

Economic downturn effects on the uk hotel industry economics essay



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The UK hotel industry, as well as the hotel industry world wide, has been hit hard by the recession which started at the end of 2007 and is predicted by many to last until at least 2010. In the course of a few months the UK's economy has gone from boom to crisis and by early 2009 the attitudes and beliefs of consumers and businesses in the marketplace had altered radically from previous optimism (Mintel Reforecasts 2009 [online]).

Prior to the 'credit crunch' which commenced in August 2007 when the European Central Bank and the US Federal Reserve put £45bn into the financial markets (Elliott 2008 [online]), Europe, the USA and the UK were enjoying an economic boom with rising house prices and high consumer confidence (Budworth 2008 [online]). Gross Domestic Product (GDP) rose to £381, 565 Million in 2007, and household disposable income per capita to £14, 321 in the same year (Key Note 2008, p. 18). During these 'boom' years, lending was high and borrowers able to raise large sums of money due to relaxed lending restrictions by banks. Individuals whose circumstances would have at one time barred them from borrowing were allowed to access many times their salary (Budworth 2008 [online]). Debts secured upon property were sold on to investors. Property prices thus became vastly inflated creating a 'bubble' which burst when borrowers started to default on their loans and the value of the investments therefore fell heavily. The huge losses by the banks leading to the collapse of Lehman Brothers in the US and the near collapse of Northern Rock in the UK meant that lending became much more difficult and banks stricter about who they lend money to. (Budworth 2008 [online]). The resulting shortage of funds due to fears about lending and lack of loans has led to a downturn in the

economy, falling house prices and increasing unemployment with many firms going out of business altogether and many more making drastic savings (Budworth 2008 [online]). Further consequences include a vast increase in public spending which is predicted to take years to pay off, a predicted rise in unemployment (by the British Chamber of Commerce) to 3.2 million, wage freezes or cuts and massive job losses (The Economy News 2009 [online]). The collapse in available credit started in the USA but in these days of global trading the implications were soon felt around the world with the UK quickly facing problems. Germany, France and Italy – the three largest economies in the Eurozone – were officially in recession by late 2008, and others rapidly followed suit. Both Spain and Ireland have witnessed a housing bubble burst and contraction in wider economic activity (Foresight 2008, p. 7).

2.2 The Pound Against the Euro and Dollar

One factor that complicates the situation somewhat is the pound's weak status against the Euro and Dollar. Sterling has lost value rapidly over the last year or so. In July 2008, one pound would still buy \$2, but by November 2008 it was worth only \$1.48, the lowest point for 6 years. Similarly at one point £1 was almost equal in value to 1 Euro. While this is bad news for people buying goods or traveling outside the UK, it also means that UK goods and services become more attractively priced from the point of view of Eurozone or USA travellers (O'Grady 2008 [Online]). Specifically, hotels in the UK will appear relatively cheaper since this fall in the value of sterling, and hence more attractive to inbound travellers and tourists. At the same

time, it means it is less attractive for the UK holidaymaker to travel to the Eurzone or USA, and more attractive to stay 'at home'.

3. Hotel Industry Background

3. 1 Introduction – The Growth Years to 2007

Hotel operators in the UK cater both to the corporate sector and consumer sector. Both are significant parts of their operations and both includes not just accommodation but also facilities such as meeting and conference rooms in the case of the corporate sector and add-on services like food and beverages for both sectors. The UK has been historically an important business destination with the growing importance of the London stock market and financial sector (Key Note 2008, p. 11). In the consumer sector most activity is accounted for by holidays and short breaks with a significant minority for wedding or party venues.

The UK hotel market grew in 2008 to a value of £11. 5 billion, which is an increase of nearly 20% since 2002. This growth took place against the backdrop of a healthy worldwide economy with the global travel market recovering after the 2001 terrorist attacks (BMRC 2009, p. 1). Factors influencing this growth were varied and included an increase in the number of tourists coming in to the UK in the years since 2002 and a diversification in the hotel market with increases in the budget sector as well as luxury brands. There was an increased call for upmarket brands as London in particular saw an increase in the ultra wealthy market sector for which money was no object (BMRC 2009, p. 1). Other factors driving growth include the growth in internationalisation and global business, rises in disposable

income, and the development of tourism from emerging economies such as former East Europe and India. The growth of the internet and online booking also paid a part as well as increased marketing by hoteliers (Key Note 2008 pp. 19-21).

During 2008 this boom came to an end. The hotel industry was hit relatively late by the depression, and even during 2008 industry experts were proclaiming that the previous 12 months had been a time of overall growth (Cater & Hotelkeeper 2009, p. 6). Occupancy rates were static in the first part of 2008, but then hotel transactions started to decline and during September 2008 occupancy fell steeply as did revenue per room (Cater & Hotelkeeper 2009, p. 6). Further, developments for new hotels and improvements were cancelled and budgets reduced.

