings, guests can enjoy resort pastimes like dancing and live entertainment. Children's programs are also offered. According to the ISPA Spa Industry Study (Thacker, 2004), the resort spa represents 14 percent of spa locations in North America but accounts for almost 41 percent of the total industry revenue, 27 percent of all spa visits, and 26 percent of the industry's employees.

A luxury resort spa has the ambience of a secluded retreat on the grounds of a first-class resort. Set in beautiful surroundings, these resorts commonly have world-class golf courses and other excellent recreational facilities. Gourmet dining and exceptional spa therapies are not only expected but demanded.

▶ Day Spas

Day spas are designed to provide a healing, beautifying, or pampering experience in a short period. Guests may book individual treatments that last as little as an hour or a package of treatments that take up to a whole day. Found throughout North America, day spas are freestanding or located in health clubs, hotels, and department stores. The day spa industry constitutes 72.2 percent of the total industry revenues, per the International Spa Association's 2004 Spa Industry Study. The large percentage of day spas and their growth pattern reflect spa goers' time crunch. Day spas can be owner-operated or chain-affiliated.

Preliminary data from ISPA's 2004 survey show that industry growth is still robust. As of midyear 2004, there was a total of 12,000 spas nationally, of which 8,700 were day spas. These numbers reflect 25 percent growth in the industry in general and 20 percent growth exclusively in this market. The total number of day spa visits in 2003 was 81.2 million. However, only 13 percent of the general population had used a spa in the prior three-year period, indicating that the industry still has large growth potential.

▶ Medical Spas

Medical treatments in various spa environments represent a significant trend in the scope, depth, and inclusiveness of numerous spas. Medical spa treatments can range from elective, reconstructive surgery to noninvasive Eastern modalities incorporating elements of Eastern philosophy that draw on the body-mind-spirit connection to create positive, measurable changes in the client/patient. Slightly over half (51 percent) of the medical spas in North America have a partnership with a medical doctor, and 26 percent have a doctor on staff. The remaining configurations include being located in a doctor's office or having licensed staff members. Botox and microdermabrasion are the two most popular treatments, followed by chemical peels and laser hair removal.

In North America, allopathic or Western medical procedures found in medical spas often incorporate Eastern-based treatments. Day, destination, and resort/amenity spas are adding medical treatments to their spa menus. Part of this trend is directly attributed to market demand, and part is attributed to health insurance plans that reimburse for some procedures. According to the ISPA 2004 survey, medical spas are the fastest-growing spa segment with respect to number of locations. The
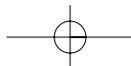
average annual growth in medical spas by location since 1999 is approximately 45 percent. Cumulative growth from 1999 to 2004 is 205 percent and from 2002 to 2004, 109 percent. Medical spas generated an estimated 1,900,000 visits in 2003, representing 1.39 percent of the total spa visits. However, this percentage of visits accounts for approximately 2.1 percent of the total industry revenues, reflecting the lucrative nature of this segment of the industry.

▶ Mineral Springs Spas

Many mineral springs spas are considered to be the original spa prototype, where guests go to "take the waters." Mineral springs spas, by definition, are located at naturally occurring mineral springs, and by number of locations represent 2.8 percent of the total spa industry, or 1.3 percent of the total industry revenues, making this one of the more modest income-producing segments of the spa industry. The popularity of mineral springs spas is reflected in a cumulative growth from 1999 to 2004 of 143 percent. Growth from 2002 to 2004 represents only 15 percent, implying that the number of sites available directly affects the growth in this segment.

▶ Club Spas

Club spas lack a lodging component, and their primary objective is to facilitate daily fitness activities. Many club spas' services complement the primary fitness component of the club by offering sports massage (deep tissue), chiropractic services, physiotherapy, and related treatments that address issues of pain management, flexibility, and mobility. By lo-cation, club spas represent 5.8 percent of the total spa industry in North America and account for approximately 3.7 percent of the industry's revenues. Growth in the club spa portion of the spa industry is the lowest of all spa segments. Between 2002 and 2004, cumulative club spa growth was only 3 percent.

