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A Look Back To Look Forward: New Patterns In The Supply/Demand Equation In The Lodging Industry

Abstract

In his dialogue entitled - A Look Back to Look Forward: New Patterns In The Supply/Demand Equation In The Lodging Industry - by Albert J. Gomes, Senior Principal, Pannell Kerr Forster, Washington, D.C. What the author intends for you to know is the following: "Factors which influence the lodging industry in the United States are changing that industry as far as where hotels are being located, what clientele is being served, and what services are being provided at different facilities. The author charts these changes and makes predictions for the future."

Gomes initially alludes to the evolution of transportation – the human, animal, mechanical progression - and how those changes, in the last 100 years or so, have had a significant impact on the hotel industry.

"A look back to look forward treats the past as prologue. American hoteliers are in for some startling changes in their business," Gomes says. "The man who said that the three most important determinants for the success of a hotel were "location, location, location" did a lot of good only in the short run."

Gomes wants to make you aware of the existence of what he calls, "locational obsolescence." "Locational obsolescence is a fact of life, and at least in the United States bears a direct correlation to evolutionary changes in transportation technology," he says. "... the primary business of the hospitality industry is to serve travelers or people who are being transported," Gomes expands the point.

Tied to the transportation element, the author also points out an interesting distinction between hotels and motels. In addressing, "... what clientele is being served, and what services are being provided at different facilities," Gomes suggests that the transportation factor influences these constituents as well.

Also coupled with this discussion are oil prices and shifts in transportation habits, with reference to airline travel being an ever increasing method of travel; capturing much of the inter-city travel market. Gomes refers to airline deregulation as an impetus. The point being, it's a fluid market rather than a static one, and [successful] hospitality properties need to be cognizant of market dynamics and be able to adjust to the variables in their marketplace. Gomes provides many facts and figures to bolster his assertions.

Interestingly and perceptively, at the time of this writing, Gomes alludes to America's deteriorating road and bridge network. As of right now, in 2009, this is a major issue.

Gomes rounds out this study by comparing European hospitality trends to those in the U.S.

Keywords

Albert J. Gomes, A Look Back to Look Forward: New Patterns In The Supply/Demand Equation In The Lodging Industry, Hotel/Motel, Oil embargo, The U.S. Corporate Average Fuel Economy Standard (CAFE Standard), U.S. highway and bridge deterioration, Airline travel, location

A Look Back To Look Forward: New Patterns In The Supply/Demand Equation In The Lodging Industry

by
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Factors which influence the lodging industry in the United States are changing that industry as far as where hotels are being located, what clientele is being served, and what services are being provided at different facilities. The author charts these changes and makes predictions for the future.

A look back to look forward treats the past as prologue. American hoteliers are in for some startling changes in their business. The man who said that the three most important determinants for the success of a hotel were "location, location, location" did a lot of good only in the short run. If this adage is meant to imply that there is something immutable or constant about a hotel location in the long run, or that there is no such thing as locational obsolescence, then hoteliers have been led seriously astray. Locational obsolescence is a fact of life, and at least in the United States bears a direct correlation to evolutionary changes in transportation technology. This should come as no surprise to hoteliers since the primary business of the hospitality industry is to serve travelers or people who are being transported.

Look at transportation in the United States in the last 100 years. In the period prior to 1870 people walked; the ultra rich rode horses or used horse drawn carriages. Transportation was powered by human or animal muscle. As a result, urban areas were compact; most could be described as pedestrian cities. During this period long-haul transportation between cities was generally by water, and hotels tended to cluster around seaports, river landings, or canal terminuses.

The second period, which lasted until the end of World War I in 1918, coincided with the most explosive population growth in the United States with massive immigration mostly from Europe; this was the fixed rail era. Cities developed strong urban radials with the advent of street cars, cable cars, and finally electric rapid transit, all using steel rail beds for locomotion. This was therefore also the era of the greatest suburban expansion of U.S. cities. The dominant mode of inter-city transportation was another system based on rail, the railroad; hotels in most cities tended to cluster around the railroad station.

The demise of the railroads began with the arrival of the automobile

in the 1920s. A largely European development, the internal combustion engine passenger car literally took off in the United States. The assembly line methods introduced by Henry Ford not only produced many more cars but made them affordable to people of modest means.

With the emergence of the passenger automobile as the most important means of urban transportation, the city expanded well beyond the original suburbs created by fixed rail. Except for a small temporary hiatus during World War II, when gasoline was rationed and railroads were pressed into service to move American soldiers, the private automobile was the principal mode of inter-city transportation as well during this period.

