



Leveraging customer equity to create shareholder value

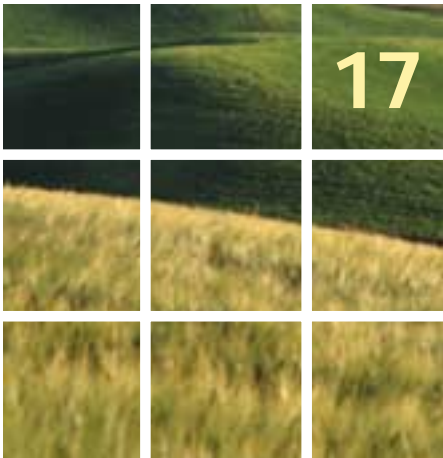
In 1996, Arthur Andersen in conjunction with New York University published its report on a landmark body of research entitled Hospitality 2000. From this global study of the key issues facing the international hospitality industry, a new

following processes and using technology. Our research clearly confirms actually what many of us already know—that is that the way to the future and the way to enhancing shareholder value in any business no matter whether it be manufacturing, telecommunications, healthcare or indeed hospitality is

Hospitality 2000: A Business Model for the Next Millenium

A review of the opportunity, strategy and solution

BY
ROGER S. CLINE
CHAIRMAN AND CEO



business model has been constructed. The model uses the results of this global research study as well as financial market research to support a premise that has also been reported on previously—that is that the successful hospitality organizations of the next millennium will be those that forego the traditional asset focus of the past in favor of an exclusive focus on the customer. The model is designed to create shareholder value in the hospitality industry by leveraging what we have called customer equity.

The original Hospitality 2000 study was inspired by some broad questions:

- who will be the guests of the future ?
- how will today's hotel companies adapt to meet the needs of a rapidly changing clientele ?
- what role will technology play in enabling the industry to become more customer- focused in a globalizing market ?

As in any business, hospitality companies need to have a clear strategy in order to face the future. Supporting this strategy, must be a plan for both organization and capital with support from people,

through customers. Quite simply, the strategy and the supporting organizational and capital plan in any business and certainly in our industry has to be

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established with a singular focus on the customer.

Redefining wealth

It is helpful to set a high-level subject like this in context. And to this end it is interesting to revisit the definition of wealth as recently suggested in Forbes Magazine...

"In the not-so-distant past, wealth was almost always based on the possession of physical assets—the means of production, Marx called them... wealth



was timber, oil, real estate, factories or printing presses. That was yesterday. Almost all of today's new fortunes are based not on hard assets but on ideas and organizing principles". *Forbes Magazine, Oct 14 1996*

With this concept in mind, the argument for a customer-focused future may be divided into four segments. Firstly, an articulation of the **Opportunity** that we see to create shareholder value in our industry. Secondly, the **Strategy** that needs to be pursued. Thirdly, an outline of some of the **Solutions** that we see in terms of marketing, technology, finance and organization and finally, the **Proofs** arising from our Hospitality 2000 research as well as other research that we have completed on this subject that supports the strategy.

The Opportunity

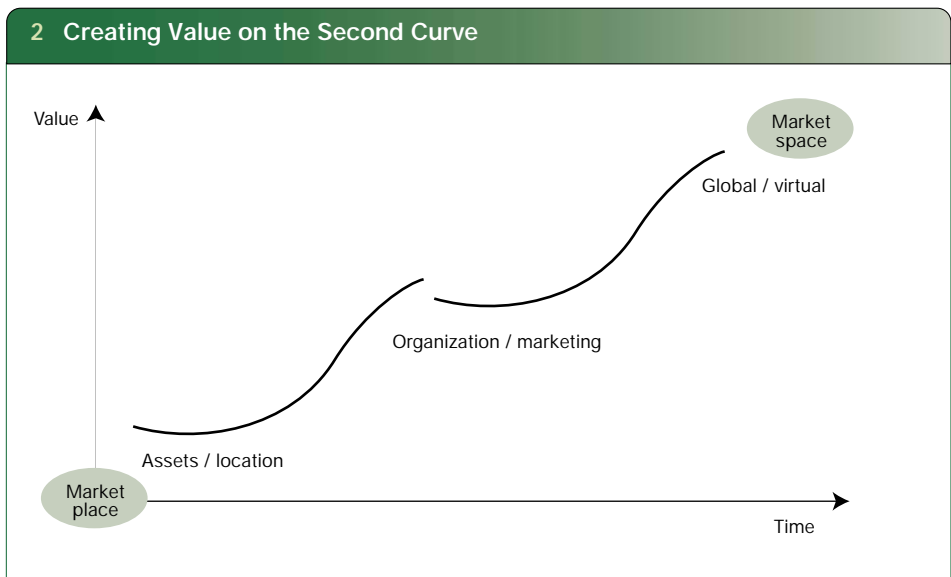
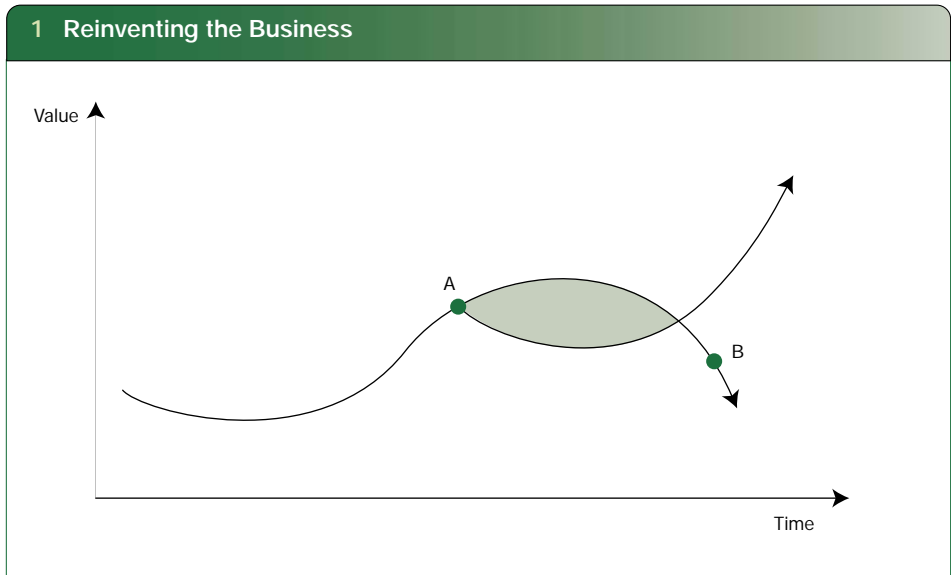
The Opportunity is to create shareholder value through new revenue opportunities and lower operational costs by changing the definition of the business and developing information on and providing access to the assets of the future—the Customers.

