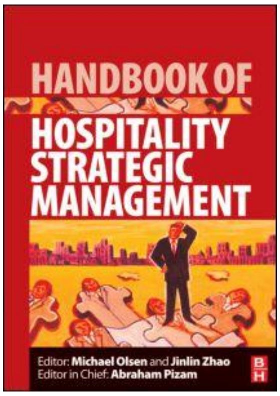

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The development of international hotel chains in Europe

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Part Two

Strategy as investments in competitiveness

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CHAPTER 3

The development of international hotel chains in Europe

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Introduction

At the end of 2006, the 52 countries of Europe had around 5 million hotel rooms of which 1.5 million were affiliated to hotel chains. In total there were more than 400 companies that operated portfolios of hotels within which there were more than 500 hotel brands. Of these brands, 185 accounting for 1.1 million rooms were present in more than one country and thus were international in their supply profile. In the year 2000 the European hotel chain presence accounted for about 100 international brands with about 700,000 rooms. Over the period, international chains grew their room stock in Europe by 410,000, an annual average of 8% and an indicative capital value of €88 billion. Drawing on the Otus Hotel Brands Database (2007) we will illustrate patterns in the international development that occurred, we will explain why this burst of international hotel chain expansion occurred and we will identify how it occurred. Before we tackle these questions we will review the academic literature on the internationalization of hotel chains and we will conclude with more effective interpretations of the development of international hotel chains.

Literature review

Contractor *et al.* (2003) are of the view that there has been little research on the growth and internationalization of service firms. While it is not clear as to the criteria employed to justify this comment, Litteljohn *et al.* (2007), in their review of publications from 1996 to 2005 from academic, industry, and policy sources confirm that research in the area of hotel internationalization is growing. However, when compared with research into hotel marketing, operations, and customer satisfaction it is much smaller.

In hotel internationalization research there has been a fixation with studies into the modal choice decisions or market entry strategy of hotel chains, much of it described as relatively homogenous in nature by Litteljohn *et al.* (2007). Dunning's (1981) eclectic theory has been favoured as the theoretical foundation for much of this research, possibly due to its holistic approach to explain hotel internationalization (Litteljohn *et al.*, 2007). However, transaction cost theory has also been applied and over time the hotel literature has begun to integrate a range of theoretical positions.

Research studies (since 1996) into those factors that influence international expansion overall, and modal choice more specifically, are examined comparatively by Litteljohn *et al.* (2007); it is therefore our view that they do not require further review here. It is interesting to note though that the majority of these previous enquiries identify the importance of internal, firm-specific factors with the experience and extent of internationalization and perceptions of executives being the most prevalent aspects influencing international and modal choice decisions. This perhaps reflects the more internally focused research efforts as well as the employment of more qualitative in-depth methodologies by researchers than in the past. Over the years, the unit of analysis has changed to that of the multinational firm as opposed to earlier work where, although senior executives in international hotel chains were the sample, the focus was more on individual hotel location decisions rather than on the strategic advantage of multinationals.

This body of previous research offers no outcome that prioritizes particular areas or possesses significant predictive power. Indeed, in more recent research carried out by Jones *et al.* (2004), no consistent pattern to entry mode choice was found within or across a sample of 512 firms. New lines of enquiry however are developing in more recent research, which reflects more contemporary developments among international hotel chains. We summarize some of these below:

- O'Gorman and McTiernan (2000) concluded in their analysis of Irish SME hotel chains that investment in organizational capabilities was more important than international experience, reflecting the identification of the phenomenon of the resource-based view and organizational competencies in the mainstream internationalization literature (a move on from the predomination of internalization and eclectic theories). A similar line of enquiry was taken by Aung and Heeler (2001) who applied the core competency concept to Accor and its competitors in the Thai marketplace. Their work is particularly useful in reminding us that while there is still multipronged competition with chains based in North America, Europe, and Asia competing in most of world's largest markets (Whitla *et al.*, 2006) multinational hotel chains are also being forced much more to "share the same economic and competitive pie with small local firms" (Aung and Heeler, 2001, p. 638). The latter of course is even more the case in certain market segments, a point established next.
- Chen and Dimou (2005) identify the importance that market segmentation plays on modal choices, a factor that seems to have been wanting in previous studies perhaps due to the fact that early internationalization was "based on branded,

often North American branded, relatively up-market and business-travel oriented provision" (Litteljohn, 1997, p. 187). In terms of the extent of internationalization, up-market brands require substantial capital, average €280,000 per room, to create portfolio mass. It is budget and economy hotel portfolios that need most length, because they are in the mass market, but require significantly less capital, average €75,000 per room for economy hotels and €30,000 per room for budget hotels.

- While demand has often been identified as an important driver for hotel development (it is explicit in the location-specific advantage construct), access to capital has so far been insufficiently explored as a driver for decisions on where, what and how to develop hotel brands. Altinay and Altinay (2003) establish the importance of this factor in their paper, although one cannot generalize single case study findings. Doherty (2007) has similarly identified the issue of capital availability as a driver, but in the context of fashion retailers.
- Doherty (2007), although outside the hospitality area, also establishes the importance of the presence of strong franchiseable brands, which attract franchise partners and third party investors. There is a link between franchising and the availability of capital, given that it is a non-equity means of growth for hotel brands. The key to growth through franchising is the availability of potential (franchise) partners, which in turn depends on the availability of capital for single hotel assets. While all other factors maybe in place, the reality of the marketplace and its impact on the availability of franchise partners may make entering through franchising difficult. This is a line of argument not fully appreciated in the location-specific advantage construct and is linked to the accessibility of investment capital, as mentioned above. Connell (1997, p. 95) recommends that "Franchisors need to assess not only whether…strategy would work for customers but how departures from domestic formats will affect longer-term efficiency and effectiveness of the wider franchise network."
- More recent research by Dev *et al.* (2007) and Brown *et al.* (2003) is somewhat revolutionary in finally arguing that ownership and control dimensions of foreign market entry choices can be separated and that decisions relate to more than just production and distribution and include marketing and operations. Using an integrated theoretical framework they focus on three factors important to the entry strategy of their 124 hotel chain sample: namely, the firm's ability to transfer its

know-how to the local market, the ability of potential local partners to absorb the know-how, and the availability of qualified and trustworthy investment partners in the local market (Dev *et al.*, 2007, p. 21). The authors conclude that the "interplay between the company's strengths and local resources drives the type of partnership or affiliation arrangement that the company uses to enter the foreign market" (Dev *et al.*, 2007, p. 13). This research reflects much more the state of play among hotel chains today and recognizes that at the hotel property a number of different parties may be involved in its ownership, management, and marketing.

