Traveling through the recovery

Ways THL companies should consider navigating the upturn

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Are we there yet?

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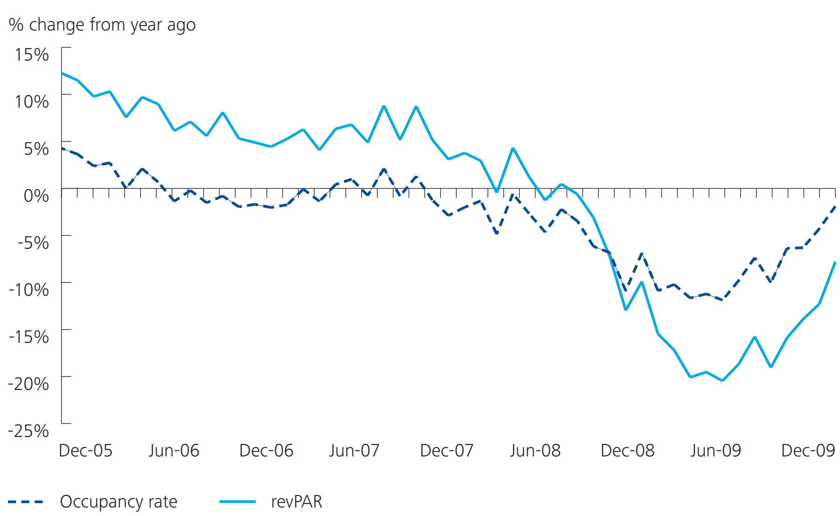
Over the last several years, tourism, hospitality, and leisure (THL) companies have experienced a downturn of historical proportions. Companies were glad to see 2009 come to an end. The protracted US recession that began in late 2007, and the global meltdown of financial markets that occurred a year later, led to a sharp cutback in spending from businesses and consumers. As both leisure and business travel contracted, many sectors suffered multi-year declines that were the worst ever recorded by industry-watchers.

The US Travel Association estimates that total travel expenditures in 2009 were $704.5 billion, representing a 9% decline from 2008[1]. Spending declines have been across the board and include international visitors and domestic travelers.

Hotel metrics: The worst may be over



Source: Smith Travel Research

Business travel, a large source of revenue for many hotel chains, has also been sharply curtailed. The declines came as companies looked for cost savings amid falling profits. Businesses cancelled many conferences and events or turned to video-conferencing. Increased scrutiny from the public on corporate travel spending was also partly responsible for these cutbacks.

The lodging industry experienced particularly steep declines during the recession. Smith Travel Research (STR) reported that occupancy fell for three consecutive years; in 2009 it was down to 55% — far below the 63% average of the last 20 years. Revenue per available room (revPAR) in 2009 dropped by a record-setting 16.7% and was the second consecutive annual decline. The luxury hotel segment has suffered the worst decline of any segment, with revPAR down 24.4% in 2009[2]. A sobering January 2010 comment from STR in HotelNewsNow.com was that "Every day in 2009, the industry sold 159,000 fewer rooms, and revenue was down more than $41 million. That amounts to 58 million fewer rooms, and $15.2 billion less in revenue. Those are huge numbers[3]."

Other hotel-related results were equally grim. In 2009, the hotel industry's estimated pre-tax income, at $12.8 billion, was half of its 2008 figure, according to Standard & Poor's. The industry's financial troubles have led to increased defaults on mortgages, and hotel construction has been sharply curtailed as a result of the weakened demand.

By late 2009, however, signs were emerging that the worst was over for travel-related companies, both in the US and abroad. As shown in the chart, the hotel industry's year-over-year comparisons, while still negative, are inching their way toward positive territory.

We expect US travel-related spending in 2010 to be helped by the anticipated passage of the Travel Promotion Act, which will likely increase advertising in foreign markets to encourage international travelers to visit the US. Additionally, the improving economy should ease budget constraints for both individuals and businesses. In early 2010, analysts were already noting that corporate meetings and conventions appeared to be picking up, following the steep declines of the last two years.