The dominance of private gasoline-powered automobiles for inter-city travel rather than public transportation modes - gasoline or diesel-powered buses and trains - was aided by two factors. The first was the production of large and powerful passenger automobiles, capable of sustained high speeds and featuring a great deal of passenger comfort over long journeys.

The second was the construction, mostly through federally subsidized funds, of an extensive, interconnected, limited access interstate highway system designed for fast long-distance travel from one end of the country to the other. Since most of the interstate highways by-passed cities and urban areas in order to maintain uninterrupted high speeds, many traditional hotels located in center city U.S.A. and along the older turnpike roads became locationally obsolete and were replaced by motels, motor hotels, and tourist courts along the new highways.

Oil Embargo Began A New Era

The current era for hotels really began in the 1970s starting with the Arab Oil Embargo in 1973-74 and the second oil shock of 1979 which produced a physical shortage of gasoline, long lines at gas stations, and gas prices in excess of a dollar a gallon. Even though there is a current decline in oil prices, it is not likely to change things at least as far as the hospitality industry is concerned.

The total number of hotel/motel rooms in the U.S. since 1939 has shown a pattern of consistent growth, according to the U.S. Bureau of the Census and Pannell Kerr Forster, from 1.44 million in 1939 to a projected 2.77 million, almost double, by 1987, and 3.1 million in 1992.

However, while the total number of rooms is continuing to increase, the internal split between the hotel and motel segments shows an interesting pattern. There has been a consistent increase in the percentage share of motels in the lodging industry from 1939 to 1972. The share of the motel industry in total supply of rooms increased from only 10 percent in 1939 to more than 62 percent by 1972. However, what is extremely interesting is that the percentage share of motels in the industry's room supply declined for the first time in 1977, which was the first hotel-motel census taken since the Arab Oil Embargo of 1973-74.

The results of the 1982 census confirm the clear decline in the number of motels in the United States; this can be related to the changes in transportation patterns. There is currently a modal split in inter-city

passenger mileage between private automobiles, airlines, buses, and trains, with an overwhelming preponderance of private automobiles in inter-city passenger travel. Buses and trains don't really account for much traffic and are literally going nowhere. However, the airlines are becoming a real factor in the movement of people between cities although they still have a long way to go before they will be in the same league as the private automobile today.

The point to make, however, is that the first signs of what promises to be a profound change in our industry are already here. In 1978 inter-city automobile travel hit a peak; starting in 1979 long distance auto miles actually declined, something that had never happened before. Passenger car registrations have been going up all through these years, which probably means that while there are now more cars on the road, the number of cars on inter-city and interstate highways is declining. This is going to have a significant impact on many hotel and motel establishments that have relied on the highway traveler for their main source of business.

The U.S. Corporate Average Fuel Economy Standard (called the CAFE Standard) is a legal requirement which mandated that by model year 1986 all automakers selling cars in the U.S. had to meet an average fuel consumption of 27.5 miles per gallon for their entire line-up of cars. Technologically it is possible to make even more fuel efficient cars than the CAFE-mandated 27.5 miles per gallon standard. Legislation now before Congress could further increase the fuel efficiency of cars to 36 miles per gallon by 1991 and to 45 miles per gallon by 1995. GM has completed engineering on a three-cylinder commuter vehicle that can reach 86 miles per gallon at 25 miles per hour, and 60 miles per gallon at highway speeds.

America's Roads Are Deteriorating

However, by the time all this happens, we may not have too many roads where speeds of 55 miles an hour, the current national speed limit, could be reached. Road statistics indicate the following:

- An estimated 210,000 miles (10.5 percent) of America's two million miles of paved public roads and streets are in "poor" or "very poor" condition, according to engineering standards of the American Association of State Highways and Transportation Officials (AASHTO). Some states have allowed many miles of paved roads to revert to gravel surfaces due to lack of necessary funding for their upkeep.
- An additional 1.03 million miles (51.8 percent) of paved roads are rated only "fair" - also a substandard category according to road engineers. Altogether, the U.S. now has one and a quarter million miles, or nearly two-thirds of all its paved roads, in need of surface repairs.
- Nationally some 260,306 bridges in the United States are "structurally deficient" and "functionally obsolete." They account for 45.6 percent of the 571,246 bridges inventoried by the Federal Highway Administration (FHWA).

- The average design life of a U.S. bridge is 50 years, and some 75 percent of the nation's bridges will be that age or older by the end of 1986.