▶ SPA OPERATIONS

▶ Spas as an Operating Department

Historically, spa operations were treated by management similarly to other revenue departments, like catering and restaurants. These departments were simply perceived as an amenity needed to attract guests to the hotel. As long as the department broke even, or didn't lose too much money, their ability to increase occupancy was deemed sufficient justification for their existence. However, in the late 1990s, hotel spas followed the path of other operating departments and transformed from support facilities to profit centers. This trend is strong and continues today.

In 1999, PKF Consulting identified only 30 hotels in the United States, thousands that report data to the PKF, extensive spa facilities and analyzed the financial performance of those properties and their spa departments. Dedicated destination spa resorts were not included in the analysis due to an insufficient sample.

While spas were a relatively small source of revenues for the sample properties, spa revenues grew at a relatively strong pace. In 1999, spa revenues for the subject sample represented just 3.3 percent of total sales. However, from 1998 to 1999, spa revenues grew
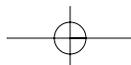
16.6 percent. This compares to revenue growth rates of 5.2 percent for rooms, 12.2 percent for food, and 3.2 percent for telecommunications, and a 0.3 percent decline in revenues for the beverage department.

During 1999, the spa departments in the sample of hotels averaged a departmental profit margin of 30.7 percent. However, spa department profits did grow a strong 51.3 percent from 1998 to 1999.

Spas mirror and enhance trends in the lodging industry. Drawing heavily from residential design and the use of technology, hotel designers and operators create a spa experience that:

- Complements the lodging experience
- Drives occupancy levels
- Enhances average daily rate
- Provides a distinctive marketing advantage

North American spas are rapidly becoming more segmented, pursuing market niches well outside the traditional ladies-who-lunch demographic. Adventure spas, fitness spas, children spas, family spas, and even pet spas are part of a new generation of spa facilities, spa programs—and, most importantly, spa aficionados. Spas now attract a much wider demographic that includes men, women, couples, children, teenagers, and families.

Since the early part of the twenty-first century, spas have been redirecting their menus to include stress relief and results-oriented therapies. By focusing on the social benefits of hanging out in a safe, relaxing place, they not only address current market needs but also support the development of spa programs that can be incorporated into virtually any leisure-oriented environment or level of lodging. In particular, destination spas and full-service resorts provide platforms that have both the infrastructure and the economies of scale to support cutting-edge spa treatments, sometimes also referred to as *spa modalities*.

Spas are no longer solely about frivolous self-indulgence and luxurious pampering. They are being reevaluated and repackaged with a broader emphasis on self-care, stress relief, emotional balancing, and preventative (as opposed to reactive) wellness modalities. This trend is being embraced by aging baby boomers as an adjunct to traditional health care. Because of this trend in health care, hotels and resorts have acknowledged and embraced the need for full-service spas as part of their amenities and facilities. The inclusion of a well-integrated spa can provide additional (and lucrative) sales and marketing opportunities. Conversely, the exclusion of a spa facility may disqualify a property from consideration. Ironically, many hotel guests may dismiss a property out of hand for lacking a spa not because they require the services of a spa but rather because its absence may imply other areas of the hotel are also deficient in meeting current market expectations.

Is it logical, then, that all full-service hotels and resorts without a spa should, without hesitation, incorporate one into their property? Clearly not. Numerous factors must be considered in developing or repositioning a spa, especially in chain environments where the lodging brand is already established. Because spas are capital- and labor-intensive, they must materially enhance the property's revenue stream to be considered viable. In addition to creating spa revenue, a spa facility also must extend length of stay, drive room rates, enhance shoulder and low-season demand, augment food and beverage revenues, and capture new market segments.

