



HOTEL DEVELOPMENT IN THE AGE OF UNCERTAINTY

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The hospitality industry is undoubtedly reliant on the availability of air transport, and development strategies for hotel companies such as Accor do take into account the availability and extent of air transport available to the destination.

Air transport's impact on tourism and hotels was illustrated graphically in Australia over the past two decades. In the early 1990s when there was a pilot's dispute leading to most planes being grounded, and again in the early 2000s when Impulse Airlines and then Ansett went into receivership leaving Australia with limited services and, in many cases, a monopoly situation on certain routes.

On both occasions the collapse of airline travel caused massive disruption to tourism and stopped major hotel development programmes.

In the early 1990s, the pilots dispute co-incided with the first Gulf War as well as recession, where as the Ansett collapse coincided with September 11, then Iraq, Bali and SARS.

Airlines and the stability of airline routes are fundamental to tourism development, and the use of airliners in the September 11 attacks has fundamentally affected the way travellers feel about air transport.

The greatest affect has been on the top-end of the market. The collapse of the American and Japanese markets was the main result of travellers refusing to fly. Even now, the outbound Japanese market is still depressed, with many travellers concerned about the possibility that SARS will re-emerge and that flying increases of catching the disease.



On the other hand, the mid market and the backpacker sectors have been far less affected because these sectors are usually more resilient and committed to their travel.

This is one of the reasons why Accor's main development drive in Australia and Asia Pacific has been narrowed down to three major areas:

- economy hotel sector (Ibis & Formule 1)
- mid-market (Novotel & Mercure)
- backpackers (Base Backpackers)

The most exciting area for development is the backpacker sector, and Accor has identified this as a prime market. This has a great deal to do with air transport because as I mentioned before, backpackers will continue to travel even if there is regional conflict, medical problems like SARS, or economic downturns.

Not only has the backpacker sector proved itself to be the most resilient in the market, but it is also the sector with the greatest potential for future growth and diversification.

The backpacker travel experience is a very different one from that of the traditional tourist, who books an all-inclusive holiday package and stays in hotels, And all the evidence suggests that more and more travellers - irrespective of their financial status and even age - are choosing to travel this way because of the lifestyle aspects of the experience.

Our aim is not to change the backpacker experience, but rather to make it better and more reliable.



Until now, most backpacker accommodation demand has been channelled into unbranded, low quality backpacker motels and hostels due to the lack of quality branded accommodation, but Accor is set to change that with a fully branded and professionally managed operation that will attract even more travellers to the sector.

The backpacker segment is a logical progression for Accor, as we already are the leaders in providing accommodation for the economy and budget sectors, and we have experience of the youth market through operating the first-ever Contiki Resort in Australia, on Great Keppel island. Incidentally, Great Keppel was also very much affected by the changes to air travel patterns, with the resort becoming a major alternative to Bali, when Australian travellers cancelled tours to Asia following the Bali bombings.

While predicting events such as September 11, Bali, Ansett's demise and SARS are impossible, the fact that so many companies in the hotel and tourism sector are facing difficulties is more to do with ignoring fundamentals and makes them prime candidates for acquisition or consolidation.

The hotel industry – like all others – must heed the principles of supply and demand. There is excess supply in the 4 and 5 star markets throughout Australia and Asia. There are a few pockets left, particularly in resort areas, where development may be justified, but these are few and far between.

Developers seem to ignore the fact that without significant air infrastructure there is no way that you can build a 5-star or even 4-star market.



Accor operates the largest number of hotels in Western Australia's north-west region. We manage one of the world's most prestigious and renowned resorts called El Questro in the Kimberleys, but until recently it was very difficult to access the area because only Qantas flew into Broome following Ansett's demise.

I know Virgin Blue's David Huttner is speaking later, but the impact of VirginBlue beginning services to Broome was immediate. Our hotels in Broome, Kununurra and El Questro had their best season ever and while I would like to say this is solely because of the quality of the product and Accor marketing, airline access was crucial.

Gateway cities will always be favoured by hotel developers because of the extent and reliability of international and domestic airline services. In Australia that has meant Sydney has been the favoured location for hotel developers, though for two decades in a row there has been a boom in room supply followed by a very significant downturn. The restrictions on the growth of airline services to Sydney – because of the physical restraints of the current airport – means that there is unlikely to be any major new hotels developed in the city for a number of years.



Instead existing deluxe city hotels are being refurbished and the only new developments are economy hotels such as our Ibis and Formule 1 hotels.

Similarly, the LACK of airline access to Alice Springs and Darwin caused the Northern Territory to have one of its worst peak-seasons on record, though this has now been alleviated by the commencement of flights by Virgin into Alice Springs.

Although our three hotels in Alice Springs are in the mid-market, air fares of \$1200 Australian from Sydney to Alice Springs were naturally a complete dis-incentive for domestic travellers to visit their own country, when – for \$400 more – they could fly to Europe.

Airline access can make or break a hotel and sensible developers will decide on their development strategy according to the level of airline access.



I would like to give you an example that puts the current hotel investment situation into perspective.

The Novotel Sydney at Darling Harbour performs as well as, if not better, than any other 4-star hotel in Sydney. It has the benefit of a highly visible location – particularly after the Olympics – and has the further benefit of being located next to the Sydney Convention and Exhibition Centre.

It has been refurbished in the past few years, is supported by a global sales and marketing network, and has strong support in both the leisure and business markets, but the reality is that it still has an average rate in real terms that is much the same as it was 5 years ago.

That is hardly an inducement to invest in developing new hotels, especially when some of the newer 5-star hotels are recording occupancies of less than 50% and touting for groups for around \$100. You can see that with these figures and the cost of operating a 5-star hotel, there is little potential for a good return on investment.