In a recent report to Congress, the U.S. Secretary of Transportation provided several sets of estimates of the total cost of bringing the principal roads and bridges in the country up to certain standards between 1983 and the year 2000. The lower of these estimates of the total capital cost of maintaining the principal national and state highways at their 1983 level, along with meeting needed bridge repair costs, was nearly \$800 billion. This figure translates into an average annual expenditure of \$43 billion in 1983 dollars over the 18 years until the turn of the century, not counting inflation or the additional deterioration that is bound to take place in the interim.

The problem is that simultaneously with the huge increase in the need for repairs and maintenance, the income from the tax on gasoline that goes into the Highway Trust Fund for this purpose has not gone up sufficiently. The tax rate was more than doubled in 1982 from 4 cents to 9 cents a gallon, and the federal government will collect an estimated \$9.3 billion from this tax during the current fiscal year. Other taxes on highway users, including diesel fuel taxes, will bring up the grand total of receipts by the Highway Trust Fund to \$14.6 billion in fiscal 1986. This is substantially less than the \$43 billion dollars in average annual expenditures - a gap of more than \$20 billion a year in expenditures needed to keep the nation's highways at acceptable levels.

In the current climate of record federal budget deficits, the U.S. highway program is not going to receive any special consideration either at the federal or state and local levels. The alternative is to increase the tax on gasoline, but this is really a Catch-22 since it will involve almost tripling the current tax of 9 cents a gallon to make a dent in the funding gap and could itself cause further decline in gasoline consumption.

Based on all available data, it is quite clear that the prospects for long-distance automobile travel for both business and pleasure will continue to grow very slowly, if at all. The only feasible alternative is to fly. Since airline deregulation went into effect, the initial confusion and jockeying among airlines in air fares, air routes, and interface between trunk carriers and commuter airlines has not fully sorted itself out. But certain trends are clear. Deregulation has meant that the larger cities have better and cheaper air service because of intense competition among airlines, while the smaller cities have poorer and more costly air service. The significant diversion of long distance inter-city passenger traffic by the airlines to the larger cities will accelerate the trend toward obsolescence of the highway-oriented segment of the industry. Like the interstate highway system itself, many of these roadside establishments have reached their design life, since they were built in large numbers 25 to 30 years ago. As the economists will say, they are already technically obsolete and will soon also be locationally obsolete.

Of course, a decline in highway-oriented motels will have a salutary impact on new hotel construction in the center cities and their surrounding suburbs.

Labor Shortage Poses Problems

Demographic trends indicate that the number of adults 25 to 34 years old and 35 to 44 years old, the two most economically active age groups, will by 1990 account for about 44 percent of the total population in the United States. The economic impact of these age groups will be even more pronounced since the 60 percent of females between 25 and 44 will be working women. Families with two wage earners may have difficulty in meshing their vacation plans so there may be a trend toward more vacations, but of shorter duration. With shorter vacations, higher disposable income, and more working women as hotel customers, there will be greater insistence on personal service in hotels, and hence more employees per room.

Trends in the industry show that between 1933 and 1984 employment has doubled from one employee for every five rooms to almost one employee for every two rooms. However, while the labor needs of the industry are rising, the supply pool is in the process of shrinking. Thus by 1990 there will be a massive reduction in the under 25 age group which provides the bulk of the unskilled labor force in the hospitality industry. With renewed emphasis on restricting illegal immigrants - such as with the Simpson/Mazzoli bill - the only alternative would be to turn to retirees - the 65 and over age group - whose numbers are increasing, although not very rapidly.

The signs of a significant labor shortage in the U.S. hospitality industry are already here. In Orlando, competition for hotel workers has been taken into the high schools. Rapid growth in hotel rooms - from 35,000 in 1983 to 54,000 by year end 1985 - has hotel managers from the Central Florida Hotel and Motel Association courting area schools with Adopt-A-School programs. The hotels there are working with career guidance departments in 70 area schools.

Travel For Workers Is Difficult

There is truly a structural problem with the employment picture which should be taken into account in new hotel location studies. The problem of labor shortages is likely to be gravest in the so-called 50/50 cities, urban areas with populations of 50,000 or fewer and located 50 miles or more from a major metropolitan area. This definition is applied to fast-growing suburban areas such as those around Atlanta and Boston. These affluent suburbs cannot draw on the available and unemployed labor pools in center cities to take low-paying minimum wage jobs in hotels, as well as in retail, food service, and manufacturing. The unemployed cannot afford private auto transport which costs too much in relation to minimum wage jobs in the far suburbs, and public transportation is either not available or time-consuming.