Successful spa operations start with a standardized level of procedures and a prioritized sensitivity to guest needs. As it is for all departments in a lodging environment (or business models in the freestanding day and medical spa world), profitability is essential. Especially in a spa environment, a dynamic balance is essential to meet the fiscal requirements of the owners and the physical needs of the guest.

A savvy spa manager continually monitors the spa and hotel operations to ensure that everything possible is being done to enhance the synergy of the two entities. Constant monitoring also provides an early warning system to the spa operator if revenues are falling or if expenses are not in line with anticipated revenues or budgeted amounts. Spotting these trends early enables the manager to take efficient, proactive steps to ensure that positive trends are enhanced and negative ones controlled. Constant monitoring sets a standard of operations, which is an excellent way to train and motivate employees. It also puts employees on notice that the spa is a well-run business with extensive attention to detail, which should discourage any actions that might not be in the best interest of the spa's reputation and profitability.

▶ Customer Service Training

A spa's reputation is easily made or destroyed by its level of customer service. Guests can forgive an occasional shortcoming if the level of service is exceptional. For this reason, it is essential that all spas have an integrated quality management program that provides ongoing training to assist its employees in addressing customers' expectations. Customer service training (CST) helps ensure that guests' expectations are exceeded. In a spa environment, expectations are usually very high, and a trusting bond can be quickly established if the spa employees are sensitive to guest needs.

The guest's arrival sequence, starting at the front desk, initiates the spa ritual that brings the spa guest to a place of trust, relaxation, and rejuvenation. CST is proactive and provides employees with the tools they need to meet or exceed guest expectations. Guest CST is a never-ending, all-inclusive process that bridges textbook training scenarios with operational realities. The traditionally high turnover of spa employees in the hospitality industry requires that CST be introduced as a part of the orientation process and reinforced regularly.

Nonproductive training time (time that does not directly produce revenue for the spa) is actually a minor expense when compared to the expenses related to employee turnover, poor service, dissatisfied customers, and, ultimately, loss of business and reputation. Budgets must include CST as a nonoptional employee expense. For long-term success, CST is vital when margins are tight, business is slow, and turnover is high. There is a strong correlation between high employee turnover and low CST. Employees should know that the training program is an investment in them.

CST gives the employee the means to understand what is expected of them as a representative of the establishment and identifies what guests expect from their visit. Seeing the process from the guest's point of view helps employees meet or exceed expectations. This minimizes the need to provide discounts or compensation in cases of service delivery problems. Discounting or "comping" goods and services is a knee-jerk response to poor

service and should be reserved for the last effort in service recovery; CST should stress this.

An inclusive training program is the engine behind stellar customer service and guest loyalty. CST should be seamless; while it predominately addresses the needs of the guest, the program also includes instruction on profitability and yield management, thus addressing the needs of the owner as well. In order to meet or exceed profitability goals, customer service must be delivered in a fiscally responsible manner. Employees must understand customer service in the operational context of the property in which they are employed.

Minimizing the expense of a CST program starts with the proper selection of employees. While there is no steadfast guarantee that a potential employee will work out over the long haul, first impressions, prior work experience, references, and, above all, attitude and enthusiasm are indications of whether or not it is appropriate to hire and invest the time and money in an applicant.

Management's expectations of guest service delivery should be clearly articulated and integrated into the corporate culture and reinforced daily at all levels and in all departments. Employees, no matter what their responsibility, position, or tenure, must be treated with the same level of respect and dignity that management requires for their guests. Reinforcing the tenets of customer service within the corporate culture provides the employee with the tools to do the right thing—that is, to ask, "What do I need to do to make a spa guest happy? How do I exceed their expectations?" Sometimes the little details reap the greatest rewards.

Employee empowerment is a key component in CST. As an employee's experience and skill base develops (and as management becomes comfortable with an employee's performance), levels of empowerment should be increased proportionately. Empowerment is a vote of confidence in an employee and a way to quickly resolve problems as they arise. This situation is said by spa managers to increase job satisfaction, and the employee's ownership of his or her position.