Despite recent signs that a recovery has arrived, most economists do not expect it to be robust. The economy is still far from healthy. Unemployment is likely to remain high in 2010 and growth in consumer spending should continue to be subpar over the next year or so as Americans work at paying down the high debt they accumulated during the house-as-ATM boom period of the mid-2000s. They also are expected to be saving more for retirement, particularly as the oldest Baby Boomers start turning 65 in 2011. We expect tourism, hospitality and leisure to be one of the last sectors to experience a turnaround, given that most spending in this area is highly discretionary.

Which road to take next?

Even after the general economy recovers, the environment will likely still contain challenges for THL companies. While certain regions will show improvement in occupancy rates, the industry will need time to heal.

Bottom line, it may be a slow and difficult turnaround in the days to come. As a result, THL companies may need to prepare themselves for the long haul. Many will need to do more with less money and less resources – and be clever about it.

In the remainder of this report we discuss several areas that THL companies might want to consider to help them "own the upturn" as the market slowly begins to heal. The following five insights may offer some of the best opportunities for hotel companies to improve cost expenditures, streamline operations, and connect with customers:

- Information-Driven Enterprise Resource Planning (ERP) Initiatives
- Virtualization and Information Technology (IT) Cost Reduction
- Retaining and Managing Talent
- Strategic Marketing
- Strategic Cost Reduction

"The best way to predict the future is to invent it."

– Alan Kay, American Computer Scientist

Insight 1. Information-Driven Enterprise Resource Planning (ERP) Initiatives

Imran Aziz, Principal, Deloitte Consulting LLP

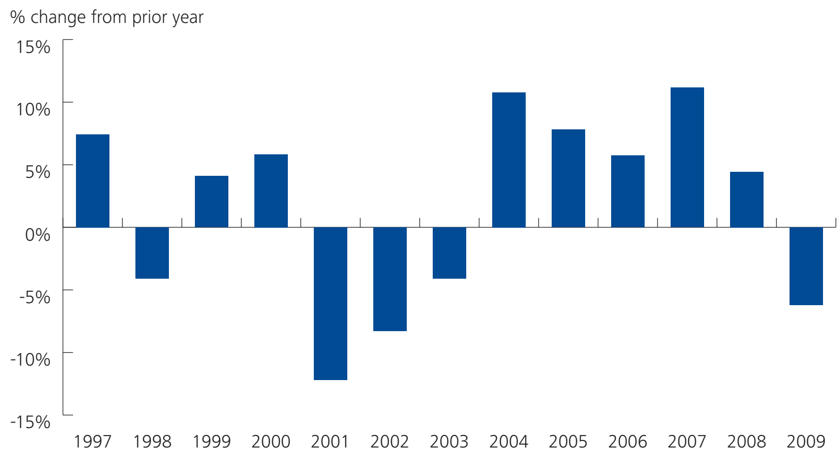
Many companies no longer dispute whether ERP initiatives add business value. The real question now is how far a successful ERP initiative can help a company launch itself ahead of its competitors by enabling the differentiated capabilities that drive business performance and improve shareholder value. An ERP initiative consists of streamlining the processes and technologies that support all functional departments relevant to the operation of a company. These departments can include customer service, product development, property management, strategic management, finance, and human resources.

Travel-related companies have historically regarded enterprise-wide projects as process-driven initiatives, asking the questions "What do I want to do?" (or, "Which processes should I include in the program?") and "How do I effectively execute those processes?" Advancements in ERP technology and service-oriented architectures provide the ability to consolidate and they give visibility to disparate information sources in the early stages of an ERP program.