- The preference of senior managers (often resulting from past experience and stakeholder needs) is a further interesting line of enquiry. Several authors (Altinay and Roper, 2005; Altinay, 2005) suggest that the influence is often strong of those key managers responsible for international franchise operations as they are driven, experienced people with very definite ideas as to why franchising is the best method to internationalize. The impact has also been felt at property level where hotel managers' relational skills and expertise has had to be extended due to the importance of mutually beneficial relationships between hotel chains and their property owners (Gannon, 2007). The research carried out by Groschl and Doherty (2006) also points to the fact that traditionally market entry modes used by companies were strongly influenced by national origins.

Limitations still exist among these more contemporary studies. The analyses by academics of the internationalization of hotel chains have tended to be empirically small, discrete, one-off analyses with a variety of methodologies from shallow surveys of managers to single case studies and offer conclusions that rarely progress beyond the commonplace. In contrast, the analysis that follows here draws on the continuous tracking of all hotel chains in all 52 countries of Europe, the continuous tracking of the economic structure of each country as well as the response by hotel chains to the specific sources and patterns of demand in each country and its sources of capital.

There are fundamental questions for hotel chains faced by the need or inclination to expand beyond their home country. The first is, which countries to expand into and within the selected countries, which regions, cities, and specific sites on which to concentrate and why. In parallel, the chains need to satisfy themselves about which of their hotel brands will be most effective for the available demand in the selected countries and which new brands will need to be developed and why. We start by providing an overview of the growth of international hotel chains in Europe between 2000 and 2006.

Overview of international hotel chains in Europe 2000–2006

As the table below illustrates, in the period since 2000 significant international development by hotel chains occurred in Europe (Table 3.1).

Of the 52 countries of Europe only Belarus, Liechtenstein, Moldova, San Marino, and Turkmenistan are without a presence of international hotel chains. This should not come as a surprise since they are also the only countries in which there is no hotel chain presence whatever. Of the 410,000 rooms added by international chains over the period, more than 60%, 256,000 with a capital value of €49 billion, were added in only four countries: Spain, UK, France, and Germany, which are among the largest, with a combined population of 243 million and structurally most developed economies. This translated to 950 citizens per international chain room and an average capital cost of €190,000 per room. The hotels added by international brands in these countries covered all market levels: deluxe, up-market, mid-market, economy, and budget, but three quarters were at mid-market, economy, and budget. They also covered all affiliations: owned, leased, management contract, and franchised.

A further nine countries: Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, Kyrgyzstan, Serbia and Montenegro, Ukraine, and Uzbekistan, which have a combined population of 110 million, are among the weakest and structurally most underdeveloped economies, which were the target for international chains to add only 2580 room additions with a capital value of only €1.4 billion. This translated to 43,000 citizens per international chain room and an average capital value of €530,000 per room. Three quarters of these rooms operated

Table 3.1 Total International Hotel Brand Development 2000–2006

Year	Brands	Countries	Rooms	Capital Value (€bn)
2006	185	47	1092 K	196
2000	100	40	682 K	108

Source: Otus & Co. Advisory Ltd.

at the up-market level, all hotels were affiliated to the brands by equity free management contract or franchise and none of the international chains invested capital in any of the hotels.

Estonia, Iceland, Latvia, Lithuania, Macedonia, Portugal, and Slovenia, which have a combined population of 22 million are stronger economies, but still are structurally weak, added only 2460 rooms with a capital value of only €1 billion. This translated to 8900 citizens per international chain room and an average capital value of €420,000 per room. The hotels covered a wider range of market levels and all of the affiliations. Gibraltar, Luxembourg, and Monaco, which have a combined population of only 510,000, but are among the strongest and structurally most developed economies, added only 800 rooms mainly mid-market, up-market, and deluxe at a capital value of €0.5 billion. This translated to 435 citizens per international chain room and an average capital value of €660,000 per room. In these countries, the chains invested more of their own capital. In the remaining 24 countries with a population of 486 million the international chains added 155,000 rooms, around 6500 in each country amounting to a capital value of €36 billion. This translated to 3130 citizens per international chain room and an average capital value of €230,000 per room.

All of the chain presence in 20 of the European countries is from international hotel chains—Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, Kazakhstan, Kyrgyzstan, Ukraine and Uzbekistan; Estonia, Latvia, Lithuania, Macedonia, Malta, Norway and Slovenia; Andorra, Gibraltar, Luxembourg, and Monaco. This list of countries very closely resembles the countries in which international chains added fewest hotels. The simple reason why all of the chain presence in these countries is by international chains is that there are no domestic hotel chains. The remaining 27 countries contain both international chain hotels and hotels that are in the portfolios of domestic hotel chains that do not operate in any other countries.

Just as there has been explicit patterns in the countries of Europe into which international hotel chains have expanded so also has there been explicit patterns in the choice of cities into which they have expanded. The two major hotel cities in Europe—those with more than 30,000 chain rooms—London and Paris, saw international chains add 20,000 and 11,000 rooms respectively. The 29 primary hotel cities—those with more than 6000 chain rooms, but less than 30,000 chain rooms—including: Madrid, Berlin, Barcelona, Amsterdam, Frankfurt, Munich, Vienna, Rome, Budapest, and Stockholm, saw international chains add 106,000 rooms, an average of 3650 per city. The remaining 273,000 rooms added by international chains are located in around 3000 conurbations, an average of less than 100 rooms per conurbation. A fundamental driver of the choices of countries and cities for expansion by international hotel chains is the expectation of superior demand growth and this is a function of the structure of the economies.