CST also requires a strong foundation in the technical skills of how a department runs. Routine procedures, appropriate lines of oral and written communication, and what is expected of each employee in the normal course of his or her shift help minimize problems. When problems do occur, a strong foundation in technical skills makes it easier for the employee to create alternative solutions for the guest.

Training draws on employees' EQ (emotional quotient) as well as their IQ (intelligence quotient). CST requires that employees draw on their ability to empathize with the guest. This starts by training employees to suspend judgment of a situation, become attentive listeners, and know the right questions to ask. This allows them to understand what the actual problem is. Training employees in this type of customer service delivery assists them in focusing on the salient issues and creating ways to address them.

Because CST is ongoing, employees can benefit from their peers' experiences. Vehicles to exchange this type of information can be as informal as role-playing and round-table discussions, or as structured as an employee newsletter. Incentives, acknowledgments, and rewards for excellent customer service delivery are an integral part of the training program. Successful CST supports a skilled and unified staff, which translates into profitable operations. CST is an investment in property that owners can't afford not to make.
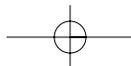
▶ Provide Value, Create Value

Spa aficionados are savvy. They are looking to be indulged, pampered, and nurtured, not fleeced. Setting price points with market sensitivity can create tremendous customer loyalty. Because spas are no longer a one-time indulgence but rather a lifestyle choice, it is important to price services competitively and provide incentives for customers to return regularly.

Numerous variables are involved in the development and operation of a spa as part of a hotel or resort. Doing one's homework is essential to success. When a spa is developed or repositioned correctly, it can be a lucrative and rewarding experience. When it is not developed correctly, it can be a financial liability that haunts the spa director and jeopardizes the hotel's market position.

If spas and their programming are not an integrated part of the hotel's future development, the property may lose a significant competitive opportunity. Spa-less hotels or poorly run properties have an inherent competitive market disadvantage. Not only do they find it more difficult to penetrate the market but they also often lose market share.

▶ HOW BIG SHOULD IT BE?

▶ Resort Spas

The ratio of guest rooms to treatment rooms is based on many factors, including the anticipated return on investment to the owners, the topography of the site, the scope and theme of the spa, and the competition. In a destination resort, where the reason for the spa facilities is the reason for the trip, there should be an average of 1 treatment room for every 4 to 5 guest rooms. At the other end of the spectrum, such as a casino hotel, the spa is definitely an amenity, and 1 treatment room should be built for every 50 to 100 guest rooms.

The spas at lower-end hotel properties normally are limited in scope and are often between 3,000 and 6,000 square feet, whereas luxury spas at full-service, high-end resorts average between 10,000 and 35,000 square feet. These ranges vary based on each hotel's specific circumstances, including seasonality, accessibility, meeting space, fill patterns, and local demand. Each market and each lodging product must be individually evaluated to assess the appropriate ratio of treatment rooms to guest rooms.

Another matrix that measures the viability of a resort or hotel spa is the cost to build the facility. Once again, a number of factors support various outcomes in this process, including the amount of available land, the finishes of the spa, the finishes of the hotel (these should be compatible), and the need to develop a spa either vertically or horizontally. Vertical spas are most often built in environments where land is scarce or the allocated footprint for the spa is too small for one floor. Vertical construction always raises the price per square foot, as load distribution, drainage, and the weight of equipment and water must be factored into the construction design and budget. The cost to construct a resort or destination spa can range from as low as $200 per square foot to over $450 per square foot. High land-value areas and plumbing-rich design schemes will send cost dramatically above this range.
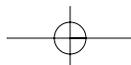
▶ Day Spas

Day spas often lack the grand infrastructure associated with resort spas, and for this reason the ratio of spa revenue to treatment room space is much closer. In terms of number of square feet, day spa revenues account for 43 percent of the total spa space and provide approximately 52 percent of the total day spa revenues. The remaining 57 percent of the day spa environment is allocated to guest flow, check-in desk, retail, back-of-the-house support, and, on some occasions, food and beverage areas.

