Inside hotels

The UK general manager perspective on trading, operational challenges and guest demands
A sector dealing with increasing change

In the hotel industry, achieving growth while maintaining ‘no vacancy’ is a huge challenge.

For operators and owners alike, the pace of change when it comes to consumer expectations is relentless. In terms of growth strategy, brands that choose to keep the status quo might just be risking more than brands that take a leap in a new direction.

There is no shortage of analysis of the challenges hotels face from industry commentators and leaders. However, the views of those closest to the customer – hotel general managers – are not often heard.

EY teams set out to capture their perspective and conducted a survey for this group of individuals, with hotel general managers participating in the survey across UK regions and segments.

The objective of this research was to identify the key operational issues and challenges that hotel general managers deal with on a day-to-day basis, the nature of changing customer demands and how these impact strategic priorities, expenditure and planning.
About the survey

EY teams commissioned independent research across all UK regions and hotel asset classes. The survey was conducted during September and October 2018.

In the EY survey, we defined the hotels segments as:

- **Luxury** (6%)
- **Upscale** (13%)
- **Midscale** (64%)
- **Budget** (17%)

*The results show the sample is slanted towards hotels where the guest mix is mostly business travellers. However, the luxury segment deviates heavily with strong leisure traveller bias.*
Trading

Hotels have generally achieved strong occupancy and rate growth in the last year. The only exception has been the budget hotel segment, where less than 40% have experienced an increase in both occupancy and rate growth, suggesting that the supply of budget hotels may be nearing saturation.

All hotels surveyed rely to some extent on online travel agencies (OTAs) for bookings. Interestingly, hotels with a declining occupancy or ADR generate c.15% more (than the average) of their bookings through OTAs. This reflects the reality that weaker performing hotels rely to a greater extent on OTAs to fill rooms, but also the limitations of this strategy, particularly when OTA commissions are considered.

Some examples of differentiation include partnering with businesses in the travel and entertainment sector to offer unique experiences or combine loyalty schemes to increase profitability through greater cross-selling opportunities. We’re also seeing larger brands spend more on marketing to promote their own apps, increase brand awareness and encourage loyalty – all factors that discourage customer use of OTAs.

A further challenge is generally flat or declining food and beverage income, in part reflecting the significant increase in the number of casual dining outlets in recent years. Hotels, especially those in the luxury and upscale segments, are feeling the pressure to be more competitive and creative to keep guests from leaving the hotel.

<table>
<thead>
<tr>
<th>Hotel occupancy in the last year:</th>
<th>Average day rate (ADR) in the last year:</th>
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<tbody>
<tr>
<td>Increased</td>
<td>£ 72%</td>
</tr>
<tr>
<td>Decreased</td>
<td>£ 17%</td>
</tr>
<tr>
<td>Stayed the same</td>
<td>£ 11%</td>
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</tbody>
</table>

What percentage of your bookings are through OTAs?

<table>
<thead>
<tr>
<th>Percentage of Bookings Through OTAs</th>
<th>Number of Hotels</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 75%</td>
<td>1%</td>
</tr>
<tr>
<td>50%-75%</td>
<td>18%</td>
</tr>
<tr>
<td>30%-49%</td>
<td>41%</td>
</tr>
<tr>
<td>10%-29%</td>
<td>29%</td>
</tr>
<tr>
<td>Less than 10%</td>
<td>11%</td>
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</tbody>
</table>
Growing food and beverage demand is particularly difficult when consumers demand experiences as well as convenience: trying to find the right balance is an issue the casual dining sector itself is also now grappling with. Luxury brands have frequently put in high-end restaurants or renowned chefs to help to counter this, with upscale or midscale converted restaurants to mainstream casual dining brands. However, in off-peak periods, this can be a costly and challenging way to attract non-guests. The increased cost of food and beverage adds insult to injury, especially with the rise in demand for trends such as ‘farm to table’, and seasonal and wellness offerings.

Nearly half the respondents believe that new competition has impacted their hotel’s overall operating performance. Interestingly, however, those who believe new competition has had a major impact have not, overall, experienced a decline in occupancy or ADR. Where we might see impact is on profitability, as spending to maintain customer expectations as new supply opens is often a defensive investment. Customers still expect competitive rates, even for hotels that have invested in upgrades or improvements to their services.

