CHAPTER 1.2

Adapting to Uncertainty—The Global Hotel Industry

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The travel and hospitality industry is increasingly operating through prolonged periods of uncertainty and instability. Effective business leaders seek to understand the impact of different shocks on their operations and to develop the tools required to manage the consequences.

Operating in a globally inter-connected and consumer-led environment, the hotel industry is exposed to various risks of business interruption. This chapter explores case studies of four common demand shocks—economic volatility, political instability, terrorism and pandemics—along with tools and approaches to manage uncertainty.

THE HOTEL INDUSTRY FACES UNIQUE CHALLENGES

Hotels are complex organizations, creating value for consumers and investors by combining bricks and mortar with people and technology. Their performance is not only affected by macroeconomic cycles and consumer trends, but is also linked to that of parallel sectors such as airlines and travel companies; seasonality of demand, product innovation and development pipelines also affect performance. As a result, demand shocks impact the industry in differing ways.

THE IMPACT OF SHOCKS

Economic shocks typically result in a protracted recovery

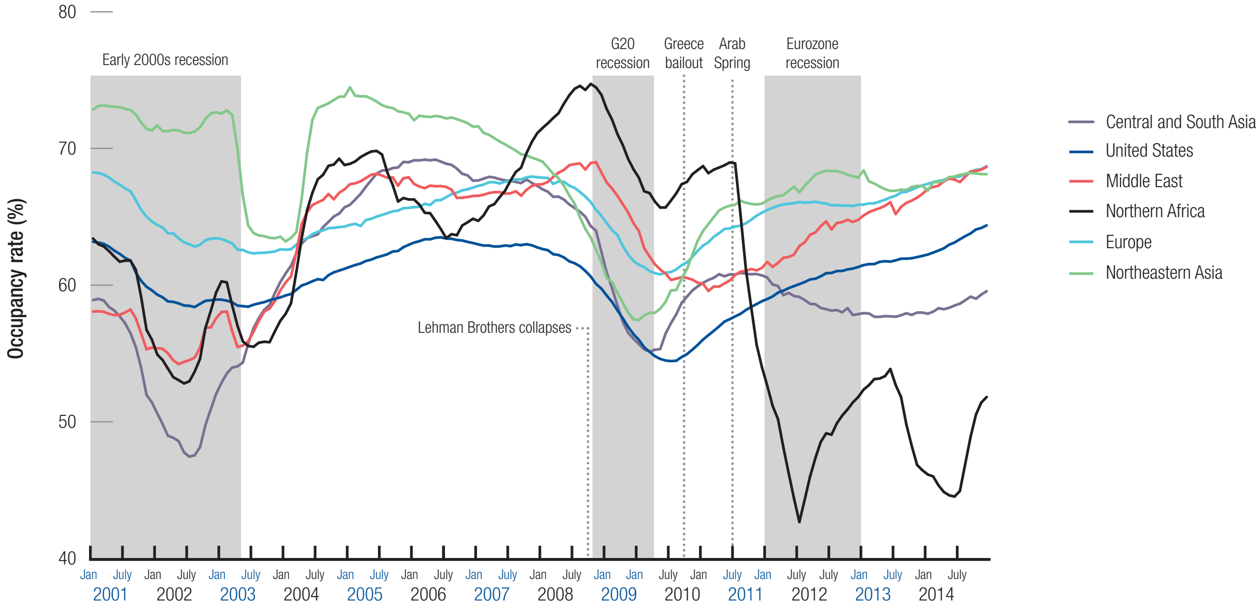
Consumer spending on hotel accommodation is directly correlated with GDP performance, so economic recessions typically have the most widespread and protracted impact of all demand shocks on the hotel sector. There can be a short-term lag in the industry entering recession, due to fixed contracts and pre-bookings, but there is likewise typically a delay in recovery, as corporate and leisure consumers remain cautious until a convincing economic recovery is well underway.

Historical trends across multiple regions reflect a consistent pattern in recession (see Figure 1). Increased price sensitivity triggers a decline in demand, occupancy levels fall and hoteliers discount prices to try to secure bookings. Recovery is also demand-led, with occupancy levels typically rising close to previous peaks before hoteliers can implement price increases.