▶ Medical Spas

Historically, medical spas have placed less emphasis on the aesthetics of the spa experience and more on the treatment provided. Therefore, it is not surprising that 45 percent of the medical spa space provides 63 percent of all medical spa revenue. Retail sales are limited in medical spas, as outside of cosmetics and prescriptions there are limited branding opportunities. While resort spa goers are anxious to wear a sweatshirt or ball cap that announces to the world where they last vacationed, most medical spa clients do not share the same need or enthusiasm about their recent microderm abrasion or rhinoplasty. Medical spas may require the use of pharmacies to fill patient's prescriptions, which from a business model could be considered part of their treatment-related retail sales.

▶ Treatment Type Versus Revenue

To this point, we have evaluated the economics and use patterns of spa types. The focus of

most spas dictates how the space is allocated and where the income is generated. Spas should aim to have at least 50 percent of their total space—their prime real estate—produce direct revenue. Secondary real estate is the support and public areas necessary for atmosphere and supporting functions that assist in delivering the spa services. Secondary spa real estate includes areas where people can prepare for or relax from their spa treatments. These secondary areas are an important component in the spa development plan, as they allow guests to prolong their experience, which enhances the perceived value. If guests are hurried from their massage or facial out of the spa and back onto the street, the magic that is created can be abruptly snapped and the overall spa experience is compromised. Conversely, if a guest is allowed to soak and relax for hours after a body wrap is completed, emotionally speaking, the cost of the body wrap is amortized over the entire spa experience and not just for the time the client was enjoying the body wrap in the spa's prime real estate.

Combination rooms account for about 36 percent of North American spa spaces, but because of the various treatments offered in them, a revenue percentage generated from these spaces is hard to predict. Combination spaces allow the spa to address surges in demand for specific treatments and at the same time be flexible and respond to global market changes. Massage rooms account for approximately 27 percent of the total space in North American spas but 47 percent of the spa revenue. Given these factors, an operator would need a compelling reason to not include massage on the spa menu. Facial treatment areas reflect 19 percent of the total spa space and result in about 33 percent of the spa's overall revenue. Wet rooms, often the most underutilized portions of the spa, account for 7 per-

cent of the space and revenue. Because many spa modalities involve water therapies, many spa developers and owners believe that wet rooms are essential, even if they seem under-utilized. Because wet rooms are one of the most expensive components of a spa, it is essential that they be utilized to their fullest extent. Packaging wet room treatments with other spa services is one way to better utilize the space and create value for the spa.
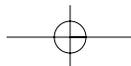
▶ SPA TRENDS

▶ On-Site Industry Trends

Anti-aging treatments and products are driving much of spa menu and retail development. This calls for devoting a treatment room to outpatient medical procedures. Programming and spa menu items include sun damage treatments, chemical peels for skin renewal, and other rejuvenation techniques that build on repeat procedures. Commensurately, spas are developing retail product lines that can take the spa experience home and continue the wellness regime.

Gift card sales are driving new users to spas. In the friends and family sector as well as the corporate gift-giving world, day spa certificates are creating demand that is not directly user driven. Third-party purchasing brings to spas clients who may not normally have chosen the location or treatment, creating a large but undefinable market demand.

Regional specialties that relate to indigenous and climatic influences continue to create unique spa experiences based on site-specific supply. This has excellent leverage potential for spa operators working to differentiate their product matrices in densely operated areas.

Increased stress management. It is important to position services for stress relief, especially to the male business traveler. Spa programming that requires a limited amount of special equipment and minimal changes to a property's infrastructure can do this.

Impulse appointments. "Life is uncertain, but I want a massage (reflexology appointment, yoga class, etc.) now!" This trend may result in developing adjunct programs for on-call staff resources. The as-needed portion of the program limits a hotel's payroll burden and other related fixed costs. Of course, this implies existing core programs and facilities where these programs can be developed and supported.