Economic structure and the growth of hotel brands in Europe

Economic activities have been classified and periodically revised by the United Nations Statistics Division (2006), International Standard Industrial Classifications into three groups:

- Primary industries such as cultivation of crops, livestock production, fishing, forestry, and hunting.
- Secondary industries such as construction, manufacturing, mining, quarrying, and utilities.
- Tertiary industries such as banking, bars, betting shops, bingo clubs, casinos, cinemas, communications, distribution, education services, finance, health services, hairdressers, hotels, insurance, logistics, personal services, professional services, public administration, restaurants, retailing, security services, sports clubs, storage, transport, travel, theatres, visitor attractions, and welfare services. Within each of these activities there are sub-divisions that extend tertiary activities throughout the lives of citizens of advanced economies and establishes the tertiary segment as the most diverse and complex of the three economic segments.

Employment in each economic segment is different. It requires different knowledge and skills and it involves different relationships with the land, with machines, with colleagues, and with the buyers of their output. As the balance of an economy ascends through the economic segments so its structure becomes more complex and diverse. It is what is meant when we talk of economic progress. At any one time within any economy some economic activities are in a period of growth, others are in decline and yet others have not emerged. There are skills and jobs that are in demand to deliver the economic output, others that are in decline and vanish, and others that have yet to emerge. As a result, the availability of products and services is not constant and their provision and consumption is not uniform. The economic activities and jobs within an economy are the building blocks of economic structure. As they change so do patterns of provision and consumption and vice versa.

Each European economy is involved in primary, secondary, and tertiary economic activities and the amount and types of activity in each segment determine its economic structure. Tertiary activities are different in kind from primary and secondary activities. At the core of the difference is that tertiary activities are concerned with the provision and distribution of services whereas primary and secondary activities produce durable and non-durable goods. Within primary activities the dominant work interaction is between the worker and the land. Within secondary activities the dominant interaction is between the worker and the machine. In tertiary services, the crucial relationship is between people. A wider range and frequency of operational interaction with colleagues is necessary for the provision and delivery of services as is the interaction between the providers of services and the consumers of the services. Reflecting this, services involve more mental work than the manual work that is characteristic of primary and secondary activities and consequently more white-collar work than blue-collar work.

The range of tertiary activities is too diverse to be of sufficient analytical value to explain the demand for services and they need to be classified into more homogeneous groups. The classification of tertiary services must accommodate two influences: one is the inherent features and functions of the services and the other is the influence of the political system of a country on its economy. The political influence is crucial. At one extreme, under Communism, the government controlled all services, whereas at the other extreme, in a free-market economy, many services are businesses with little control exerted by the government. The more that the supply of and demand for services within an economy are controlled by the government, then the weaker the structure, performance, and growth of the economy as a whole and services in particular. Accordingly, we present the tertiary economy in three stages: citizen services, market service businesses, and experience businesses (Pine and Gilmore, 1998).

Citizen services are controlled by governments. In Europe, access to many citizen services such as public education, public health care, and social services are available to all as a right of citizenship and most are free at the point of delivery. As a result, some citizen services such as public health and public education have grown to be among the largest employers in a country. As the structural balance of an economy becomes tertiary, citizen services expand. Education expands as childhood and adolescent education become mandatory and a higher proportion of the population have access to further education, higher education, continuing education, and pre-school education. Health care improves to sustain longer life expectancy and diversifies to include preventative as well as curative medicine. Community health grows and paramedic disciplines such as nutrition, physiotherapy, and holistic medicine advance and the prison service seeks to reform criminals in addition to their basic custodial role.

The extent to which the citizen services dominate the tertiary segment is both a political and an economic matter. Indeed the main theme in political economy throughout the 20th century in Europe and North America was about the most effective way to provide citizen services. Europe emphasized the moral responsibility of governments not only to provide citizen services, but also to ensure that all citizens had access to them. In contrast, the US approach emphasized the role of citizen choice in accessing many services and that when choice was involved a market was created. Thus, the US approach was to involve business in the provision of many citizen services. The distinction between Europe and the US in the role of the government in the provision of citizen services was at the core of the distinction throughout the century between the left wing and the right wing in politics. The more leftwing a government, the more its commitment to managing citizen services and the more it extends its management of the economy by taking control of key sectors including: coal, oil and gas, water, electricity, telephony, roads, rail, air transportation, and any other that it deems sufficiently important to national preservation. In these ways its commitment is to big government. The bigger the citizen services segment the more income the government needs to generate from other parts of the economy to fund the provision of citizen services. The result is that when the market service and experience segments are minor, a higher tax burden falls on the primary and secondary segments and the poorer the quality and scope of core citizen services such as health and education. The more rightwing an elected government the less it is committed to the encroachment of citizen services and the more it is committed to the development of market service and experience businesses. In these ways its commitment is to smaller government. The less pervasive the citizen services segment and the larger the market service and experience segments, the more business activities there are in the economy from which to generate government income to provide citizen services. The result is a lower tax burden on primary, secondary, market service, and experience businesses and the higher quality and scope of core citizen services such as health and education.

Market services include: banking, communications, distribution financial services, logistics, personal services, professional services, real estate management, retailing, and wholesaling. Unlike citizen services, market services are not administered by the state. They are businesses whose size, range, and performance are determined by prevailing conditions in the two markets that they serve, the corporate market and the personal market. As secondary activities mature, the growth in market services businesses is faster because of the growth of the personal markets in addition to the growth in corporate markets. The growth of personal demand in market service businesses requires their adaptation to meet the demands of the mass of the population.

As secondary economies grow and prosper there is increasing growth in the range of consumer goods produced and retailing emerges as a distinct skill to maximize the sale of goods. There is the recognition that manufactured goods do not sell themselves and that advertising, marketing, merchandising, and in-store facilities are necessary to sell more goods. Shops become larger and retail chains grow nationally. Buying consumer goods involves the transfer of ownership of the goods, but there are differences in the patterns of purchase and use of durable goods and non-durable goods. Consumer non-durables such as food and drink involve frequent repeat purchase because they have a high degree of perishability and once consumed cannot be re-used. Once consumer durables such as brown goods, white goods, cars, and houses have been acquired there can be continued gratification from their use and re-use. Repurchase of consumer durables depends on the goods wearing out, falling out of fashion, or becoming obsolete. Moreover, the consumption of many consumer durables, particularly brown and white goods, is private consumption, which occurs within the home.

