



## **CHAPTER 1: Hospitality industry situation in Spain: Challenges faced today and tomorrow. Why is it more difficult to compete in a hyper competitive business?**

### **7 facts**

We should take certain facts into consideration in order to explain why the hotel business is more complex than not long ago. These facts are new business issues and complicate more things. Some of these business issues are uniquely happening in Spain, but others also happen everywhere in our hospitality industry. However, all of these facts might perfectly happen in other countries as well in near future. For example, in China.

#### **1-Over supply situation.**

During the economic boom –from 1998 to 2007 Spain developed a real estate bubble, which reduced significantly, the entry barriers to the hospitality markets. The banks opened up financing and credits and the investors –especially construction and real estate companies- found a new business opportunity: hotel development. However, business for these new players wouldn't stop there; they also wanted to run the hotels.

It was an easy business to enter and very positive for investors. The hotel project was profitable in itself, because the bubble would generate secure gains over the real estate and building property. This fact attracted

many new hotel developers and investors. Though hotels were constructed everywhere to a point of oversupply. That is, supply grew at a higher rate than demand.

#### **2-Quantity not Quality.**

These new players –real estate owners and construction companies, found hotel management as an easy business in which to operate. So they wanted to become hotel managers too. In fact, the professional and traditional hotel operators – NH, AC hotels... did not have any business competitive advantage, such as brand loyalty differentiation or operational know-how advantage in running their hotels. Under these traditional premises, hotel management and hotel operations were not a very complicated issue, nor a question of expertise.

Most of the hotel companies had a common strategy –if we can properly call it a strategy. Which was (1) hotel expansion –hotel boom- in order to make their brands grow. And, (2) maximization of profits. Shareholders were the first priority along with profits, and profit growth over the years as the first management objective. These two priorities made the following facts: (I) a development fever; organic development brought more debt –and financial risk- together with brand depreciation; yet management contracts or property rentals, often impoverished the brand since these hotel companies added older properties to their portfolios. (II) Economic performance despite being a very important business priority was achieved by mismanaging work and workers. Management focused only on the short term and did not focus priorities on staff. Instead, hotel operators created rigid bureaucratic systems –working processes. As service and operations became more mechanic –no



thinking or delighting guests by the service worker was required. Yet a well execution from operational work of the designed processes from the top was the main premise. Therefore, a kind of more radical cost savings in order to maximize profits was also a main objective.

### **3-Hotels are in a Commodity market.**

The new hospitality scenario turned into a hyper competitive market, that is, a market with oversupply and very strong competition, without any competitive advantage between brands. Thus, hotel business become a Commoditized market. Spain developed a very new hotel infrastructure and products, in which every new hotel was stronger in



architecture, decoration and comfort. So the tangible part –product- would not make significant difference among customers. Commoditization occurs as a goods or a services market loses differentiation across its supply base. In the eyes of the customer there is no significant value differentiation among brands, or even stylish hotels; so the lower is price the main consideration for the customers when making their decision. In fact, price turned out to be very important, because in the commodity market prices went down. In a commodity market the one whose prices are lowest is better positioned to attract guests. The million-dollar question is: what do you do when your competitors keep dropping prices? There is not an easy

solution to this dilemma.

### **4-Hyper-competition.**

Let's first define what a hyper-competitive market is. Hyper-competition is definitely the opposite situation to London, Rome or Paris. In between, there are many other markets with decent ADR and Revpar, since demand is strong enough. Nevertheless, in Spain there are many markets such as in secondary cities, even major cities or tourism areas in which demand has dramatically decreased –e.g. national tourism and corporate business segments because of the economic crisis. On the other hand, supply has increased significantly, not only in quantity but also in quality. We can find a very strong competitive situation in which many hotels –brand new and stylish upscale and upper upscale hotels- compete for a more reduced demand. Among this competition, there are no significant competitive advantages (good hotel location may still be a significant advantage). In a hyper-competitive market it's very difficult to drive demand to hotels; even through increasing online advertising or web optimization. In such situation, marketing and sales (off-line and on-line) efforts are futile.

Since hyper-competition means a very commoditized market, price drives customer purchase decision. The lower the price the better for the customer. Very competitive hotels still providing good quality and service are competing each other lowering their prices. In contrast to price reduction, cost increases. Although most of these hotels have decreased labour costs, there is a minimum of labour costs to maintain –structured labour costs cannot be further reduced in order to maintain a proper level of service. Indeed, the hospitality business is a labour intensive industry. Unions and labour



politics were not flexible either, and increased the payrolls annually. But also, other costs such as energy cost skyrocketed. The conclusion is that lowering prices -to a point- is not a proper strategy, if demand does not increase in order to compensate this price reduction and hotel profitability would suffer to death.