3. 2 Strengths and Weaknesses of the UK Hotel Market

A Key Note report identifies aspects of the UK hotel market influencing the vulnerability or resilience to recession. On a positive note, the UK hotel market is a strong and sophisticated one with a wide range of different options to appeal to a range of different types of customer and including internationally recognised brands as well as smaller individual operators. Developments in technology and the increase of internet use over the last 10 years mean selecting and booking a trip is easier than ever before. The fact that most UK residents do not use hotels further offers an opportunity for growth, as does the potential for further increase in internet use.

Restaurants attached to hotels and other such 'add on' services provide further expansion potential. Finally, the UK is experiencing a growth in its older population, who have more time to travel.

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On the negative side, the hotel market is particularly vulnerable to an economic downturn as travel and trips are often seen as an area in which spending can be cut back. (Key Note 2008, pp. 48-50). Research also suggests that despite the apparently rosy outlook of the years immediately prior to 2008, the market had other issues to contend with even without recession. The long-stay leisure market (defined as those travellers staying away for five nights or more) has been in decline since 2004: the number of long-stay hotel rooms booked in 2008 was half that in 2006, at 11 million (BMRC 2009, p. 1).

4 The Impact of the Recession on the Hotel Industry in the UK: Specific Factors

4. 1 Introduction

This section looks at some of the factors which impact upon the Hotel industry, and why they are important. The messages are mixed. Some of the factors are detrimental to the industry while others have more positive impact.

4. 1 Air Travel in Decline

Although long-term growth in demand for air transport is projected, growth rates in the short to medium-term are likely to be affected by the general slowdown in the economy and by the rising cost of air travel. A market-wide study indicates that although long-term growth in demand for travel by air is expected, short to medium term projections are for negative growth in 2009 with the beginnings of recovery in 2010 (Key Note 2009, p. 10). This will have an impact upon the UK hotel market as there will be fewer travellers

into the country. However, it should be borne in mind that fewer UK holiday makers will want to holiday abroad due to financial considerations, thus boosting demand for hotels.

4. 2 Collapse of the Property Market

One of the hardest-hit sectors of the economy in the recession has been building as house prices have crashed and loans to finance building projects have dried up together with the market for the finished product. The UK enjoyed some of the highest periods of growth of house and other building prices, and the construction industry has been particularly badly hit by the latest recession. Developers are unable to access credit to fund large scale building schemes, so many hotel projects have been stalled (Blitz 2009 [online]). Aside from new developments, hotel owners who are unable to access further credit are also finding things more difficult. While larger operators and branded chains are able to look to the medium and long-term, over which a boom for hotel and travel are predicted due to emerging markets, smaller operators have less access to the resources which will see them through the next couple of years (Blitz 2009 [online]).

The domestic travel area offers some possible positives for the industry as a whole. It is arguably the case that tourism and the hotel industry in the UK are better placed to withstand the results of a recession than either other industries or other holiday destinations. The reputation of the UK as a whole is very strong as a destination, as is that of England in particular. A 2008 survey by Visit Britain of 614 respondents based in the UK who regularly take short breaks reported that 9 out of 10 people consider England when

choosing a short break. The branding of England has improved over the course of this tracker study, 58% of respondents say it is their favourite holiday destination considered. It is considered easy to get around and seen as having beautiful scenery (Visit Britain 2008, p. 2). Short breaks account for almost 2/3 of breaks taken in the UK, so these findings are significant for the industry as a whole. (Bainbridge 2009, p. 1).

Another consideration is the rising concern with being 'green' and the impact of frequent air travel on the environment (Bainbridge 2009, p. 1). Consumers who want to reduce their carbon footprint and impact upon the environment are increasingly opting to stay within the UK (Bainbridge 2009, p. 1). What Bainbridge does not highlight, however, is that the new concern for 'green' issues is not completely beneficial. Tourists from overseas will be equally concerned to cut their travel abroad, so this could also reduce inbound tourism into the UK. Research is conflicting with some showing that interest in saving the environment is fairly low priority for the majority of consumers and other studies confirming the idea that 'green' issues will become increasingly important (Key Note 2009, p. 49). Hoseasons, the self-catering leader, also take this view, claiming that more people are choosing to holiday in the UK because of a demand for a 'green' and alternative to flying abroad. Similarly, the ferry lines entered 2008 assuming that demand would increase for their services as a greener alternative (Key Note 2009, p. 49).

The UK has the most expensive rates for hotels in Europe, and average prices rose by 12% in 2007 to an average of just over £100 per night.