The largest and fastest growing of the market services are financial services. As secondary economies grow and prosper so does the demand for financial services from both corporate and personal customers. The proportion of the population with bank accounts increases materially and financial services diversify. The access to personal credit is eased so that the volume of unsecured loans increases as does the supply and use of credit cards, which accelerates personal spending on both goods and services. There is also an expansion in savings through pension schemes, insurance policies, stock market investments, and other forms of saving. The provision of mortgages to enable citizens to own their home rises sharply and provides the widespread source of ownership of an appreciating asset. The communications industry was transformed by the inventions of the postal service, the telephone, radio, motion pictures, and television. In the late 20th century there was a further explosion in communications for both the corporate and the personal markets with the invention of mobile telephony, personal computers, and the Internet. Personal demand for domestic services such as housekeeping, home repairs, home maintenance, and gardening increases as do quasi-domestic services such as laundry, dry cleaning, and car maintenance. As an economy develops its tertiary sector so the range of asset classes increases. As well as land and industrial real estate, which are the preserve of the primary and secondary segments, domestic housing increases with population growth and the growth in prosperity. Citizen service expansion produces an increase in the number of schools and hospitals. Commercial real estate increases with the market service economy as a result to the greater need for offices, warehouses, and retail outlets. However, the widest diversity of real estate occurs as the experience segment of the economy grows. Experience activities occur in venues: hotels, restaurants, bars, nightclubs, sports clubs, health clubs, hairdressers, visitor attractions, cinemas, theatres, aircrafts, and cruise ships. As the experience segment grows to become a significant part of the economy so experience properties emerge to become a significant asset classes and real estate management becomes a specialist professional service.

In addition to its demand for banking and financial services, communications, and real estate management there are two other ways in which the corporate market accesses market services. First, distribution and wholesaling are the preserve of the corporate market and secondly, as well as professional services occurring in their own right there are professional services within corporations. Such jobs include white collar and professional jobs in accounting and finance; marketing and selling; human resource management; and other professional services. The larger the size of an organization the larger the corporate infrastructure and the more and wider the range of professional service jobs within companies, irrespective of the industry or service in which they operate. The development of larger industrial companies in the US than in the European countries meant that the US also developed larger professional services within these companies and at an earlier stage of economic development than in Europe.

The third tertiary segment relates to experience businesses that include hotels, restaurants, bars, nightclubs, casinos, bingo clubs, hairdressers, health clubs, and visitor attractions. They also include passenger air travel, sea travel, and rail travel; sports watching and sports playing; other out-of-home recreation activities such as theatres and cinemas as well as private health care, private education, and private custodial services. Experience businesses provide contexts in which their customers, students, patients, clients, passengers, prisoners, audience, players, and spectators are participants in events, which are designed for them to experience sensations such as enjoyment, knowledge, health, or remorse. The prime market for experience businesses is the personal market. Corporate demand for experience businesses is limited to business travel and the use of hotels, restaurants, and other experience venues for business entertaining. For the personal market there is a sequencing of demand between market services and experience businesses. The frequency of personal demand for a wide range of experience businesses accelerates when ownership or at least the access to the compass of household and personal consumer goods has been achieved. In contrast, there is less sequencing between market services and experience services for the corporate market, which accesses the services as required. As with the other classes of tertiary activity, the political influence on the experience segment is crucial. State involvement in the experience segment has shown itself to be the major depressant of personal experience businesses since they become prescribed by the state. The only economies in which personal markets for experience businesses have become economically significant are those in which government intervention has been slight.

There are six features of buying experience services, which differentiate them from other purchases:

1. Experience activities occur in specific venues such as hotels, casinos, and aeroplanes designed to deliver specific experiences.
2. Consumption in experience businesses occurs on site. Central to the management of experience businesses is the creation of the conditions for consumption in the venue and the management of the consumption process. This is different from market services such as retailing where consumption occurs away from the point of sale and outside the control of the retailer or service provider. Retailers do not manage the consumption of the products that they sell.
3. Consumption in experience businesses is both time and location specific. Thus, experience services cannot be stored. A hotel room, which is not rented for any night is business lost forever whereas consumer durables can be stored, sold, used, and re-used.
4. Buying experience services involves renting, but not transferring ownership of facilities and the relationship between the buyers and the providers of the experience services is a

crucial ingredient for the buyers to achieve their goals. Thus, jobs that involve direct contact with buyers of experience services are relationship intense.

5. Because the buyer of an experience service does not own the service, continued gratification can only be gained by buying again. After the experience of hospitality only the memory sustains gratification until repurchase. Enjoyment of an experience, for example, is a powerful motivator and the memory is short term in its capacity to sustain gratification without re-experience.
6. Consumption in experience businesses occurs out of home. They involve conspicuous public consumption, which defines status, standard of living, and lifestyle of the participants.

Economic performance and economic structure

Economies with low GDP/head in primary and secondary activities are not able to make an effective transition to tertiary under any political system because there is not enough government revenue to fund any more than basic citizen services and there is not enough corporate and personal income to generate demand for any more than the most basic market service and experience business. The prime condition for an economy to make the transition in structural balance from secondary to tertiary is a sufficiently high GDP/head in primary and secondary activities to generate enough government income to fund more extensive citizen services and to generate demand from the population and from corporates for mass-market service and experience businesses. In 2005, the Russian GDP/head had reached $4000. In the same year the US economy achieved $40,000, 10 times more and Britain achieved $36,000, nine times more. Also in 2005, Russian GDP/head in agriculture reached $200 at a time when the US achieved better than two and a half times more and Britain better than one and a half times more. In the same year, Russian secondary industries achieved GDP/head of $1400, while the US and Britain each achieved more than six times as much, but the sharpest differences were the tertiary segment. Russia delivered tertiary GDP/head of $2400, while the US bettered it by 13 times and Britain by 11 times.

The figure illustrates the diversity of economic structures in Europe and the US is added as a comparison (Figure 3.1).