A special sign of the times is the recent report that Wendy's - the people who found the beef - is busing workers from central Boston and other areas of high unemployment to its restaurants in Natick, a Boston suburb. Wendy's is not only absorbing the cost of the bus and driver but paying these workers for their daily two-hour commute. Is the hotel industry in the United States going to have to absorb the commuting costs

of its low-paid employees, or are we going to have to institute a guest worker program as they have in Europe? There is a remarkably even relationship today of roughly one hotel room for every 100 persons in the U.S. There are also temporary imbalances between hotel demand, which is highly variable, and hotel supply, which is static, at least in the short run. There is a sympathetic vibration between hotel occupancy rates and industrial plant utilization. The econometric measure of correspondence shows an extremely high coefficient of correlation between the two trends (See Figure 1).

Figure 1 also shows that industrial plants generally and consistently use more of their capacity in good times and bad than the hotel industry. The answer may be given in Figure 2 which compares the final output of the hotel industry to the U.S. gross domestic product over time in constant 1972 dollars. The result is from an inter-industry input/output model and superimposes the solid hotel trend line on the shaded national GNP line. Notice again the great degree of symmetry (except in 1972) between the two lines. However, something extremely interesting has happened since the energy crisis in 1973-74.

Price escalation by hotels during this period has been at a rate higher than the so called GNP deflator measured by standards such as the Consumer Price Index. The United States hotel industry apparently is able to consistently outperform other elements of the U.S. economy in keeping pace with inflation. The average hotelier may prefer to sell fewer rooms at a high price rather than achieve a full house by lowering room rates.

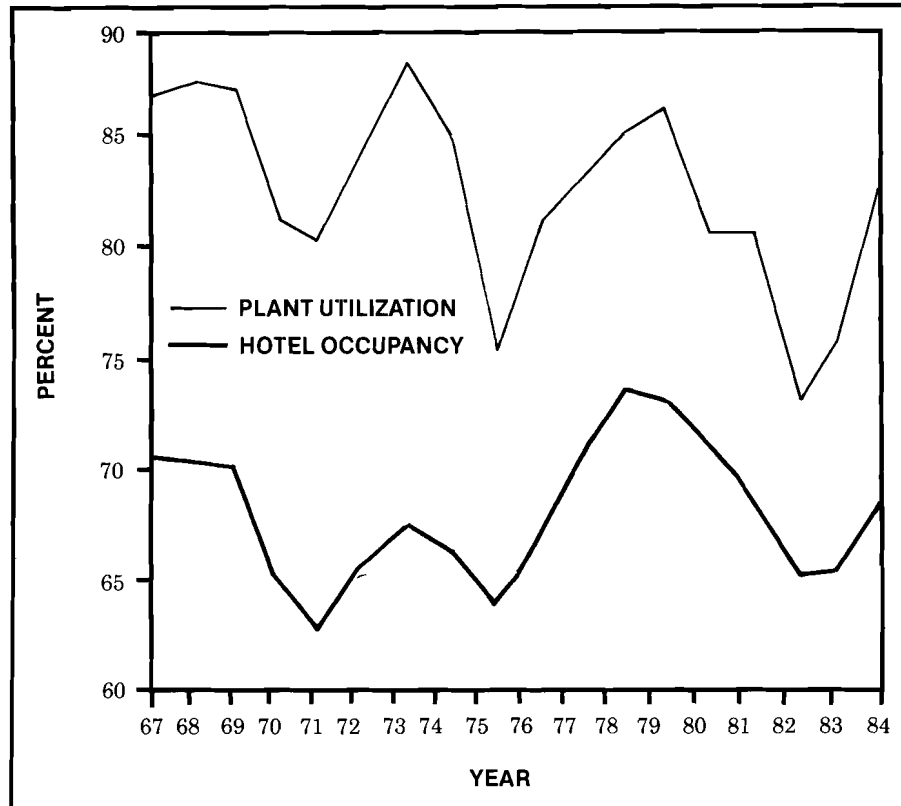
One element which has been a destabilizing factor is the recent exchange rate situation which affected the United States in many ways. As noted in the *1985 Outlook for Summer Travel* by the U.S. Travel Data Center, many more Americans planned and took vacations overseas in 1985 compared to 1984 because of the strength of the dollar. At the same time, the strong dollar put a real crimp on the ability of foreigners to visit the U.S. This affected hotels in certain destinations more than others, but it is a reversible trend.