## 5-Bargaining Power.

Do you know what bargaining power is? It is concept brought by Michael Porter in the 80` -A Harvard Business School teacher. It means the ability from distributors or customer to put the firm –business- under pressure to reduce prices. Bargaining power used to be on the side of distribution channel: TTOO. Nowadays, is also on the side of the online distribution channels... and customers.

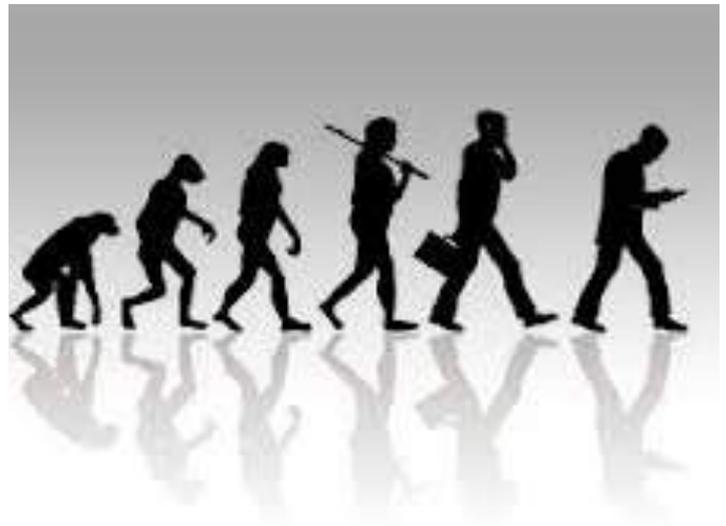
## 6-Hotel Transparency –value vs. price.

There is another important new business issue, common to our hospitality market, as a consequence of technology evolution: Internet, but especially the Social Media has wide-open hotel visibility. Not long time ago, it was very easy to camouflage any hotel shortcomings by having a good department of marketing or public relations. It was very easy to sell, maybe old-fashion and decadent hotel, as an elegant, comfortable and beautiful property. In the present is impossible: guest comments and pictures are very clear. Also price is very clear. So price versus quality, -real quality not the quality the hotel says is giving- is crystal clear.

## 7-Customer evolution.

Guests have evolved. As an important

French sociologist -Gilles Lipovetsky, wrote: “Guests, at the present are more unpredictable, variable, and, of course, have less loyalty to brands”. We will be listening or reading about the simple cause and effect that, by providing good service and good product we should keep our guests loyalty. But this fact is no longer very real. It`s not



that simple.

As a conclusion we can say that a Differentiation of services or better product is a taught strategy, since guests' wouldn't accept easily to pay more for better quality or service. Excellent hotels providing good services are everywhere in a hyper-competitive market. Even the hotel higher category or classification system is not anymore a differentiator. We can see many five star hotels in hyper-competitive markets, selling rooms at 69€ to 76€ (taxes included) in certain low yield periods. Exceptions to hyper-competitive markets are there such as in Barcelona, Palma or Ibiza. But even these prolific markets today, may become hyper-competitive markets tomorrow.



In Spain, due to the hotel development boom and oversupply, and because of new innovative business models (e.g. Chic & Basic such as Room Mate hotels); hotel Star Classification System is no longer a good value guide to customers.

## How is the business reacting?

How are hotels reacting? Doing the common things is no longer a solution, since hyper-competition is a new problem that has dramatically affected profitability. As Albert Einstein said: "we cannot solve our problems with the same thinking we used when we created them". New problems, like the ones we see, need different reasoning to solve them.

But it seems most of hotel operators and managers are reacting as they usually did, and thus doing the common things. Most hotel operators are very concerned with cost reductions. Guests take for granted good quality and good service and these two management objectives, are no longer a differentiator; hence the common strategy consists of balancing the best possible quality with a lower cost structure.

During this crisis hotel top management have reorganized organizational structures into -an even more- centralized system. If in the past the common organizational structure was towards a more mechanical bureaucracy, nowadays it is even more centralized. Top Management in corporate offices had no choice to reduce costs but lay off employees, re-think hotel procedures and simplify hotel operations. Because the hotel classification system is so ambiguous and obsoleted, even a 5 star hotels could maintain a lower level of services and not lose its category.

This common management practice of cutting costs by centralizing decisions and management, and mechanizing operations, lead down to a vicious circle impoverishing business strengths by putting service and operational employees at the bottom of their priorities list. Yet hotels, still "produce" service as a core business product. Hotel Management, by acting in this way thus commoditized more hotel services and operational knowledge. By limiting operational knowledge management is also limiting the role of innovation as a possible solution to differentiation.

Hotel Management competences and profiles were limited too. Inasmuch as management and decisions were centralized, the common profile of the hotel director was also lower in professional education, experience and, of course, salary.

The result of this conventional wisdom is, that companies' know-how and knowledge became more obsolete. They get trapped in a kind of obsolescence trap because their reaction to escape from that trap, paradoxically, depreciates more their business value and knowledge.