The significance of economic structures for making sense of hotel demand and supply is that greater the proportion of GDP generated by the market service and experience segments, the greater the volume of hotel supply and the greater the level of

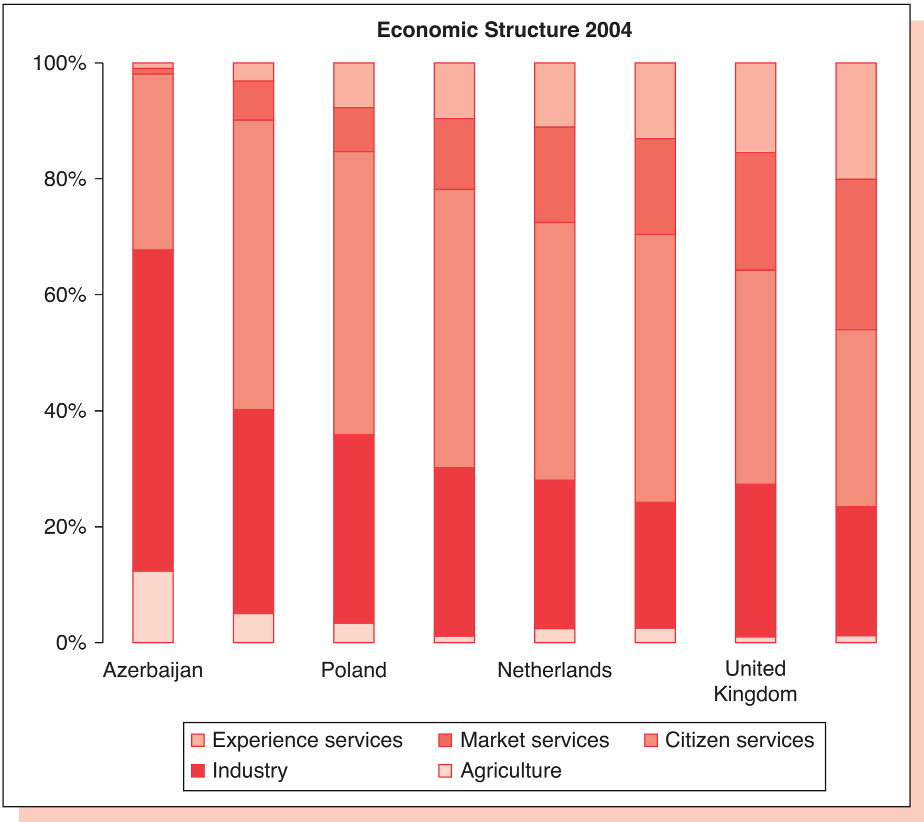

Figure 3.1
Economic structure in selected European countries (*Source*: World Bank and Otus & Co. Advisory Ltd.)

concentration in the hotel business as the figure below illustrates (Figure 3.2).

Many countries of Europe including: Austria, Belgium, Denmark, France, Germany, Ireland, Italy, Netherlands, Spain, Sweden, and Switzerland have reached the stage at which the structural balance of the economies is moving towards service businesses, which provide their most effective source of growth and employment. Britain has already passed this stage and now enjoys the benefits of being a full-blown service business economy. This group of countries account for 76% of the rooms and 56% of the total capital value added by international hotel chains since 2000, in spite of the recession, sluggish growth, and geo political atrocities suffered by many in the early years of the period. The economic policies being pursued by the governments of these economies are designed to grow market service and experience businesses and accordingly they present the

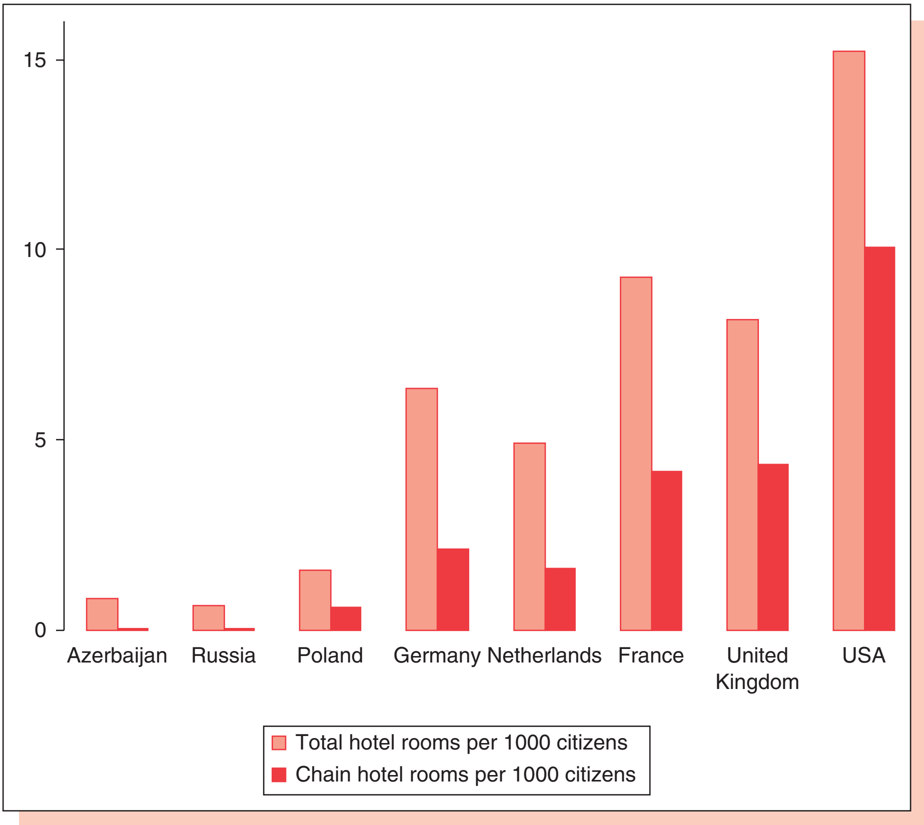

Figure 3.2
The supply of hotel rooms and chain rooms per thousand citizens (*Source*: Otus & Co. Advisory Ltd.)