We believe this new approach to viewing enterprise application projects should be information-driven to answer the question "What do I want to know?" or "What information is required by my company to make better decisions?" THL companies can leverage ERP initiatives to help them in their efforts to increase customer satisfaction, improve operational efficiency, and achieve flexibility to keep pace with changing economic conditions.

In today's economy, faster and better decisions are essential to creating a differentiated capability. Many THL companies are recognizing data (which drives business decisions) as a key enterprise asset requiring the adoption of data governance, master data management, and data privacy principles. By implementing master data management and business analytics applications in parallel with the enterprise applications, companies can gain access to business data in an accelerated timeframe that can enhance customer service. The faster access to business data enables THL companies to better measure the effectiveness of their service offerings and take appropriate actions based on actual performance.

2009 International Arrivals to U.S.: Down 6%



Source: U.S. Office of Travel & Tourism

Insight 2. Virtualization and Information Technology (IT) Cost Reduction

Michael J. Benore, Director, Deloitte Consulting LLP

Cost reduction remains a major focus in the THL industry, as well as almost every industry, even as the economy points to recovery. In the IT arena, organizations have been achieving significant levels of cost reduction through server virtualization, where companies are significantly reducing their server and data-center footprints by replacing multiple physical servers with one logical or virtual server. Often, cost reductions in double-digit ranges can be realized, with accompanying savings in licensing, hardware, maintenance, and support costs.

Many organizations in the hospitality industry have undertaken at least one and sometimes two rounds of virtualization. Many THL organizations have undertaken virtualization programs and achieved significant results. For example, one large casino chain reduced their server footprint from 30 sites to three, and their physical server count by nearly 50%. However, based on our research and experience, after their first wave of virtualization, most of these organizations only achieve 20-50% of the potential virtualization possible. The greatest cost reduction benefits can be achieved through the virtualization of complex, core business systems (enterprise resource planning, customer relationship management, financial, etc.), which many organizations are afraid to consolidate or "virtualize" due to the criticality of these systems to their business operations.

Additional benefits of virtualization include enabling rapid disaster recovery, high availability, resource leveling, and advanced power management. Disaster recovery times, often typically one or more days for complex systems, can be reduced from a day or more to just a few hours. Even dynamic, real-time computer resource leveling and failover, which allows for data to be rerouted to an alternate path so that services remain uninterrupted, are possible with a well designed virtualization architecture.

Insight 3. Retaining and Managing Talent

Tammie Potvin, Principal, Deloitte Consulting LLP

Successful companies today are owning the upturn by proactively and effectively managing their human resources. Having high talent, high performing, motivated staff working with customers is particularly important in a "high touch" service industry such as travel.

Not paying appropriate attention to employees can result in decreased productivity, turnover, and a loss of internal/institutional knowledge. Ultimately a lack of the right human resources can be detrimental to a company's long-term growth strategies and its attempts to drive positive change.

What are some good talent management moves to consider? A comprehensive talent management strategy includes a variety of different solutions, which may include:

- Talking to top performers one-on-one – about the company's future, their future, and thanking them for their contributions. Personal connections mean a great deal.
- Thinking outside of the compensation box – considering alternatives to pay that matter to people, like flexible work arrangements.
- Implementing flexible career paths that accommodate the unique needs of different generations, e.g., Gen X, Gen Y, Baby Boomers.
- Succession planning for key roles.
- Enlisting the help of managers and front-line supervisors by preparing them, giving them talking points, and asking them to help re-recruit top performers. People often take their cues from their immediate supervisors – if the supervisor is positive about the company's future, it's more likely that his/her direct reports will be as well.
- Providing appropriate training and development opportunities. This is particularly important in the THL industry where high turnover has always been an issue. Training budgets are often the ones that get cut first during belt-tightening. Don't scrimp on employees. Develop their skills and demonstrate that the company is interested in their long-term careers.