Recessions can leave the hotel industry vulnerable to further disruption from secondary shocks, as demonstrated by impact of the Arab Spring. In line with other regions, the North African hotel market had entered recovery by January 2010, but the Arab Spring movement plunged the region into the steepest decline recorded over the period under review.

The Eurozone crisis had a similar but less severe impact on European hotel performance. European and US hotel occupancy levels enjoyed similar recovery

Figure 1: Economic cycles and demand trends, by region



Source: STR Global and Deloitte analysis, strictly illustrative.

patterns through to Q3 2011, but while the US market continued to improve through 2012, recovery in the European market stalled until 2013.

An economic downturn is one of the most challenging demand shocks from an operational and investment perspective, as it typically has a protracted impact on revenues and capital expenditure. Hoteliers must balance the short-term need for cash flow with long-term strategy such as pricing, service and product levels.

Political shocks have a muted impact outside the center of unrest

The impact of political shocks on hotel performance is typically less widespread than that from economic downturns. However, the fallout from political events is highly dependent on the influence of diplomatic travel advisories, press coverage and consumer perceptions.

Disruption to hotel performance typically concentrates on locations directly experiencing political turmoil and demonstrations (see Figure 2). The impact of political shocks is relatively muted elsewhere, particularly in isolated leisure destinations with direct international transport links, enabling visitors to bypass the unrest.

Thailand, for example, has suffered a range of political shocks over the last decade, with several coups and military crackdowns, including the temporary closure of Bangkok's Suvarnabhumi International Airport. In each case, Deloitte analysis of STR Global data shows that Bangkok hotel occupancies declined at a steeper rate than the wider national market, with resort markets such as Phuket and Koh Samui recording only minor dips in occupancy.

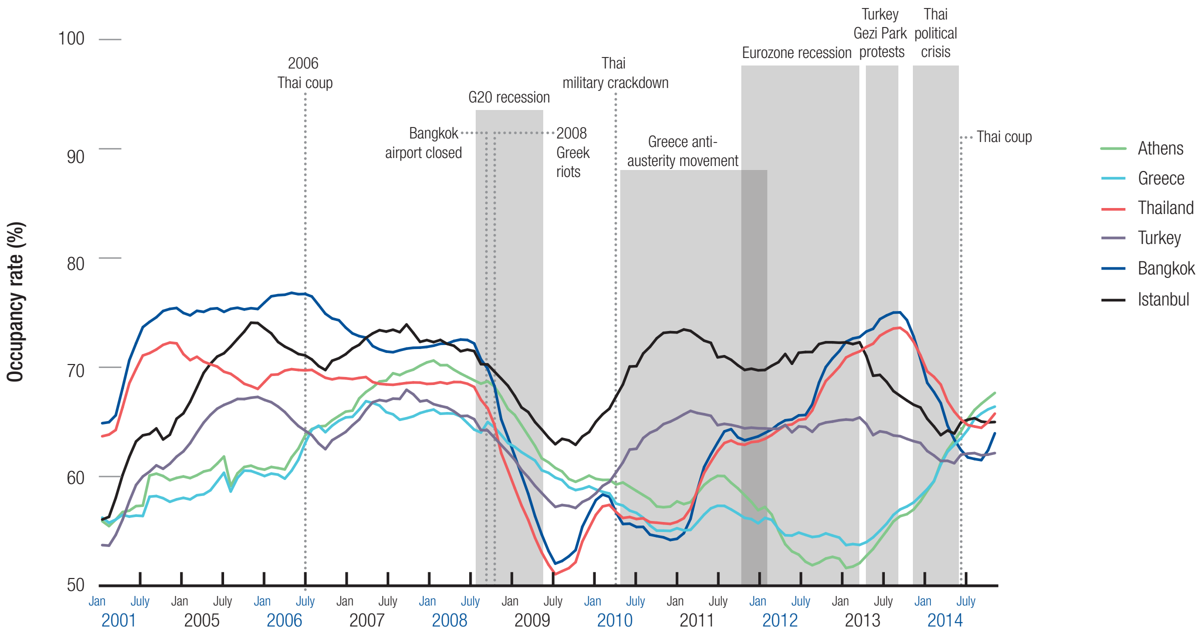
The effect of political shocks on the Greek hotel market displays a similar trend. Athens was at the heart of the 2008 riots and the anti-austerity movement, triggering occupancy declines that were significantly more pronounced in the capital than in the wider Greek hotel market. Persistent social unrest coupled with ongoing economic uncertainty resulted in Athens not entering recovery until 2013—some three years after competitor destinations Barcelona, Lisbon, Madrid, Milan and Rome. The resort market was comparatively unaffected.

