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A review of the current status and prospects for the US mid-level hotel sector: A survivor in uncertain times

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Abstract

It is no secret that one of the hardest-hit industries in the USA since September 11 has been the lodging industry. As a result, hotel demand, occupancy and new construction have reached their lowest points since the early 1990s. Despite this, the mid-level hotel segment has continued to remain strong, experiencing the lowest declines of any segment. Tighter budgets, more drivers on the road and continued strength in leisure travel have all contributed to the mid-scale's stability during this period of recession.

INTRODUCTION

The general economy and the lodging industry have a love/hate relationship. During good economic times, the lodging industry soars as consumers celebrate their financial stability by travelling more. The increased travel spending in turn nourishes the economy, creating an ongoing productive cycle of wealth (Figure 1). The most recent example of this phenomenon occurred in the late 1990s and early 2000, when US GDP reached the highest it had been in almost a decade. During that time the US person-trip volume

Source: D.K. Shifflet & Associates Ltd

Figure 1: During recessions, hotel demand declines more than GDP

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Source: D.K. Shifflet & Associates Ltd

Figure 2: 1992–2004 total US person-trips (2003–2004 projected)

registered an all-time high, with 2.67 billion people going on vacation (Figure 2).

Things, however, are much different now. The once-productive cycle has turned destructive, as overall room demand and occupancy have seemingly gone into free fall, making way for the recession the US is currently in. The bottom line is that the events of 11th September made an already sluggish year for the hotel industry into the worst it has been in over a decade. Hotel room nights were down 4 per cent in 2001, and a total of 8 per cent from October 2001 to March 2002.¹ With the economy, new construction and room demand all reaching their lowest levels since the early 1990s, the lodging industry in general has responded by decreasing prices in an effort to attract more business.

THE MID-SCALE HOTEL SEGMENT: THE SURVIVOR

Leisure

The mid-scale segment's strength has come from its ability to maintain its leisure customer base in the face of a recession. According to a March survey, only 16 per cent of leisure travellers in the mid-scale segment are expected to take fewer trips in 2002, compared to 24 per cent taking fewer trips in the upscale/luxury and 19 per cent in the budget/economy markets, respectively.² This means that nearly 84 per cent of all leisure travellers in the mid-scale segment are expected to take the same number or more trips by the end of 2002 as they did in previous years, as compared to only 76 per cent of upscale/luxury-end customers, many of whom have already traded down for financial reasons (Figure 3). The net change in overnight stays for the mid-scale leisure market has only

Recession

Upscale/luxury

Figure 3: Changes in leisure trips by hotel segment

been down 1 per cent overall, while the upscale/luxury segment experienced a loss of 3 per cent and the budget level a loss of 7 per cent.³

The power of brands

The mid-scale's strength in its leisure customer base can be summed up in one word — brands. Since autumn 2001, an increasing number of leisure customers have preferred to stay in brand-name hotels that have been around for many years. Some speculate that this is due to the need for people to seek out the familiar during times of great change. Most hotels that are a part of the mid-scale segment *are* familiar brand names that the majority of travellers have grown up with. The strong familiarity and longevity of these brand names gives guests a feeling of comfort and security that many of the less familiar brands in the upscale/luxury and budget/economy sectors do not.⁴ Moreover, a recent survey compiled by members of the National Consumer Opinion Panel shows that 'comfort' and 'security' — the two highest sought-out emotions among hotel guests since 11th September 2001 — are commonly reported by guests when asked why they stay at brand-name hotels.⁵

Business

2001 was not a good year for industry-wide business travel, and when it is all over, 2002 is not expected to be much better. Total business person trips are expected to decline an additional 5 per cent in 2002, and business room nights are also expected to decline 3.8 per cent, following a 10 per cent decrease in 2001.⁶ Like the leisure market, business travellers blame the economy as the main cause of taking fewer trips, followed by cancelled meetings and a recent concern about safety.⁷ More and more business travellers are travelling for essential business only, and one in eight of them have replaced some travel by a technological travel alternative (TTA).⁸

Despite these losses, the mid-scale segment has outperformed

Brands

Business travel

Budget/economy

both the budget/economy level and the upscale/luxury level in total business travel for 2002.⁹ The budget/economy sector has been affected the most, with nearly half of its customers stating that they expect to take fewer business trips in 2002, while a majority of the other half have traded up to take advantage of discounted hotel rooms in the mid-scale segment.