Insight 4. Strategic Marketing

Christine Cutten, Principal, Deloitte Consulting LLP

As the economy shifts into recovery mode, THL companies have the opportunity to refocus their resources and spend in a meaningful way to better position themselves for the new realities. This new positioning should start with clear, meaningful customer insights and strategies that better deliver the brand promise in an unclear market environment. A reevaluation and refocus of marketing activities and resources can enable hospitality companies to drive profitable growth by optimizing the return on their marketing investments. In today's interactive world, savvy THL companies are taking advantage of the opportunities provided by social media, mobile commerce, and blogging. Measuring the effectiveness of marketing campaigns and better aligning market strategies to processes, organization structures, and performance metrics across the sales and marketing value chain can lead to reductions in selling expenses, stronger customer relationships, and improved ROI.

Important steps to consider include:

- Review of customer data to determine changes in buying patterns. This can help improve the ability to effectively segment and manage the changing needs of the customer base.
- Analyze whether revisions to the brand promise and messaging are necessary. The analysis can help highlight customer values, strengthen existing relationships, and improve target marketing capabilities.
- Undertake possible changes to the promotional mix to support changing lifestyles. This can help improve the effectiveness and reach of current marketing spend. Social media and mobile are likely to be at the forefront of many marketing strategies in coming years, yet many THL companies lag in these areas.
- Re-evaluate marketing channels to leverage more cost-effective methods and/or social media. The cost of reaching core customers may, as a result, decrease.
- Make enhancements to loyalty programs that encourage longer-term relationships, help drive repeat business, and increase brand loyalty.

The ability of a hospitality company to market and sell to a changing customer base in a new market reality could help THL companies blossom in the post-recessionary world. If managed and executed correctly, marketing effectiveness activities can position an organization for long-term success.

Insight 5. Strategic Cost Reduction

Jean-Emmanuel Biondi, Principal, Deloitte Consulting LLP

During the downturn, most companies adjusted to the pullback in spending by reducing their costs. However, the "good times" that propelled the previous economic upturn concealed many business challenges related to structural costs. These deficiencies now need to be addressed.

- The customer base and product/service offerings have grown with limited focus on the "cost to serve" and profitability issues. These areas should now be reevaluated.
- Growth in different and new geographies proliferated, which strained processes, resources and systems. These resultant issues now need to be addressed.
- The increased volatility in demand levels and commodity prices require more flexible cost structures that can rapidly adapt to market realities.
- Many acquisitions have not been adequately integrated, leaving unnecessary duplication.
- While there have been some recent right-sizing efforts, there still is a critical need to simplify or standardize many organizations' hierarchies and processes.

Significant opportunities remain that can achieve strategic, sustainable cost savings and build a scalable cost structure to support the upturn. In particular, THL companies should consider taking action in three different areas:

- Challenge the existing business model and portfolio:
  - Reduce business complexity, e.g., rationalize products and customers, simplify and standardize business processes.
  - Resize the business portfolio to better align with new and shifting market demand.
  - Reassess operating models in light of the upturn.
- Improve infrastructure scalability:
  - Convert fixed costs to variable costs, possibly through outsourcing.
  - Increase the use of variable pay compensation.
  - Optimize labor through better planning, simplification and standardization of operations and training.
- Decrease functional costs:
  - Improve the service delivery model for general and administrative (G&A) functions.
  - Flatten the organization – reduce the management layers and increase the spans of control.
  - Leverage scale to improve the service delivery in such back-office areas as accounting and marketing.
  - Improve policies and processes for greater efficiency and effectiveness.
  - Reduce direct and indirect material costs for such items as food/beverages and supplies through sourcing strategies and vendor management.