Turkey's Gezi Park protests also adhere to this trend, as occupancy levels in Istanbul declined rapidly compared to the wider Turkish market. Although a series of Kurdish protests coincided with a previous dip in Istanbul occupancy levels, this was attributed principally to oversupply, as data indicates growth in average room rate and underlying demand during the period.

A notable outlier to this trend is Egypt. During the Arab Spring in 2011, not only did occupancy levels fall almost 30% in Cairo, but the resorts of Sharm El Sheikh and Hurghada also suffered, plummeting a steeper 39%. While diplomatic travel advisories categorized both resort areas as comparatively safe, international press coverage highlighted a high degree of regional instability, with civil war in neighbouring Libya and protests across North African territories. Conversely, the UAE benefited from redirected demand as it was regarded as a "safe" destination; occupancy for the year increased 8%.

The relative impact of political instability varies widely depending on both the actual and perceived severity of events. Deloitte analysis of long-term demand trends indicates that hotel demand recovers relatively

Figure 2: Political events and demand trends, selected citites



Source: STR Global and Deloitte analysis, strictly illustrative.

quickly from political disruption, provided it does not weaken the underlying demand drivers such as the economy, consumer spending, destination perception, product/service offering and access.

The hotel market is becoming more resilient to terrorism shocks

The hotel industry is becoming more resilient to shocks from terrorism, with Deloitte and STR Global analysis indicating that recovery times have shortened significantly over the last 15 years (see Figure 3). While domestic and regional travellers appear to be less deterred by isolated incidents, international demand is sensitive to the threat level portrayed by press reporting and diplomatic travel advisories.

As an example, occupancy levels in New York hotels took 34 months to recover from 9/11 (2001), and the wider US market took 45 months, with the impact compounded by an economic recession. For comparison, Madrid bounced back in 12 months from the 2004 train bombings, and London recovered in nine months from the July 2005 attack. More recently, the Boston Marathon bombing and the murder of British soldier Lee Rigby in London had a limited impact on hotel occupancies, even at a city level.

While the impact of the Charlie Hebdo shootings is not evident in the data, anecdotal evidence suggests that hotels targeting the leisure market suffered an immediate short-term impact.

This trend can be attributed to mitigating factors including increased corporate requirements for robust contingency planning, disaster recovery programmes and risk management protocols; sophisticated revenue/inventory management systems, incorporating dynamic pricing; and real-time, web-based communication channels to educate consumers, manage perceptions and promote destinations. Anecdotally, observers also point to a shift in mentality among consumers and companies over the last decade, with the emergence of a "carry on as normal" culture in response to terrorism.