prospect of strong future growth in hotel demand and are a continuing attraction to international hotel chains. Otus projects that, over the next 10 years in these economies, the agriculture and industrial segments will grow at sub-market levels, that citizen services will grow in line with the market, but that market service and experience business contribution to GDP will achieve real growth. As a result, the segments of the economies that are growing at the fastest rates are also the segments that provide most demand into hotels. Otus also projects that, over the next 10 years, hotel chains will need to add at least 1 million hotel rooms to service the projected demand growth. When this stage was reached in the US in the 1950s and 1960s there was a rocketing growth in hotel demand and an equivalent growth in hotel chains. For instance, from a standing start in 1952, Holiday Inn grew its portfolio to 100,000 rooms by 1960. At this period in the US, hotel chain growth was predominantly by domestic chains since few international chains existed and the US was not only the largest hotel market in the world, but also the fastest growing. Indeed, in 1964 Hilton Hotels Corporation (HHC) sold its international business to raise the capital necessary for it to participate vigorously in the growth of the US domestic hotel market. Similarly, in the 1980s when the UK economy reached this stage in the development of its economic structure, hotel demand escalated, as did the growth of hotel chains.

The greater the proportion of GDP generated by the market service and experience segments, the greater volume of hotel demand. It is for this reason that the US has the highest level of concentration in the hotel business and the highest ratio of hotel chain rooms per 1000 citizens. Within Europe, Britain has the most structurally developed economy and has the highest level of hotel concentration and the highest ration of chain hotel rooms per 1000 citizens. The diverse pattern of economic structures throughout Europe determines the diverse volume of demand for hotels. Agriculture is not only the smallest contributor to GDP in most economies, but most of its sales are in its local region and to wholesalers. Thus, the proportion of agricultural employees whose job requires business travel is microscopic as is the volume of agricultural business demand into hotels. Within the industrial sector the bulk of domestic business travellers are sales and marketing executives, who constitute a minor proportion of total employees. As the structure of economies develop and industrial activities decline as a proportion of GDP and of employment so also does the volume of sales and marketing executives and thus, the volume of hotel business demand that they generate. Within citizen services there are no measurable sales and marketing functions that involve regular business travel with hotel stays. The majority of the business travellers within citizen services are professionals in education, health, and social services whose roles involve only infrequent hotel-based business travel. Market service businesses and experience businesses require a high proportion of executives from the corporate structure to be involved in frequent business travel, because the very nature of service businesses entails that a greater proportion of executives interact with customers and with creating the conditions for customers to buy their services. Executives in sales and marketing, accounting, finance, human resources and development are all involved in business travel as part of the operational management of the companies. Consequently, when the market service and experience segments of an economy achieve real growth so the business demand into hotels grows significantly. It is not only domestic business travel that benefits from this pattern of economic development. Foreign business demand into an economy also grows because of the range of service businesses and expertise in many of these businesses is held in the most developed economies that expand into the emerging service economies.

Leisure demand into hotels also grows when an economy grows its service businesses since the transition entails a shift in consumer spending from consumer goods to consumer services. Both long and short holiday taking are direct beneficiaries of the transition to service businesses. Economies that make the transition to service businesses have increased the volume of citizens who take foreign holidays and simultaneously the economies develop industrial cities in ways that makes them more attractive to tourists. The changes over recent decades in cities such as Pittsburgh, Pennsylvania in the US and Glasgow, Liverpool, and Newcastle in Britain are examples.

Major global hotel companies and other international chains in Europe

There is a group of seven international hotel companies that have multiple hotel brands with a presence in the Americas, Europe, and Asia. In Europe these global majors—Accor, Carlson Hospitality, Choice Hotels International, HHC, Intercontinental Hotels Group (IHG), Marriott International, and Starwood Hotels and Resorts operate 39 hotel brands with 557,000 rooms representing a capital value of €100 billion. The global majors account for just more than half of the international chain presence in Europe having added, over the period, 168,000 rooms and introduced 12 new brands including Accor's Suitehotel, Carlson's Regent International and Park Inn as well as Marriott's Ritz-Carlton and JW Marriott brands. The indicative capital value of the global majors room additions was €40 billion, representing a two-thirds increase on the 2000 value.

Of the room stock added by the global majors, 44% was in the mid-market and was dominated by brands such as Accor's Mercure and Novotel, Carlson's Park Inn, IHG's Holiday Inn, and Courtyard by Marriott. The capital value of this mid-market growth was almost €14 billion. Up-market hotels accounted for 27% of their room additions driven by the Marriott brand with almost 10,000 rooms, Carlson's Radisson with 8000 rooms, Hilton with more than 7100, Choice's Clarion with more than 6500, Marriott's Renaissance with 2000, Starwood's Westin with 1400, and Accor's Sofitel with around 1000 room additions. However, the up-market segment was not all about additions. Three brands shrank their portfolios.

Intercontinental reduced its room stock by 2600 and Starwood reduced its Le Meridien Brand by 1000 rooms and Sheraton by 300 rooms. The portfolio reductions were due to management contracts coming to an end and not being renewed and also by an issue that was specific to this period when global majors were reducing their balance sheet exposure to hotels and this involved the sale and removal of the brand from several hotels notably the Intercontinental, Paris which became a Westin and the Waldorf, London which changed flag from Le Meridien to Hilton. Overall the capital value of the up-market additions by the global majors was €18 billion.

Nineteen percent of the global major room additions were in the economy segment and were accounted for almost entirely by two brands: Accor's Ibis, which added 18,700 rooms and IHG's Express by Holiday Inn, which added 13,600 rooms. IHG also lost 2200 rooms with the progressive winding down of the Holiday Inn Garden Court brand. The capital value of the economy lodging additions of the global majors was only €3 billion. Accor added 13,600 budget rooms mostly in its Etap brand, which added 12,000 rooms with the remainder in Formule 1, which has been replaced by Etap. The difference between Etap and Formule 1 is that all bedrooms in Etap have private bathrooms. The low capital cost of budget hotels limited the value of the additions to only €600 million. The last market segment in which the global majors expanded was deluxe, the most capital intense segment in which they added 4800 rooms at a capital value of €4 billion. Starwood's Luxury collection added 1700 rooms, Marriott's Ritz-Carlton added 1400 rooms, HHC's Conrad added 1300 rooms, and Carlson's Regent added 400 rooms.

