Why Britain leads Europe in the

Introduction

Britain's hotel business has the highest concentration of chain-affiliated rooms in Europe. Why is this? To find an answer it is necessary to explore the historic development of the British economy and of hotel chains in Britain and to understand the relationship between the two. We will then be in a better position to contemplate the future.

The development of hotel chains in Britain

Way back in the middle of the 19th century Britain was the first country in which hotel chains evolved when railway companies embarked on a century of vertical integration into hotels. Later in the century this was followed by a further bout of vertical integration when the brewers acquired many coaching inns to assure outlets for their beer. The vertical integration continued in the first half of the 20th century when the food manufacturer J. Lyons created Strand Hotels, but vertical integration was not the only basis for the development of hotel chains. Entrepreneurs such as Fredrick Gordon developed two hotel chains simultaneously around the turn of the century and early in the 20th century Earl Grey developed Trust House Hotels as a crusade against drunkenness. In 1900, hotel chains accounted for around 13,000 hotel rooms in Britain amounting to around 7% of total room stock. No other country in the world at that time came anywhere close to Britain's hotel chain presence.

In the following decades, World War I and the Depression impacted severely on the development of the British and continental hotel business, but hotel chains in Britain continued to grow. By the outbreak of World War II hotel chain room stock in Britain had more than doubled to 29,000 rooms accounting for around 13% of total room stock and Trust Houses had grown its portfolio to 220 hotels. World War II caused a halt to hotel development and the continuation of food rationing and austerity for 10 years after World War II constrained much further development in total room stock, but by 1960 chain room stock had grown to around 35,000 rooms, driven more by growing hotel-based holiday demand into coastal resorts than by business demand.

Then, as the consumer economy started to develop more vigorously from the late 1950s, business demand into hotels began to grow more while holiday demand continued its rise. These developments provided another boost to hotel chains so that by 1970 they had expanded to 65,000 rooms. From the 1970s onwards the strong growth in foreign packaged holidays sapped the summer vibrancy of coastal resorts as British holidaymakers headed for the costas, and hotel stock in the British coastal resorts declined progressively. The loss of domestic holiday hotel demand from this time onwards was offset by the growth in overseas visitors to Britain and the emergence and growth of domestic short breaks. These growth markets did little to relieve the decline in coastal resorts since the new markets sought different locations. But for the British hotel business as a whole and hotel chains in particular, these trends were positive because by 1980, chain room stock had grown to more than 99,000 rooms.

The last two decades of the century produced a step change in the structure of demand for British hotels. The number of overseas visitors into the UK continued to grow as did the volume of short-breaks, but then so also did the number of outbound holidaymakers from Britain. However, the big hotel demand story of the period in Britain was the growth in domestic business demand. The pattern of that growth was not just for rooms but also for hotel packages that included rooms with meals – or conference packages that included rooms, meals and meeting facilities. Similarly, short break demand and much of the inbound demand from foreign visitors was for packages that included rooms with meals.