The mature baby boom generation in the United States is fed up with standardized products. They are already more sophisticated and more European in their tastes. The two wage earner family with one or two children at most is a prime consumer of the products of the hospitality industry.

This has led to a lot of talk of market segmentation in the hospitality industry as if it were something new. There has always been market segmentation in the industry. What is new is that the market segmentation is taking place within the same chain. It used to be that a Holiday Inn was a Holiday Inn. Now it could be an Embassy Suite, a Crowne Plaza, a Hampton Inn, or even Harrah's Casino hotel. This all provides an opportunity to European hoteliers, since these large chains - the top 25 of which now control 50 percent of the U.S. rooms inventory - may not all be able to service these product lines equally satisfactorily.

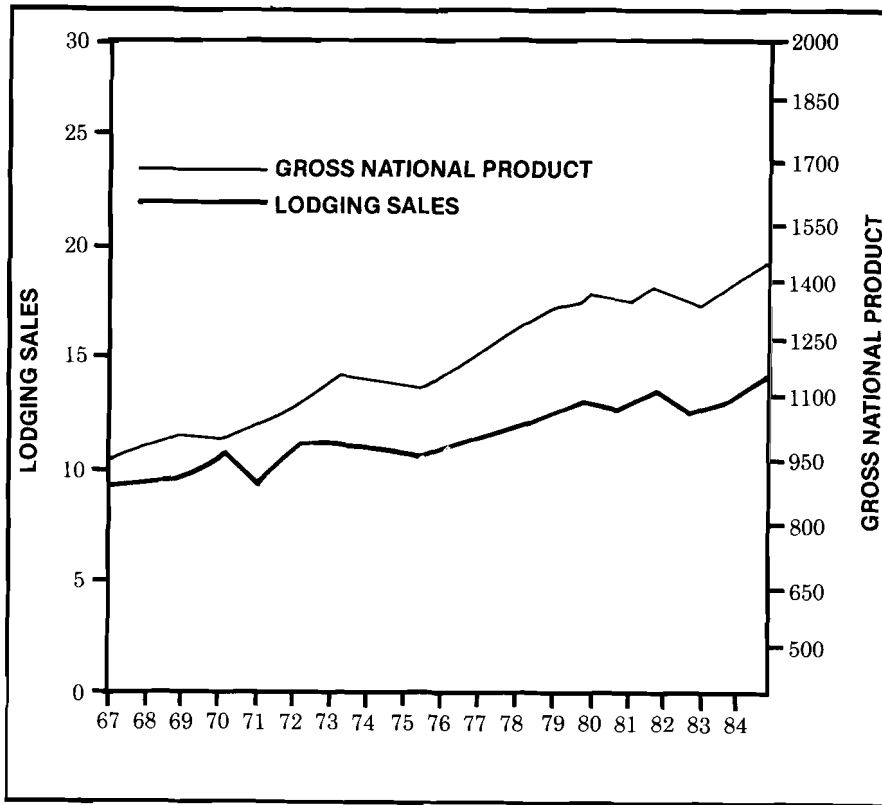
The largest chains are trying to get around the problem by erecting Chinese walls between their own divisions. The five different product

Figure 1
Plant Utilization versus Hotel Occupancy



Source: Capacity Utilization Rate from Board of Governors of the Federal Reserve System, Hotel/Motel Occupancy from Table IV-1, Pages 74 and 75, *Supra*.

Figure 2
Gross National Product and Lodging Industry Sales
(Billions of 1972 Dollars)



Source: *The National Income and Product Accounts of the United States*, Bureau of Economic Analysis, U.S. Department of Commerce.

managers of Holiday Corp. are now housed in five separate campuses, all in the fair city of Memphis, presumably in the hope that they don't influence each other.

What makes this a special window of opportunity for European hoteliers is that the U.S. industry is now almost getting to the employee to room ratios prevailing in Europe, but maybe without the worst entrenched features of unionism. The more affluent American consumer is going to want a concierge to have his laundry picked up in his room and not have to carry his dirty clothes through the lobby to the doorman, etc.

The further decline of the motel industry will create demand for a replacement of that inventory of rooms either in center cities, in the surrounding suburbs, or in the airport to city corridor. Even though there is talk about overbuilding in the United States, there are today 35,000 fewer rooms in Manhattan than there were in 1946. The same applies to many other older established cities in the United States. The in-city hotel is coming a full circle and there are now tremendous opportunities in the United States for the style and service that is synonymous with European hotel-keeping.