The pattern of expansion by the other international brands in Europe was different from the global majors. In 2000, there were 73 other international brands and by 2006 this was doubled to 146 with the addition of 255,000 rooms at a total capital cost of €60 billion. In Europe these international brands are small with an average of 3700 rooms per brand compared with the global majors 14,300 rooms per brand. More than half of the added rooms of international brands, 123,000, were in the mid-market; 29%, 71,000 rooms were in economy lodging; 13%, 31,600 were at the up-market level; 4%, 9700 rooms were deluxe; and the final 3%, 6800 were at the budget level. The key difference between the global majors and the other international brands is the greater focus by the international brands on up-market hotels, while the main focus of the other international brands is on the mid-market. This difference is also evident in the location of the hotels. Up-market hotels have a greater exposure to capital and gateway cities, where much of the foreign business demand and a proportion of the foreign leisure demand are concentrated. Mid-market hotels have a greater exposure than up-market hotels to provincial conurbations where domestic demand is more prevalent. Although there is no data to prove the point, the logic is that with their greater exposure to the more significant conurbations the global majors will achieve a higher RevPAR than the other international chains at each market level. This is reinforced by the smaller brand size of the other international chains and the greater investment by the global majors in demand generating infrastructure.

Developments in the affiliation between hotel chains and their hotels

The burst of expansion by international hotel chains in Europe since 2000 has been accompanied by a shift in affiliation structures away from the brands owning and leasing their hotels and towards expansion by management contracts and franchises, which do not require the brands to invest capital in the hotels. It would be wrong to believe that the relationship between expansion by international hotel chains and the shift in affiliation was causal. There were three prime drivers of the change in affiliation. First, stock markets, particularly in the US and Britain reassessed the risk and return profiles of hotel chains and concluded that chains that owned and leased their hotels were exposed to higher economic risks and simultaneously achieved lower returns than those chains that were involved predominantly in management contracts and franchises. These chains needed less capital, achieved higher returns, and grew at faster rates. This triggered a bout of balance sheet restructuring by the global majors mostly in programmes of sale and management back, which reduced the risk and increased the returns. Over the period IHG sold around £3 billion of hotel assets converting mainly from ownership to management contracts. HHC, Starwood, and Marriott were also involved in this process. Accor, with different accounting policies from the US and British companies, embarked on a sale and lease back programme. Carlson and Choice hotels were already franchise chains and owned no real estate.

Secondly, and conveniently in parallel with the asset lightening by the global majors was the realization by real estate funds and private equity funds that they were underweight in their ownership of hotels. They became major buyers of the hotels being sold by the global majors and thus, the period was marked by the transfer of hotel ownership from stock market investors to primary real estate owners who had different risk and return criteria that could accommodate hotel ownership. Third, the rate of growth in and the size of the European hotel market are such that it is inconceivable that the global majors would be able to fund their expansion from internal equity resources. For instance, IHG's expansion in Europe alone over the period had a capital value of around €5.2 billion, which is broadly equivalent to the market capitalization of the company.

We illustrate some of the points made above by providing an evaluation of the development of international hotel chains in Russia.

The case of Russia and international hotel chains

Russia is the largest European country in terms of land mass and with a population of 144 million it is substantially larger than the next largest, Germany with 83 million. However, as far as the hotel business is concerned Russia is a backwater with only 95,000 hotel rooms, a ratio of 1520 citizens per room compared with Britain, which has 125 citizens per room. Not only that, but the chains have a paltry 12,000 rooms in Russia compared with 260,000 in Britain.

Since 1998 total Russian GDP growth has been impressive, exceeding 6% CAGR for the period 2000–2005 when many of the western European economies struggled close to recession. The growth in total Russian GDP provided growth in hotel demand, but this came largely from foreign visitors and largely in cities such as Moscow and St. Petersburg. Historically, the communists were dead against foreign visitors, but that is changing. Since 2000, the number of foreign overnight visitors has grown by more than a quarter to 9 million, significant for Russia, but minor in comparison with the 75 million who visited France. Domestic hotel demand did not grow much, which was not unexpected given the low GDP per citizen in Russia, now only $4000, while Britain achieves nine times as much. On a per capita basis Russia is a weak economy with little impetus to generate domestic hotel demand. More specifically, Russia's economic structure is not conducive to developing a large hotel business. Agriculture, which generates little domestic business demand into hotels, accounts for 5% of GDP, down from 6.4% in 2000, but still far higher than countries such as Britain with only around 1%. Secondary economic activities—manufacturing, mining, and utilities—accounted for 38% of GDP in 2000 and declined to 35% in 2004, still very high compared with western

Europe. Citizen services accounted for a high 46% of GDP in 2000 and rose to 49% in 2004. The market service and experience segments jointly amounted to only 10% of GDP in 2000 and rose to 11% by 2004, still extremely low compared with the western European economies. Domestic hotel demand is driven by the significance of the market service and experience segments of an economy and their very low levels in Russia cement the very low levels of domestic hotel demand and hotel supply.

Much of the economic growth in Russia over the past 5 years has been generated by natural resources such as gas, oil, metals, and timber, which collectively account for around 80% of exports. Importantly for the hotel business, these activities generate little more business demand into hotels than does agriculture. When it comes to manufacturing, Russia is a mess. Its productive capacity is outdated, very inefficient, and heavily underinvested. For Russian manufacturing to reach anything remotely like the productivity levels of western Europe, massive long-term capital investment in new plants and new products as well as the radical long-term development of domestic demand for consumer goods will be required. The first two do not look to be on the medium term horizon, and although consumer demand is growing strongly from very low levels, consumer access to capital is minor. The Russian banking and financial services sector is still suffering from the tribulations of the communist era when personal credit was not available, ownership of appreciating assets was out of the question, and savings was no more than a pipe dream for the mass of the population on subsistence living. The rest of the market service and experience segments are so insignificant that they hardly register.