The budget hotel segment was the most impacted by competition, consistent with our earlier observations that the segment could be nearing saturation point.

Recent analysis suggests little slowdown in UK supply growth: STR analysis in July 2018 showed 3% p.a. room growth in London, with over 25,000 rooms set to open in regional UK through 2019. Given this, the need for differentiation and continual investment remains paramount.
Retaining and attracting staff remains understandably the biggest challenge for hotel general managers and, particularly with Brexit moving closer, a shortage of overseas labour is an overwhelming concern not only for hotels but the hospitality industry as a whole.

The second most common response to address increased operating costs over the last two years has been to reduce staff or implement pay freezes: a strategy that might not address cost pressure in the long term or properly address the root causes behind the labour shortages. It’s an interesting paradox given staffing is the greatest challenge for the majority of survey respondents.

Cost increases (again partly Brexit driven) and the inability to pass costs on to guests is a close second, with nearly half the respondents who cited this as a primary challenge believing that automated check-in and more efficient back-office systems would be the best technology solutions to improve the overall performance of the hotel.
Maintaining hotel standards despite relatively low capital expenditure (capex) is also a significant balancing act for many hotels – particularly in the midscale segment. Forty percent of respondents citing this as a key challenge had received complaints about their dining and bar offering. It’s also not surprising that 48% of hotels struggling with occupancy find the ability to maintain hotel standards through capex to be their biggest challenge.

Further analysis of this data revealed that both rate and occupancy growth were more likely with a dedicated hotel revenue manager. Furthermore, 82% of respondents with a dedicated hotel revenue manager believe their software and strategy are maximising yields, compared with only 56% using a company revenue management team.

Brexit impact on labour supply: have you observed a decrease in the number of non-UK residents applying for jobs at your hotel?

<table>
<thead>
<tr>
<th>Impact</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Negligible impact</td>
<td>46%</td>
</tr>
<tr>
<td>Yes, decrease</td>
<td>39%</td>
</tr>
<tr>
<td>Yes, major decrease*</td>
<td>15%</td>
</tr>
</tbody>
</table>

* For example >50% fewer applications than before the Brexit vote.

Of these, 92% have cited recruitment as one of their biggest challenges.

Who is responsible for yield management strategy?

<table>
<thead>
<tr>
<th>Responsible for Yield Management</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reservations team</td>
<td>&lt;1%</td>
</tr>
<tr>
<td>Company revenue management team</td>
<td>51%</td>
</tr>
<tr>
<td>Hotel general manager</td>
<td>10%</td>
</tr>
<tr>
<td>Dedicated hotel revenue manager</td>
<td>37%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
</tr>
</tbody>
</table>

Of these, 82% achieved rate growth and 63% achieved occupancy growth.

Of these, 67% achieved rate growth and 56% achieved occupancy growth.
Turning to focus on annual operating budget for undistributed expenses (e.g., sales and marketing, repairs and maintenance, and IT)*, over a quarter of respondents are facing cuts on the previous year’s budget. Of those, the majority cite their ability to maintain hotel standards as a key challenge, and less than half achieved ADR growth (compared with a 72% average). These factors highlight the adverse impact of under investment on trading performance.

What might happen next?

Market commentators are regularly warning that we are approaching the peak of the current hotel cycle: EY restructuring services recently carried out an independent review of London luxury hotels that were breaching their covenants, and expressed some concerns that this might be the start of a trend, with potential pressures including an adverse impact on guest numbers through Brexit and longer-term declines in event volumes driven by technological change and a trend towards in-house training, together with ongoing capex requirements. What’s going to give: lower service standards? Longer refurbishment cycles? Will it only be the hotels that continue to maintain service and investment standards that do well?

Transaction wise, we are seeing signs that multiples are flattening and that competition for assets is decreasing. On the other hand global trends continue to show increasing volumes of international travel, which should bode well for hoteliers assuming the UK is able to maintain its attractiveness to travellers post Brexit.

How have you dealt with increased operating costs in the last two years?

- Increased rates: 35%
- Accepted lower profitability: 13%
- Reduced services (e.g., room service or dining and bar operating hours): 5%
- Reduced range of dining and bar offering: 5%
- Reduced level of maintenance or cleaning: 9%
- Reduced number of staff or implemented pay freezes: 25%
- Other: 8%

* Chart displayed on page 6.
Cost control and the need to drive operational efficiencies are a very common theme. Whilst hotels have the option of seeking to pass on cost increases to guests by increasing room rates, a substantial minority of respondents across all segments are accepting lower profitability with a reduced level of services — most likely reflecting the tight brand standards most hotels are obliged to adhere to.