London's exceptionally expensive rates influence this figure (Key Note 2009, <https://assignbuster.com/economic-downturn-effects-on-the-uk-hotel-industry-economics-essay/>)

p. 50). Against this background, and bearing in mind the recession, a move towards increasing the number of budget hotels seems inevitable. Previous expansion in the hotel industry has concentrated on the luxury end of the market with the growth of 'boutique' hotels and the interest in catering to the super-rich. While this seems unfortunate given the recession, it is not obviously a bad strategy as historically the luxury market has been shown to reflect the economy more slowly than the rest of the market. (Key Note 2009, p. 92) In October 2007, Marriott estimated the growth in revenue per available room at between 5% and 7% in 2008; however, by May 2008, this had been revised to between 3% and 5%. As clients reduce their spending, it is likely that over-supply will be seen in the market and this will lead to some brand rationalisation (Key Note 2009, p. 92).

One predictable result of the recession is to increase interest in budget holidays and cheaper hotels. The Visit Britain survey of UK residents who take short breaks reported in March 2008 that price had now overtaken other factors in choosing where to stay (Visit Britain 2008, p. 2). This is likely to increase as the UK moves deeper into recession.

The budget hotel market was under development even before the recession set in. Established brands such as Travelodge and Premier Inn expanded their operations, and they were joined by the 'Purple Hotels' from the Real Hotel Group. Hilton also developed plans for a budget hotel chain, and CitizenM, a design-led brand, was developed. Other brands include Nitenite and Yotel, built at low cost using prefabrication techniques. The growth in the market has led to further segmentation in the sector with introduction of

upmarket tiers to the budget range (for example Holiday Inns 'Express' brand (Key Note 2008, p. 16)

A Key Note report written at the beginning of the recession predicted that the mid-range hotels would be the main casualty of shrinking demand. The problems with the economy were exacerbated in the hotel industry by the recent increase in energy and food costs (Key Note 2008, p. 11)

5. 4. 2 Business Budget Hotels

As Bainbridge points out, budget hotels have benefited by both business and holiday customers downgrading in the recession. Some budget hotels have increased the range of facilities they offer to includes free wi-fi, breakfast and similar to accommodate a new business clientele. Whitbreads budget chain, Premier Inn, for example (the UK's biggest hotel brand) is upgrading its rooms with flat screen TV, air-conditioning and Freeview, and has seen sales for its business account scheme increase 36% over the previous year to February 2008. (Bainbridge, 2009, p. 1).

This increase in the number of business travellers using budget hotels since the start of the recession in 2008 is corroborated by research by BDRC in 2009. They report that budget brands are consciously aiming to compete with mid-market brands by strategies such as the ones mentioned above. This drive has been rewarded by better standing in business advertising awareness for the budget hotel brands. (BDRC 2009 [online]) Key Note also report that mid-market business hotels are likely to suffer as they are positioned between the value and luxury hotel options, and what they call '

tiering', or introducing of levels in to the budget range, will also affect the mid-market brands (Key Note 2009, p. 92).

5. 4. 3 Consumer Budget Hotels

For the non-business traveller, accommodation quality is very important in UK breaks. While travellers abroad endure less than perfect accommodation because costs are low and the weather good, within the UK they demand better quality. One issue is that bed-and-breakfasts and guest houses are notoriously prone to poorly-run individual establishments, leading to calls for the market to be tightened. However the budget hotel sector has grown and has mopped up some of the non-business market as well. The fact that there are many chains available in this sector means travellers can be reassured regarding expectations and quality as they are buying into a brand name. This is particularly true in London – a popular choice for consumer short breaks – where hotels are notoriously expensive (Key Note 2009, p. 50).

5. 5 Staff and Recruitment Impact

The recession has had a severe impact on the hotel recruitment market, and it is unlikely to recover before 2010. Job cuts look set to reach 600, 000 as businesses and consumers cut spending. The Chartered Institute of Personnel and Development warned of the toughest year in more than 2 decades, and their predictions were backed up by a survey of 150+ senior management in the hotel industry carried out by the recruitment specialists Admiral Group which revealed that over 2/3rds of those surveyed were going to delay recruitment decisions, and put fast-track graduate programmes had on hold (Sharkey 2009, p. 7). These findings are reiterated by the results of a study by Deloitte in 2008 which predicted that the downturn could cut new
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jobs in the sector by 100, 000 with a corresponding dramatic shrink in the UK tourism industry. A recession could see a £11b reduction in the economic input by visitors to the UK, currently worth £114b or 8. 2% of the UK's GDP. The British Hospitality Association also criticised the lack of help from the Government (Thomas 2008, p. 9)

One less gloomy prediction is that the recession will have less impact as the hospitality market in general and the hotel market in particular is more diverse than in the past, with some opportunities actually being created particularly in the casual and budget dining and contract catering sectors. This is reinforced by a survey carried out by the British Hospitality Association which shows that the contract catering sector has grown and will continue to do so in the recession (Druce 2009, p. 7)