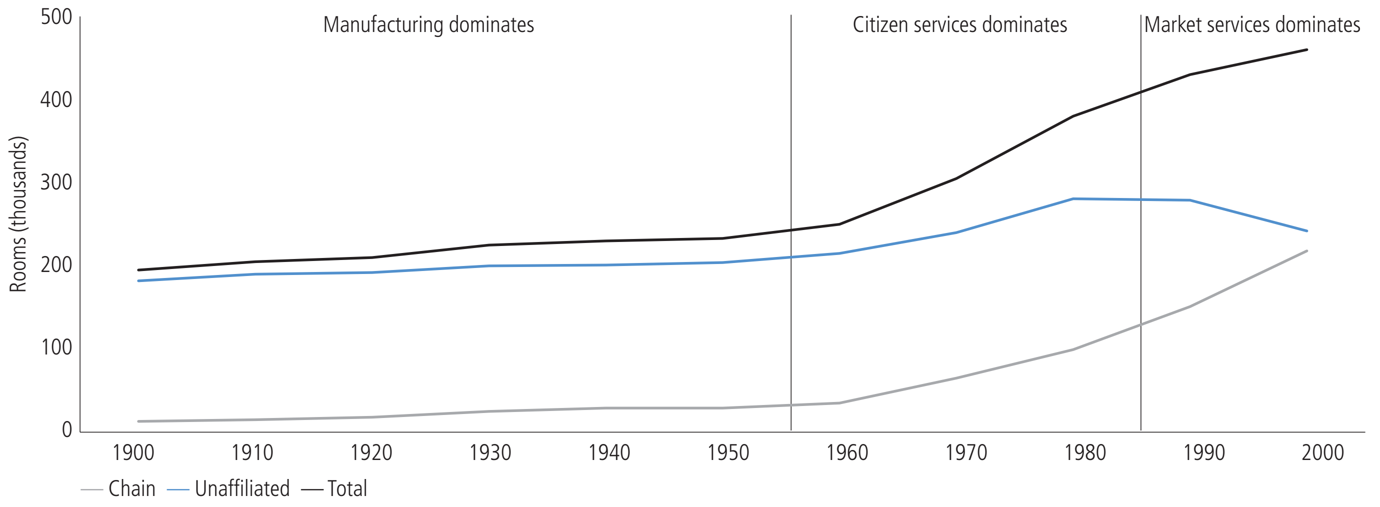
It was during this period and for these forms of demand that the hotel wholesale markets became significant. Companies with year-round demand for executives staying in hotels on business, tour operators with high volumes of inbound packaged holidays, short-break intermediaries, travel agencies and conference organisers all added to the efficiency of hotel demand generation and processing – and to be effective these wholesalers needed greater effectiveness in hotel supply. This was achieved by the parallel step change in the structure of British hotel supply over the last two decades of the century that saw hotel chain room stock rocket to 218,000, a compound annual growth rate of 4%, at a time when total room stock grew by only 1% and unaffiliated room stock declined by almost 1% per year.

By the end of the century hotel concentration reached 47%, achieved predominantly by the migration of unaffiliated hotels into chains. The construction of new hotels by the chains was a minority contributor to their expansion and progressively the construction of new unaffiliated hotels became a rarity. During the 1980s, Mount Charlotte, the precursor company of Thistle Hotels, grew its British room stock from 1,500 rooms to 13,700 rooms entirely by migrating unaffiliated hotels and acquiring short chains. During the same decade Queens Moat Houses, astonishingly, had seven rights issues to fund the escalation in its room stock from 1,250 rooms to 15,200 rooms, before it imploded in 1993. There had never before been a period in British hotel history as dynamic as this. By 1985, there were 156 hotel chains operating in Britain with a total of 125,300 rooms. By 2004 only 24 of these 156 chains continued to operate, but their British room stock had increased from 41,400 rooms to 140,400 a CAGR of 6.3%. The new millennium has seen the pace of hotel chain development accelerate again, adding 42,000 rooms by the end of 2005 when concentration touched 55%.

development of hotel chains

How does this chain hotel growth relate to the more general economic picture?

UK Hotel room development 1900-2000



Source: Otus & Co Advisory 2006

Developments in the structure of the British economy

In 1900, agriculture accounted for less than 10% of the British economy. The declining contribution of agriculture to GDP was already well-established as a long-term trend, having been fuelled by the availability of low cost imports from the empire. As a result, agriculture in Britain had already become a smaller contributor to GDP than in any of the significant continental economies. The historic low contribution from agriculture has meant that the British economy traditionally has had greater focus on sectors that contribute more business demand into hotels.

In 1900, Britain had come through a century of more dramatic industrial growth than any other European economy and manufacturing was the dominant segment of the economy. This was a factor in the embryonic emergence and development of hotel chains, because the British manufacturing industry had been larger and faster-growing than others in Europe for much of the 19th century and as a result it generated more business demand into hotels. Moreover, the hotel capital markets in Britain were also more efficient than in any other country. The vertical integration into the hotel business by railway companies and brewers was possible because they were in fast-growing and strongly capitalised industries. In 1900, there were 80 companies with 108 hotels, mostly single assets, listed on the London Stock Exchange – and that was before taking account of the hotels owned by the brewers and the railway companies.