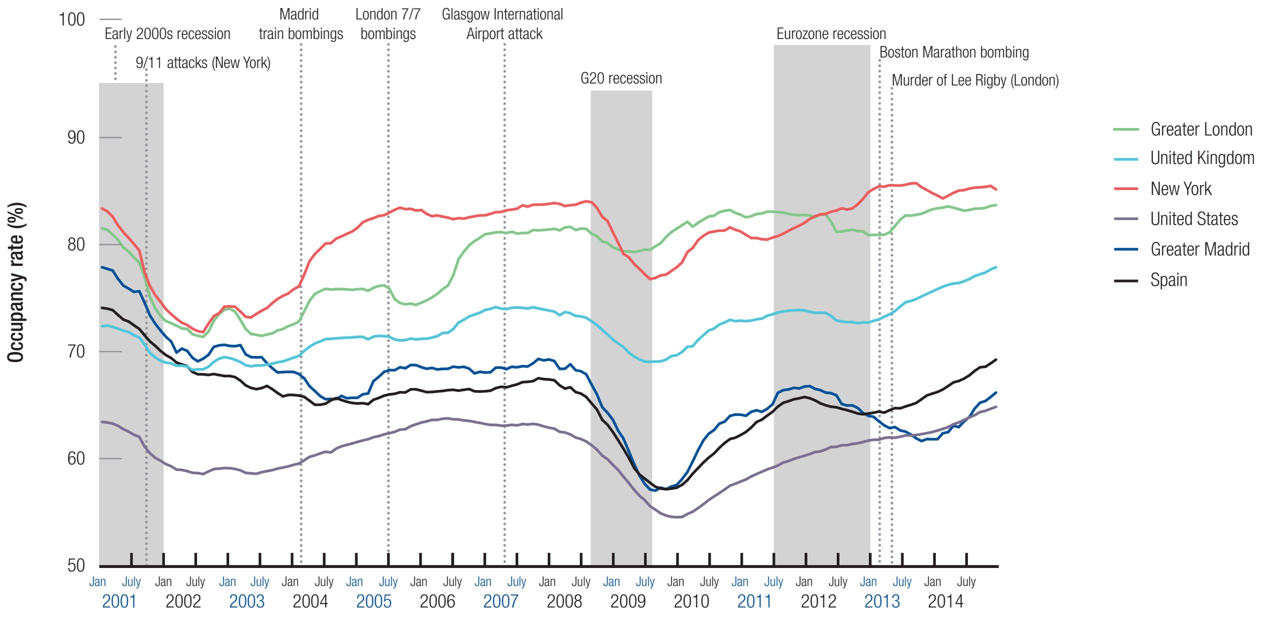
Pandemics can trigger deep declines, but markets are quick to recover

The impact of pandemics such as SARS, swine flu and Ebola on the hotel industry is generally contained to the affected regions; to date, the global impact has been relatively limited (see Figure 4). While pandemics can trigger deeper declines than other types of shock, the bounce-back to pre-shock occupancy levels is typically the most rapid.

Deloitte and STR Global analysis indicates that the SARS pandemic of 2002 to 2004 caused extreme volatility in Northeastern Asia, where the outbreak originated. Occupancy levels plummeted some 10 percentage points before recovering to pre-crisis levels within a year. This contrasts with the steady decline and protracted recovery typical of economic shocks. Geographical fallout from SARS was also comparatively limited. For example, in the United States—a significant outbound destination for Northeast Asia—hotel occupancy and ADR declined following the World Health Organisation global alert in March 2003, but returned to growth just three months later.

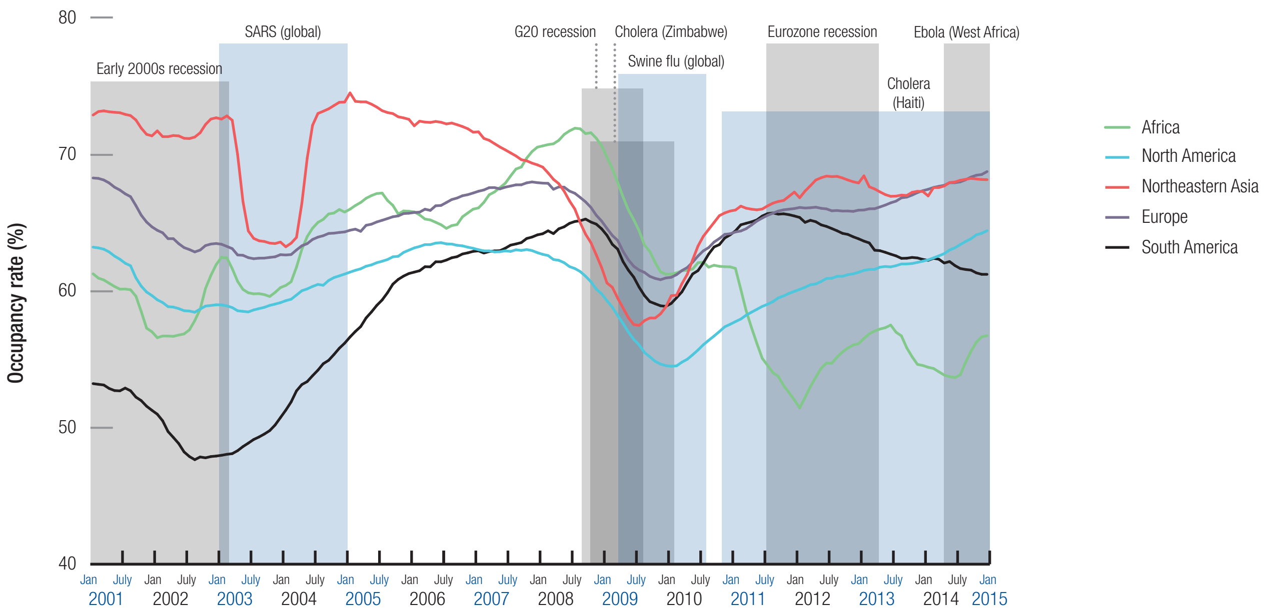
Another example is the swine flu outbreak in 2009. Mexico City recorded a 50% decline in occupancy levels at the end of April and early May 2009, when the