The challenge for the Russian government is to find effective ways to use the income generated from the export of natural resources. The problem is that it has not yet embarked on an effective policy. Indeed, it has been going backward as a result of the expansion of direct state participation in sectors such as power generation, aviation, oil, and finance. In addition, spending on public services increased by 27% in 2005. No economy has been able to develop a significant hotel business when state control has been expanded in such ways.

The most attractive context for the Russian economy is that export demand for its natural resources remains high and that producers are able to exert the same vigorous pricing power as they are presently with gas. This will allow the government to buy time to invest in other sectors, notably manufacturing, to increase labour productivity, and to reduce the cost and time of production. In parallel, there needs to be a major expansion of the banking and financial services sector to enable Russian consumers to have access to credit to acquire goods such as household goods, clothes, and cars. These are higher priorities than developing demand for other market service businesses such as retailing, communications, wholesaling, and advertising, which are likely to follow after the higher priority developments.

The World Bank (2007) projects average annual economic growth of 3.1% for Russia over the next 10 years. When we translate this into the potential growth in the economic segments there is little to suggest any structural shift in the balance of the economy. Our mid-range projection is for market services to grow by 4.2% per year and experience businesses to grow by 4.9%, which looks impressive for the hotel business. However, between 2000 and 2005 market service and experience segments grew by 9.5 and 8.6% respectively and because they came from such a very low level their impact on domestic hotel demand, while positive, was not transforming. We estimate that domestic business and leisure demand accounts for around 7 million room nights in Russia compared with 75 million in Britain, a country with a population of only 40% that of Russia, but with a significantly more developed economic structure.

Domestic leisure demand in Russia is predominantly summer holiday demand in the southern resorts. As the cohort of middle class grows we expect this demand will continue to be for summer holidays into existing heavily seasonal hotels. The current level of short break demand is microscopic and is mainly into the larger cities. We expect domestic short breaks to remain minor in the first instance because the United Nations (2007) expects the population to decline to 137 million by 2018, shrinking almost 5%. Moreover, younger adults at an early stage in the family life cycle make up a significant proportion of the population and are in the forefront of buying consumer goods rather than staying in hotels at the weekend. Older adults at later stages of the family life cycle have little or no savings, receive a subsistence state pension and are not a market for short breaks. Most foreign visitors stay in hotels and are leisure travellers, predominantly to the main cities.

Hotel chain supply at end-2000 had been around 4500 rooms. At end-2006, chain hotel supply in Russia was approximately 12,000 rooms, a concentration of 13%. International chains account for 32 hotels in the country and only in four cities, 18 hotels in Moscow, 10 in St. Petersburg, 3 in Sochi, and 1 in Samara. Of the global hotel companies, Accor, Carlson, Intercontinental, Marriott, and Starwood had 24 hotels while Hilton and Choice had none. All the hotels were in the mid-market to deluxe range and none of the chains have invested capital in the hotels. Chain room stock in Russia is equivalent to that in Denmark with a population of only 5.4 million or The Czech Republic with a population of 10.2 million. As the Russian economy continues in its current economic structure there will be growth in hotel demand, but without significant change in economic policies the Russian hotel business will continue to lag behind those in western Europe. If hotel demand grows in line with the projected growth in the key sectors then around 50,000 hotel rooms will be added over the next 10 years, which will reduce the number of citizens per hotel room to 945, down from 1520 in 2006.

Most of the global majors have arrived in Russia and are seeking further exposure, but all of the international chains will be faced with several challenges in the years ahead. First, they are unwilling to risk their own capital in the face of questionable rule of law and questionable security of foreign investments, so significant local capital will need to be invested in hotels. The issue is the low proportion of local capital seeking hotel investments in the face of more pressing need for investment in other asset classes such as industrial, residential, and commercial, each producing higher volumes of development opportunity and greater political support. Secondly, the chain presence in Russia is located to capture foreign demand rather than domestic demand. As domestic demand grows it will spread to the cities where chains are not represented, but the chains have minimal brand infrastructure in the country and are not well organized to penetrate the domestic markets. We expect new hotel developments in the country to continue to be full feature and basic feature hotels rather than limited feature and room only because of the paucity of freestanding restaurants. This is before we get to the massive task and investment in training and education needed to provide an effective hotel workforce.

The volume and pattern of hotel demand in Russia is a function of its economic structure. The economy is weak and is particularly weak in those segments necessary to generate a meaningful level of domestic hotel demand. The recent economic history and current government economic policies do not hold out much hope of a dramatic increase in hotel demand or hotel supply to the levels common in western Europe. However, the current low level of total hotel provision and the token presence of hotel chains coupled with the economic developments and opening of the borders to foreign visitors means that there will be expansion by hotel chains. The problem is that many other European countries have more developed economies, with greater capacity to generate hotel demand, larger and faster growing hotel businesses and lower operating risks. For the hotel market in Russia to narrow the gap on western Europe will need sizeable change in government economic policy, secular shift in the structure of the economy, and monumental improvement in the standard of living and lifestyle of the Russian population. This is likely to take decades.

Conclusion

The chapter has shown the significance of Europe to the development of international hotel chains. Previous studies have failed to predict and explain the burst of hotel chain and international hotel chain development in the region. Perhaps this is because they have tended to focus on providing short and superficial answers to what hotel chains have done without attention to why they took the action that they did. Our analysis is that hotel chains grew by responding to developments in the structure of European economies that generated higher growth in hotel demand. Further, it is our conviction that it is necessary to give prominence to the economic context, which propels the developments of hotel companies, because to ignore this is to produce sterile analyses of hotel chains with no hope of explaining the actions on which they embark. Prior available analyses of the internationalization of hotel chains have been short and one-off analyses that have tried to shed some light on investment and management issues that were too big, too complex, and too changeable to tackle. Our solution is the incessant tracking of three activities: the economic structures of the countries, including the economic policies that influence the developments in economic structure; the sources of demand for hotels generated by developments in the economic structures; and the supply variables of all hotel chains. Only by investing in these activities are we able to identify the opportunities and threats to the hotel business and to have sufficient longitudinal data to explain why hotel chains develop as they do. Anything short of this fails to address the significance of the issues that are involved.

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