Until 1950 the centre of gravity of the structure of the British economy was in secondary activities – manufacturing, mining and utilities. The volume and frequency of business demand was constrained by the natural limitations of secondary activities, as business demand generators for hotels. Moreover, the first half of the 20th century was peppered with political and economic traumas – two World Wars, several revolutions and local wars; political upheaval with the arrival of communist and fascist states; and the Depression, which lasted for much of the 1930s – that constrained the performance and development of the structure of the European economies to the extent that at the end of World War II radical changes were required to improve the unacceptably low standard of living of the population.

At the core of the radical changes was the escalation of the citizen service segment of the economies with the creation of the welfare state and the nationalisation of many industries. In Britain, the major changes were instituted by the Atlee government immediately after World War II and were extended by successive governments until the late 1970s. The citizen service expansion did not add materially to business demand for hotels since most employees in citizen services work in hospitals, schools and welfare offices and only a minor proportion are involved in business travel. Their business travel is infrequent and their spending is constrained by the government. It was for this reason that during the citizen service period from the end of World War II until the 1980s there was only a marginal increase in domestic business demand into hotels with most growth coming from domestic holiday demand and inbound foreign visitors. Thus, the rate of growth in total hotel room stock was modest and hotel chain growth was more about consolidating existing unaffiliated hotels than building new ones.

Why Britain leads Europe in the development of hotel chains continued

Thereafter the sea change in the structure of the economy was defined by the Thatcher reforms, which boosted the market service and experience segments of the economy by creating the conditions in which government controlled less of economic life; unemployment was lower; increasing proportions of the population had access to ownership of appreciating assets, mainly through home ownership; the personal credit markets were loosened; and many new businesses were started in the service segments. The two great advantages for the hotel business from growth in the market service and experience segments are first that a higher proportion of their employees travel more frequently than those from any other segment and secondly, that higher proportions of their employees stay in hotels on leisure. By 2000, agriculture had declined to 1% of GDP, secondary industries were down to 28% and market service and experience businesses had risen to more than 36%. The sea changes in the volume and structure of hotel demand and hotel supply were paralleled by the sea changes in the structure of the economy.

The other main continental economies, by contrast, have not yet made the transition in their structural balance to the market service and experience segments. Economies such as France, Germany, Italy and others are still stuck in the citizen services cul-de-sac that inhibits the development of service businesses and the accelerated growth and development of their hotel businesses.

In Britain however, the process of service business growth has continued during the new millennium. By 2005, agriculture had fallen below 1% of GDP, secondary industries were down to 26% and market service and experience businesses had grown to 38%. Add to these structural developments the overall growth in GDP during this period and we have the prime drivers of the accelerating growth in hotel chain presence in the country. The future development of the British economy is firmly grounded in growth in the market service and experience segments and this is most advantageous for the hotel business. These segments have the greatest capacity to grow and to generate business demand into hotels. They also have the greatest capacity to supply the necessary standard of living and style of life for increasing proportions of the population to become hotel customers and to increase the frequency of their hotel stays. In parallel with these developments we should note the increasing effectiveness of the hotel capital markets in terms of the availability of capital to chain hotels and their starving of capital to unaffiliated hoteliers, which will continue to drive upwards the level of concentration within the hotel business.

Conclusion

The parallel between the development of Britain's economic structure and the size and structure of its hotel business is fundamental to our understanding of the dynamics of the hotel business as a whole and hotel chains in particular. As the market service and experience segments of the economy grew in significance, so domestic business demand into hotels grew materially. Similarly, this was the trigger for the marked growth in domestic leisure demand into hotels. The pattern of development was broadly similar in the US, which leaves us to contemplate the changes in the size and structure of the continental hotel business as their economic structures develop more in the market service and experience segments.

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