Figure 3: Terrorist attacks and demand trends, selected locations



Source: STR Global and Deloitte analysis, strictly illustrative.

Figure 4: Pandemics and demand trends, by region



Source: STR Global and Deloitte analysis, strictly illustrative.

outbreak was confirmed as emanating from Mexico, and resort markets suffered from tour operator cancellations for the season. However, by early 2010, occupancy levels were in recovery.

As pandemics are typically short-lived and localized, robust contingency plans and good management should help to carry affected hotel markets through a short-term dip in demand. However, the growth of global travel means international cooperation is increasingly important to manage the spread of virulent diseases.

HOW TO PLAN FOR THE UNPREDICTABLE—A DELOITTE PERSPECTIVE

In this interconnected, dynamic environment corporates need to be prepared for business interruption. A risk management strategy includes various considerations, some of which are considered below.

Understand all the forces at play

The hotel industry is highly dependent on a complex web of socio-economic, political and environmental drivers. By identifying and quantifying the principal threats, companies can develop a comprehensive risk profile specific to their business. This is the first phase of developing a risk management strategy.

Expect the unexpected

Preparing for unforeseeable shocks should be a key part of a company's risk management framework. Having identified and quantified the risks, companies need to plan a response to shocks and threats that are as yet unknown. For example, the Eyjafjallajökull volcano eruption in Iceland in April 2010 had global ramifications due to airspace restrictions. In such an event, a business continuity planning framework is vital to minimize fallout.

Respond rapidly to pursue new opportunities

An agile business will respond rapidly to shifting conditions and seek to capitalize on new opportunities that emerge from a challenging situation. Management with a strategic and entrepreneurial approach has potential to move the business ahead of the market and increase market share.

Engage with regulators

Engaging with government and regulators as part of a recovery strategy can open up alternative channels of fiscal and financial support. For example, in the aftermath of the 2004 Boxing Day Tsunami, the Thai government offered businesses loans, grants and equity sharing deals to speed up recovery and reconstruction efforts.

Collaborate in promoting destinations

Governments can also convince their foreign counterparts to lift travel bans/advisories or to publicize locations that are comparatively unaffected. Cooperation with the wider tourism industry is paramount, particularly in a period of political flux, to maintain a clear and consistent message from the industry to the consumer.

Prepare to capitalize on a successful recovery

Strategic planning should incorporate not just how to survive a shock, but how to emerge in a stronger position. Although financial investment can be harder to secure when performance is weakened, periods of low demand can be utilized to reposition for recovery, through capital investment or strategic re-branding as well as through strategic acquisitions.

CONCLUSION

The hotel industry needs to adapt to living with uncertainty. Preparation is key to surviving shocks, minimizing fallout and maintaining hotel performance. To succeed in this environment, companies will need to identify and understand the entire risk picture, to prepare for the unforeseeable and to be agile enough to respond to new opportunities. Winners will be prepared to emerge from a crisis in a stronger position and capitalize on the recovery.