The majority of respondents see upgrading back-of-house technology and systems as a priority ahead of focusing on directly customer-facing innovation. There is also a considerable portion of respondents who believe customer data analysis would improve their hotel’s overall performance, suggesting many hotels lack a proper understanding of what their customers value most, and hence what measures might have the most positive impact on overall performance.

To improve your hotel’s overall performance, which of the following tech solutions do you believe would have the greatest impact?

- New back-office IT systems (e.g., property management system (PMS), reservations, revenue management) 28%
- Automated check-in 22%
- New in-room technology (e.g., Alexa) 14%
- Customer data analysis 17%
- Integrated room key and point of sale card 14%
- Other 5%

When did your hotel last carry out a substantial capital improvement (e.g., major refurbishment of rooms or of a common area)?

- Less than one year 33%
- One to two years 27%
- Three to five years 19%
- More than five years 22%

Is the rate at which capex is spent aligned to the rate customer behaviour and demand is changing?

- Yes 49%
- No 47%

We could analyse our customer data better to help prioritise capex spend.

Ability to convert OTAs better
Perhaps predictably, room and common space upgrades were viewed as the capex projects most likely to drive profitability increases. Despite the challenges around food and beverage revenues, restaurants and bars were also highly ranked as a capex option. All this points to the prevailing view that defensive capex is the key priority in order to maintain that guest experience meets expectations.

**What kind of capex would most positively impact profitability?**

<table>
<thead>
<tr>
<th>Capex Project</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Room upgrades (including bathroom)</td>
<td>27%</td>
</tr>
<tr>
<td>Refurbished or repurposed common areas</td>
<td>18%</td>
</tr>
<tr>
<td>Improved Wi-Fi</td>
<td>7%</td>
</tr>
<tr>
<td>Back of house (new boilers, kitchen, etc.)</td>
<td>6%</td>
</tr>
<tr>
<td>IT systems (PMS, revenue management, etc.)</td>
<td>7%</td>
</tr>
<tr>
<td>Conversion of meeting rooms to bedrooms</td>
<td>8%</td>
</tr>
<tr>
<td>Restaurant or bar upgrades</td>
<td>15%</td>
</tr>
<tr>
<td>New facilities (e.g., spa, leisure centre or concierge)</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
</tr>
</tbody>
</table>

We need capex to keep up with competition – doesn’t necessarily mean we will get ROI.
Customer

Respondent comments confirm the view that it is not easy to justify expenditure on introducing new services, upgrades, furnishings, offerings, etc., given customers generally expect modern or new or different without appreciating the extra cost they will need to pay for the changes.

**Guest complaints:**
- Wifi 10%
- Size of room 12%
- Quality of housekeeping and room service 14%
- View from room 5%
- Dining and bar offering 19%
- Quality of room amenities 17%
- Service at reception 7%
- Other 16%

*Other includes:*
- Condition of rooms generally, dated state of rooms and bathrooms
- Noise
- Price
- Air-conditioning

**Actively monitor online reviews:**
- 90% of respondents actively monitor online reviews daily (10% weekly or monthly).

**Review and discuss all feedback daily with teams**

**Respond within 24-72 hours**

**Airbnb impact:**
- 56%
- 27%
- 16%
- 1%

- It’s costing us revenue and market share
- I don’t know
- Business has actually picked up
- No material effect
Has your hotel made any changes to food and beverage offering in last two years?

Of these respondents, 51% believe a restaurant or bar upgrade would have the greatest impact on profitability.

Of these respondents, 77% have experienced revenue or margin growth.

62% of respondents have made changes to food and beverage offerings in the last two years.