In addition, upscale/luxury users have contributed to the mid-scale's stability by trading down to the mid-level due to cuts in expenses and a large increase in TTAs. The upscale/luxury segment has the highest rate of TTAs, with nearly 17 per cent of its users claiming they have replaced some travel by technology (net-meetings, video conferences etc). Of these 17 per cent, 48 per cent have permanently replaced business travel with a TTA.¹⁰

Drivers

Mid-scale

A large contributor to the mid-scale segment's stability during the recession has been the increased number of drivers on the road, commonly referred to as the 'over-the-road market'.¹¹ After the attacks on the USA, fewer travellers have been willing to fly because of safety concerns in both aeroplanes and airports.

Constant terrorist threats issued by the government in conjunction with increased armoured security and long waits for airport check-in have driven more and more frequent air travellers to the road. In fact, recent studies show that one in five air travellers are willing to replace air travel with land transportation, and air travel is seen as 'unsafe' by about one in six travellers.¹² Moreover, business travellers are now willing to go five hours by land to avoid flying, while leisure travellers are willing to undergo a six-hour ride. Highways, which were once ranked among the highest of unsafe travel means, are now rated the safest form of transportation, followed by local transit, trains and finally airlines.¹³

So how does this relate to the mid-scale segment? Well, a large majority of mid-scale hotels are large chains that are frequently located off major highways, not at airports. Driving is the current choice of travel among business and leisure travellers and this has greatly fuelled the brand-name, mid-scale hotels that rule the highways.¹⁴ The mid-scale hotel industry has never been an airport-centric market, so the drastic decrease among people flying has only served to increase business for the popular brand names of its particular segment. The traveller who would normally stay at a hotel located a short distance from where his plane landed (usually luxury) is instead staying at the hotel located right off his highway exit (usually mid-scale).¹⁵

As much as a fear of flying has factored into a traveller's decision to take to the road, economic/financial instability still remains as a significant reason for more driving and less flying. In other words, travellers are not only driving to feel safe but are also driving to save money. The decrease in prices for all segments has been an even greater incentive to remain for the loyal mid-scale user.

Source: D. K. Shifflet & Associates Ltd

Figure 4: Industry room demand growth, 1999–2004 (2003–2004 projected)

Meanwhile, the luxury customer is trading down to save money while the budget customer is trading up to get more for his money.

Another reason to drive, as cited by travellers, is a feeling of being in control. Recently, ‘need to control transportation’ has been rated as having one of the highest impacts on travel choice.¹⁶ Over 40 per cent of travellers stated that the need to control his/her choice of transportation dramatically affects choice of travel.¹⁷ In short, driving fulfils this need to be in control. Hence, for many travellers, staying in a mid-priced hotel has been a by-product of the need to be in control of their transportation.

THE FUTURE

As long as safety and economic concerns remain a strong influence among business and leisure travellers, the mid-scale hotel segment will continue to remain the market of choice for both transient and extended-stay guests. One must note, however, that these concerns, although still largely an issue, are steadily decreasing among American travellers. Experts predict that overall industry growth should return in 2003 and 2004, thus making up for two years of recession (Figure 4). According to Salomon Smith Barney’s equity research report, ‘The combination of unprecedented depressed demand levels and historically low projected supply growth, has positioned the industry for a period of strong and sustained growth once hotel demand levels begin to improve.’¹⁸ When this happens, the task for the mid-scale hotel segment must be to continue to maintain its market share by proving it is the market of choice in both good economic times and bad. By continuing to provide its customers with extra value for the dollar, many guests who have traded into the mid-scale segment during this recession will remain there when it is finally over.

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