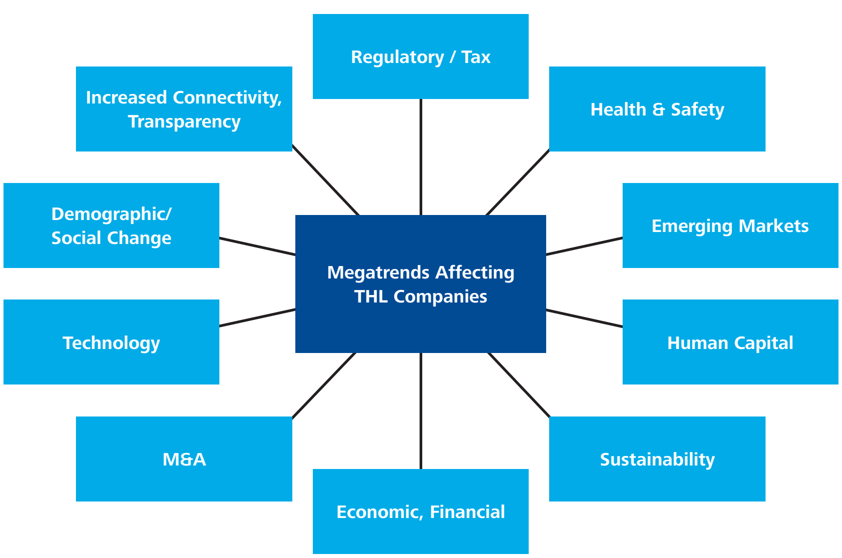
Even with the expected upturn in the economy, many THL companies will likely continue to face multiple short- to mid-term challenges. Recovery will be slow and vary by segment, market, customer group, and business unit. Capital and resources will likely continue to be constrained. Given these conditions, it is imperative for THL companies to further reduce structural costs and improve long-term competitiveness.

Moving ahead

In early 2010, the US economy showed definite signs of being on the mend. Helped by the rebuilding of inventories, Commerce Department data showed that real GDP in the fourth quarter of 2009 grew at the fastest pace in nearly six years[4]. Various leading economic indicators have been rising, signaling more growth ahead. Output at our nation's factories has been increasing and manufacturing employment is improving. Overseas economies are also recovering.

An important consideration for consumer-facing companies is that employment appears to be on the verge of turning around. Many economists expect slow growth to resume later in 2010. As consumers' incomes increase, their spending on many of the discretionary areas that encompass tourism, hospitality, and leisure will likely increase. The US Travel Association expects a near-5% increase in travel spending in 2010, but even with that increase, spending still will not have returned to the 2008 level[5].

With the expected slow recovery, companies should continue to seek a competitive edge by having access to reliable, easily accessible data that can improve decision-making, by developing and training staff so that high levels of customer service are nurtured, and by keeping on top of new ways to reach and interact with consumers.



In addition to the insights mentioned earlier, there are other options for THL companies to consider to help them build a stronger future.

- Opportunities in emerging markets may be particularly suitable to positioning for long-term growth.
- Senior management of THL companies should work to encourage collaboration and suggestions for change from the ranks. Greater efficiencies can often be achieved simply by listening to those who are closest to the customer.
- Sustainability initiatives can help grow brand awareness and acceptance. This could become an important consideration in the years ahead if environmental concerns deter greater numbers of consumers from traveling.
- Mergers and acquisitions may prove to be profitable over the near term, given the low valuations in many THL sectors.
- React to the expanding competitive landscape by focusing more on innovation. Companies should actively seek input from consumers on this topic, to help improve product and processes.
- Improve long-term finance strategies that can help better position a company for growth.

THL companies that can better integrate the objectives and resources of the organization with the needs and opportunities of the marketplace will be better positioned to capture more customers and should be stronger from having weathered the storm.

Over the last several years, the shifting economy required THL companies to become more cost-effective in running their businesses. But now that the worst of the downturn has likely passed, THL companies will need to reinvigorate themselves to operate in the new, more competitive landscape. To best navigate the recovery path, businesses will likely need to adapt their strategies to this vastly changed roadmap. Companies that are the most nimble and responsive to changing consumers will likely be best suited to capture the opportunities found along the journey.

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Endnotes

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