Shift in perspective. Self-indulgence, pampering, and luxury are being reevaluated and repackaged with a new, broader emphasis on self-care, stress relief, and emotional balancing. This is reflected in spa programming, the menu of services, food and beverage outlets, and spa-related retail. The retail positioning and spa programming components represent huge untapped revenue opportunities.

Changes in demographic use profile. Historically, the greatest segment of spa goers was women between the ages of 35 and 55. More couples and families are expected to visit the spa together as an alternative social/recreational activity. This trend has the potential to extend business-related stays, fill business hotels on the weekend, and create demand for destinations. It is important to understand this trend when evaluating ways to increase market penetration in a down market.

Medical affiliations. For some markets, an affiliation with a medical center or group in the area can be established to provide treatments such as acupuncture, nutritional assessment, laser therapies (hair removal and wrinkle reduction), Botox injections, collagen treatments, chemical peels, laser resurfacing,

body contouring, microderm abrasion, and vascular procedures. When creating these types of relationships, it is essential that spa owners thoroughly investigate the legal disclosure and liability implications of being an affiliated medical service provider.

Green environments. A spa can be ecologically sensitive by incorporating environmentally friendly features into the operation. By proactively supporting programs and products that are earth friendly, the spa does something good for the environment, provides a service to the community, and creates a competitive advantage and a unique selling point that may provide significant returns, especially in a highly competitive market.

▶ Global Industry Trends

Trends in day, destination, and amenity spas influence each other. According to Susan Ellis (2004), president of Spa Finder, a spa marketing company, after the rise of the medical spa and broadening spa participation by men and teens, spa use is expected to become more popular in 2005 and beyond. Spa Finder's trends to watch for are abstracted below:

- Those personal elements that make the spa experience special will find their way into the design of personal living spaces in private homes.

- Private, gated living communities will develop around central spa facilities, much like golf and fly-in communities.

- Some spas will compete on the far outer reaches of luxury, with ever-increasing rare and proprietary products and services.

- Spas will make house calls. Legitimate spas will offer out-call services where spa technicians travel with appropriate equipment and personnel to a client's home, office, or hotel room.

- Destination spas and resorts will develop market segments focused on personal goals—everything from spiritual awareness to sexual health to detoxification.

- The spa travel segment will grow, with more clientele booking through online portals.

- Medical spas will continue to be popular and will add alternative therapies and couple traditional medical treatment with spa luxury and innovation.

- Day spas will not grow their exotic menus much more but rather focus on the traditional; destination/resort spas will be the businesses that experiment with more exotic services and products.

- Specialized cuisine developed for spa guest consumption will find its way into mainstream grocery/specialty food offerings. Restaurants may also add lines of healthy spa cuisine to their menus.

- Eco spas—those designed and operated around green principles of management—will become a growing segment of the industry.

▶ CONCLUSION

The foregoing discussion and explanation of the service and amenity potential of spas of varying types strongly suggests that they will continue to maintain a position of importance in the inventory of hotel services. Even the most modest of spa offerings can enhance a hotel guest's lodging experience. Someday basic spa services may be arranged for at even moderately priced lodging properties.
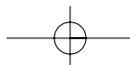
▶ BUSINESS PROBLEM ANALYSIS

Mitch Jucha (2004), spa director, Westin Century Plaza, Los Angeles, California

▶ PROBLEM

Spa Mystique, a 35,000-square-foot spa, is not turning a profit. It is a newly built, state-of-the-art spa facility located adjacent to a 728-room full-service conference center hotel. The property is located in an affluent commercial and residential area of West Los Angeles with direct access to major surface arterials and freeways.