5. 6 Room Occupancy and Prices

Room occupancy rates – the percentage of nights that hotel rooms are in active use – have been increasing since 2005. This is good for hotel operators as it allows them to repay investments and reap more return for their money. In 2007 there was a 1% point rise in domestic occupancy (61% in 2006, with the 2003 rate being 59%). This pre-dated the recession and was a result of the strength of sterling at this time (Key Note 2008, p. 14)

Returns in terms of paid accommodation in the UK show a surprising result. Gains were still made in 2008, and a report by Deloitte showed that in the early part of the year revenue per room grew strongly (Caterer & Hotelkeeper 2009, p. 6), which is unusual as the recession started to set in during this year for most parts of the UK economy. However, this seems to

be a function of gains made at either end of the booking season. Early bookings would have been made before worries about the economy set in, and late bookings made might have been as a result of last-minute demand and hence prices paid were higher (Key Note 2008, p. 15)

5. 7. Smaller and Specialist Sectors

The result of the recession can also be traced in the smaller and specialist areas of the UK hotel market. For hotel operators, boom areas in these sectors are not necessarily a good thing, as will be shown.

5. 7. 1 Activity Holidays

Activity holidays overseas were enjoying a boom in recent years, however for the next few years the market is predicted to grow less rapidly, whereas activity holidays in the UK are predicted to rise. In 2010 for example the total no of activity holidays in Millions taken by UK residents was predicted before the recession at 11. 5; this was revised to 10. 8, with 2011, originally predicted to total 12 million was revised to 11. 4. By contrast, predictions about UK activity holidays have been revised upwards: the 2011 level was predicted at 5. 0 million, and this was revised to 5. 3 million. (Mintel Market Reforecasts 2009 [online]). The impact for hoteliers is mixed. If the holiday involves hotel stay, then the news is good; however if the accommodation is self-catering the hotel operator will lose out.

5. 7. 2 All-Inclusive Holidays

All inclusive holidays, a sector which has been in decline in recent years due apparently to the increasing ease of online booking and ease of finding information, are now predicted to rise over the short-term as they allow all

holiday costs to be known in advance and paid for up front. Both Thomas Cook and TUI are aiming to increase their all-inclusive capacity (Mintel Market Reforecasts 2009 [online])

5. 7. 3 Camping and Caravaning Holidays

This sector enjoyed a boom in the 1960's and early 1970's but with the advent of cheap overseas package holidays has been in decline. However, Mintel predict that these holidays are an attractive option for the budget conscious consumer, and will benefit from the increase of families who elect to stay in the UK in 2009 and 2010 for financial reasons. They point out that the Camping and Caravanning club had their best ever year for recruitment of new members in 2008 (Mintel Market Reforecast, 2009 [online]). Domestic camping holidays are predicted to do rather better over the next couple of years before the long-term trend towards decline reinstates itself. The growth in this area is not good news for the hotelier, as by definition a stay in a hotel is ruled out for this holiday type.

5. 7. 4 Others

Other sectors, for example boating holidays, have also been affected. Even where the market remains buoyant – boating and luxury holidays – growth prediction has been downgraded and is expected to occur at a slower rate than predicted (Mintel Market Reforecasts 2009 [online]).

Sectors of the UK market which are predicted to do well include coach holidays within the UK which are seen as a budget option and so are fairly resilient to an economic downturn, and heritage tourism as well as holiday centres like Centre Parcs. Mintel see the latter as particularly resilient as

they are both perceived as a budget option and are attractive to the UK consumer as they offer 'pay in advance' all-in-one packages. An increase in coach holidays is also good to some extent for the hotelier, although the bulk of coach holiday operators chose low-cost hotels where price margins are cut very low, as the coach holiday is seen as a price-conscious alternative to the consumer.

6. Lessons Learned from Previous Economic Downturns

The last time a recession occurred in the hotel industry was in the wake of the 2001 September 11th terrorist attacks on the Twin Towers in New York. The Sept 11th attacks and anthrax scare which followed caused uncertainty about the short and medium-term economic futures and had an impact upon travel and tourism plans leading to a reduction in hotel use and travel. In the US these areas, along with airlines were significantly affected in the aftermath of the terrorist attack. (Intel Market Reforecasts, 2009 [online]). In the recession of the early years of the 21st century, the response to the challenge was to discount room rates heavily, however this strategy was of questionable use. The heavy discounting was intended to boost occupancy level, however this necessarily led to less profitability and income; it took years to recover from this as consumers became used to the lower prices. As Bloss (2009) points out, the tactic is also very easy to copy by competitors and hence a risky one.

7. Conclusion.

The UK hotel market has certainly been affected by the economic downturn. The above looked at the background to the recession and how it has affected

the corporate and consumer sector. While the sector has certainly been
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impacted with job cuts, slower, stagnating or declining predictions and less building projects, there are some positives for the UK market as holiday makers elect to stay at home rather than travel abroad.