I mentioned earlier that not all areas of the traditional hotel sector were over-saturated and didn't warrant further new development. The one area of the market where there is still potential is the economy or 2-to-3 star sector, an area where Accor globally has made a priority. We are very glad that we've had the sector almost exclusively to ourselves because it has been very profitable and continues to offer excellent returns. That's why we are currently developing new Formule 1s in Sydney's Kings Cross area, at Sydney Airport,

Perth Airport and Darwin.

Formule 1 is also now operating in Japan and we see great potential for our economy brands in both Japan and China.



China is the most exciting market because there is a vast domestic market emerging that is currently under-serviced. Leisure and business travellers are beginning to fly, sometimes for the first time, and so these travellers will be wanting accommodation in the economy or mid-scale area. You are hardly going to get on a jet for the first time and book into a Park Hyatt. But that fact seems to escape hotel developers.

I hate to use the airline analogy because it is clichéd, but it amazes me that the hotel industry works in completely opposite fashion to that of airlines. While the majority of airline seats are in the economy section, the majority of new hotel developments in recent years have been in the business class and above sectors.

To put that into figures, in 1999 for instance just prior to the Olympics, of 131 tourist accommodation developments that were under development or in the process of upgrading around Australia over 80% of them were in the 4 – 5 star bracket.

How can that make sense? Well, clearly it doesn't.

Certainly, 4 and 5 star hotels are more attractive in terms of marketing. They are the 'sexy' end of the business, and when you are designing glossy prospectuses, obviously it is much easier to "sell" marble and rich timbers compared to functional, compact 2 and 3 star hotel rooms. However, if you are looking for decent returns – then you have to look at the demand end of the equation.



Even corporate travel is overwhelmingly skewed towards this sector of the hotel market. This was highlighted in a recent survey by American Express of corporate travel management in Australia. The survey of 271 large and small companies across eight industry sectors revealed that 88% of the respondents stated they had a company policy of placing their travellers in 3 and 4-star accommodation.

We introduce our first Ibis in China at the end of the year in Tianjin, the fourth largest city in China and last month we introduced the first Ibis to Korea, and the launch of this brand recognises the changes in the travel market in Asia.

The success of budget airlines in Europe, America and Australia is well known and we'll hear from VirginBlue later, but the same trend is now beginning in Asia, and hotel developers must take note of these changes.

The arrival of Air Asia in Malaysia and the increased competition is bringing airline prices down and is creating a whole new market of regional travellers who perhaps would not have travelled if the fares weren't so attractive.

This group is internet-savvy and if they are travelling to see an event, meet family or friends, have a short-break holiday or building up their own business, then they will be looking for budget, but quality, accommodation.



Ibis doesn't take long to establish itself. In Australia, for instance, it took only five years to become the best performing brand in Australia. For October this year, our 10 hotels in Australia averaged over 85% occupancy, and even during SARS and Iraq they were averaging in the high 70s.

A hotel development strategy that recognises changes in airline patterns is crucial.

Far North Queensland is an interesting example. Once a market that was heavily dominated by inbound business, it is now a thriving domestic market as well.

So Accor concentrates its hotels for the inbound sector in Cairns city, but we have developed quite different styles of accommodation for Palm Cove, aimed at a domestic and European market.

The change was brought about in many ways because of changes to the airline industry. Iraq and SARS destroyed the American and Asian inbound business, but Palm Cove's occupancies actually grew during this period because of the increase in domestic services, competitive air-fares and Australian travellers fear of flying to competitive destinations such as Asia.

We are developing a Sofitel at Palm Cove, but its apartment-style is designed very much for an Australian and European market. In contrast our hotel developments in Cairns are very traditional, based on the fact that the majority of tourists will use the room to sleep in between activities such as reef trips, visits to the Daintree, whitewater rafting and so on.



The greater diversification of airline product has been paralleled by a greater diversification of hotel product and Accor on a global and local level has benefited from having a balanced portfolio. A few months ago we were able to announce the best – or should I say, least affected - annual results of any of the major global hotel groups. One of the main contributors to this has been Accor's choices for strategic development and the fact that we cover all segments of the market, which means that even if one region or one sector has a difficult year it is usually balanced out by good performances elsewhere.

To finish I would like to address the question of hotel development in the Pacific because it is linked totally to airline capacity.

Many of you will be aware that Accor planned a Novotel at Denerau in Fiji, only for the attempted coup and subsequent reduction in air services to Fiji effectively scuttled the development proposal. We are now re-examining it, but it highlights the vital need for stability if global hotel groups are to commit to projects on pacific islands.

Fiji, Vanuatu, French Polynesia and New Caledonia are completely dependent on air services, and this vulnerable position does make hotel development more difficult to justify. Combine airline AND political instability and the combination can be the death-knell for tourism and hotel development. Particularly for hotels as airlines can move their assets around.

We have examined many projects across the region in the past five years, but we have gone ahead with none of them. We are confident of announcing a new project in New Caledonia, but there is much to be done about improving infrastructure to warrant the new development.



If countries can provide the appropriate infrastructure, then airlines and hotels will follow. The two sectors of the tourism industry are in many ways reliant on each other, but we both rely on governments to provide the right environment for the tourism industry to firstly establish itself, then grow.

One last word concerning the Pacific area: Competitive pricing is obviously crucial. I emphasised during this presentation the attractiveness of the mid to low-end of the accommodation business. However in an expensive holiday destination such products might not be suitable as too pricey compared to a cheaper Pacific gateway unless the destination has a very exclusive offering.

Thank you for your attention and I look forward to meeting as many of you as possible during the conference.