- Upgraded beverage menu to offer more premium products
- Complete overhaul, c.£1m spend and we are currently experiencing a 22% uplift in revenue
- Installed a branded restaurant
- New extensive gin menu, which proved a great success
- Adapted offering to market trends (e.g., to include healthy options, allergens specific, seasonal menus)

38% Yes 62% No

Of these respondents, 51% believe a restaurant or bar upgrade would have the greatest impact on profitability.
Options to maintain food and beverage offering:

- Branded management of restaurant
- Converting existing kitchen facilities into a ‘dark room’
- Subcontracting room service to third party (e.g., Deliveroo)
- Introducing more automation (e.g., self-service coffee machines)
- Other

Other includes many varied opinions on how to improve:

- Attract talent and train in our processes to maintain constant focus on the areas that impact conversions
- Consider closing the restaurant
- Convert meeting rooms to bedrooms
- Give the chefs their creativity back
- Prices are too high and this is because we are expecting a food and beverage margin that is too high. If margins were set lower, we would have a better selling price, giving us better footfall
- Refresh aligned to market research

Further automation and handing over restaurant management to brands were clearly seen as the preferred solutions to recent declines experienced in restaurant profitability. However, given the turmoil that has been experienced across the casual dining sector as a whole in the last two years, it is likely the point of ‘peak-brand’ has come and gone.

**Corporate facilities**

Thirty-two percent of respondents are seeing a decline in demand for corporate facilities. Commonly stated reasons for the decline are that meetings are being facilitated by clients in their own buildings or offices as corporates are spending less; conference call technology has improved; members clubs or co-working spaces are becoming popular options for meetings, and non-hotel venues, for example galleries or concert halls, are now offering a differentiated experience for corporate events. For conference and event-focused hotels, this represents a significant longer-term challenge, and may necessitate a major reinvention of their offering.

32% of respondents are experiencing a decline in demand for corporate facilities.
Innovation and digital disruption

**Digital disruption**

EY teams have developed the Disruption Index™ to benchmark technology adoption in various sectors. The tool can help clients understand the likelihood of disruption in their sector and also identify areas of value creation.

The travel and leisure sector has increased dramatically in the period from December 2017 to September 2018. What this means is that the rate of disruptive technology activity in the sector has more than tripled in less than one year. Hospitality businesses in particular, as a substantial population of the travel and leisure sector, are feeling the pressure to evolve.

The key technologies driving innovation for the hospitality subsector are artificial intelligence (AI), internet of things (IoT) and virtual reality (VR). Together, these technologies account for c.79% of technology penetration in the hospitality industry. AI and IoT have also shown the highest rate of acceleration in the last quarter. It’s apparent from the findings of the survey that hotel general managers share a common view regarding efficiency of back-office systems, an issue most believe ought to be addressed ahead of implementing more customer-centric technologies.

**AI**

The maturation of AI, combined with advanced data analytics, is increasingly enabling hospitality businesses to create unique offers and experiences in real time (and at scale) that appeal to the needs and desires of each individual traveller.

For instance, the prices of services such as spa treatments, restaurants, special events and rooms will be accurately predicted based on market demand signals, customer needs and wants, and their willingness to pay.

Advancements in technologies such as facial recognition, video analytics, autonomous vehicle and drones are expected either to support the aforementioned disruptive trends or create new ones.

**IoT**

Hotels are starting to equip rooms with voice-activated devices that are connected to the internet to enable customers to control their hotel room by talking to a virtual assistant.

Customer data can then be extrapolated to make valuable suggestions on destinations, lodging options, restaurants and even local events or activities. Furthermore, AI-enabled robots are expected to tackle many of the time-consuming tasks currently carried out by humans: for example, check-out, room-key access and room-service ordering.
Other developing themes

VR allows potential customers to experience a virtual tour of a hotel room and premises, or take a look at nearby attractions. It is starting to emerge as a vital marketing tool and is expected to redefine how the hospitality sector engages with customers.

Hotels are also increasingly partnering with airlines and other travel providers to widen the scope of their competing reward programmes, introducing cross-selling or upselling opportunities.

How EY can help

Please contact us to discuss how we can help. The key areas of EY knowledge and experience include:

- Transaction due diligence, including financial, tax, IT, commercial and operational advice
- Advice on all aspects of financial regulatory compliance from UK GAAP to IFRS transitioning
- Corporate finance and valuation services
- Strategic advice and market studies
- Digital strategy and innovation
- Tax compliance, advisory and reporting
- Working capital optimisation
- Debt advisory and financial restructuring advice
- Statutory audits and internal audit services

The EY Disruption Index™ helps organisations understand the state of technology penetration in their sector and how this may evolve in the future, enabling them to put plans in place so they can remain resilient to threats of disruption.
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