▶ BACKGROUND/STATUS QUO

The Westin Century Plaza, a Commercial and Convention Property

- 728 rooms
- Occupancy level: 55–58 percent average (weekends 30–40 percent average)
- Primarily business hotel catering to large groups and transient business travelers
- The largest hotel ballroom in Los Angeles
- Breeze Restaurant
- Where U.S. presidents stay in Los Angeles since President Ford began using the hotel during his term
- Was once called the West Coast White House due to President Reagan's patronage

Facilities of Spa Mystique of the Westin Century Plaza

- 35,000 square feet
- Café Mystique, state-of-the-art fitness center, Yamaguchi Salon, boutique
- Designed by Silvia Cipieli
- 28 treatment rooms
- 4 outdoor massage cabanas
- Separate entrance for members and local guests with valet
- Tranquility lounge
- Separate locker rooms for men and women
- Signature massage, facial, and body treatments
- Spa membership available

Guest Utilization Data

- 22 percent hotel guests
- 77 percent local guests
- 6 percent group guests
- 1 percent hotel employees
- Based on the guest type distribution, marketing budget was redirected to local day spa guests.
- Additional internal marketing completed to increase in-house usage.

The Problem

- Many of the decisions herein were based on an analysis of the profit and loss statement and the general ledger.
- Allowed comparisons to industry averages.
- Examination results:

  Retail sales were below average.

  Cost of sales was too high.

  Payroll was too high.
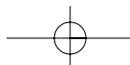
Breakeven was roughly $150,000.

Industry average profit would not be met unless $330,000 in revenue was produced.

► SOLUTIONS

After a Sales and Marketing Evaluation

- Redirected marketing efforts to local day spa guests.
- Created departmental marketing budget.
- Placed advertisements in local papers and magazines.
- Completed renewed efforts on in-house guests.
- Increased hours.

  Increased hours of operation of Sundays to include two additional bookable hours to increase revenue and meet demand.

  More recently, extended treatment hours to 8:00 each night of the week, resulting in 50 additional services per week.

  The increased hours are expected to yield $260,000 annually.

- Pursued corporate business.

  Marketed to local corporate offices by offering midweek discounts to their employees.

  Entered into a corporate membership agreement with MGM building employees.

- Modified spa menu.

  Created 25-minute services.

  Filled 30-minutes gaps and maximized utilization.

  Catered to transient business travelers and group guests of hotel.

- Created treatment enhancements, which allowed price increases without treatment time increases.
- Added corporate spa memberships.
- Create a limited spa membership that utilized spa during low demand.

Evaluation of Competitors' Price Structure

- Performed competitive price survey.
- Survey determined that spa prices were below competition.
- Consequently, increased all spa prices by 20–25 percent.
- Implemented discounted pricing and promotions during low demand periods.
- Restructured package pricing.

Modified Staffing

- Rectified overstaffing of the locker room attendants and fitness attendants.
- Added spa group coordinator or spa sales coordinator position.
- Realigned technicians' schedules to eliminate overlapping shifts.

  Overlapping shifts created an inefficiency in utilization of treatment rooms.

  Without overlapping, treatment rooms are able to be fully utilized.

  Prior to this change, maximum utilization topped out at 70 percent.

Performed Wage Audit

- Restructured spa technicians' wages because paying the technicians an hourly rate created an inverse payroll burden during low demand.
- Removed hourly pay and created a flat-rate commissionable salary structure.

- Brought pay structure in line with spa industry standards.

- Instituted system at the top of the competitive set.

- Provided an opportunity to issue annual wage increase based on performance.

After implementation of the above tactics and strategies, Spa Mystique more than doubled revenues from the previous reporting period. The changes were considered a success, and the spa is now profitable.

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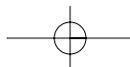
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SOURCE NOTES

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Chapter 1.3, "How Well Does the Branded Distribution Company Allow Independent Hotels to Compete with the Chains?" by Peter Cass.

Chapter 1.4, "The Art and Science of Opening a Hotel," by Tom Dupar.

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Chapter 1.7, "Spas and the Lodging Industry," by Peter C. Anderson.