Re-inventing the business

The challenge facing most mature businesses or indeed industries is expressed pictorially in **Chart 1**—a sigmoid curve depicting maturity and reinvention. It is clearly at point A when the need for a new vision and strategy for the future is required. Those industries and businesses who cannot see around the curve may clearly be destined for point B.

Creating value on the second curve

As suggested by the illustration in **Chart 2**, at the bottom-left hand corner of the two curves is the history of most businesses—a foundation set in assets and in the real estate and hospitality industries—in locations. How often have we heard the refrain that the only thing that counts



in real estate is location, location, location. As time progresses, however the hospitality industry has built businesses and developed customer loyalty around brands and standards of service. But tomorrow's companies must do more—they will need to become global in order to compete and they will need to become virtual in order to capitalize on technology. The successful hospitality organization of the future will chase share of customer not share of market—the market place will thus become the market space.

Industry balance sheet is restructured

Let's take a quick look at how the industry's balance sheet orientation is changing. In **Chart 3** on the following page, in the bottom right hand box, is depicted the 1970s orientation—in that period, the industry leveraged its use of capital to build up physical assets—the hotels that we manage and operate. In the 1980s (the top right-hand box), assets continued to be accumulated as businesses were formed in great number and chains and new brands were



launched. Switching to the bottom left-hand box in the 1990s we have seen management companies form in number concentrating on the delivery of services to owners of hotel assets many of whom did not intend to own them but were forced to do so as too much real estate built on leveraged capital began to fail.

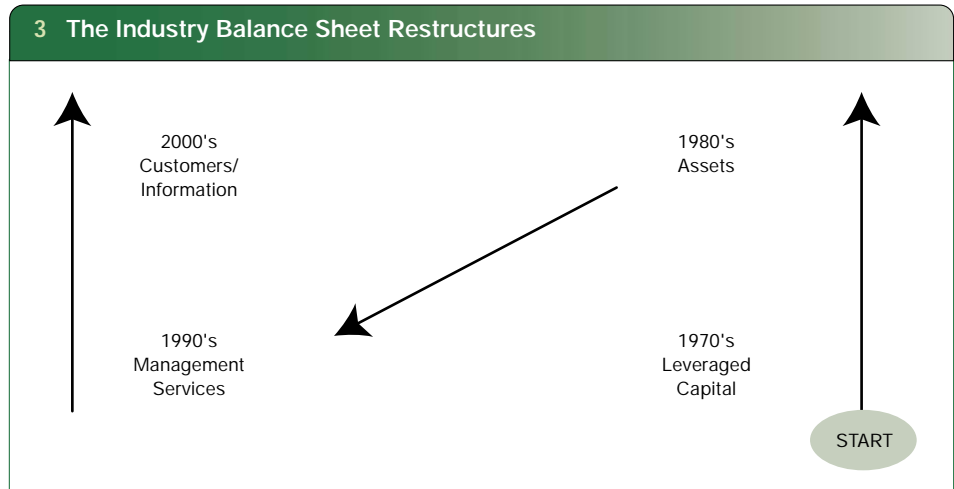
And so to the top left-hand box where we see the years beyond 2000. And it is here where the balance sheet is being redefined as the leverage is not from capital but from information and the currency of wealth is not physical assets but customers. The balance sheets of the 1970s and 1980s (assets minus leveraged capital = net worth) have given way to the value creation model of the 1990s and the 2000s (customers and information minus management).

The Strategy

The essence of the above quadrant analysis is that the leveraged capital business has collapsed, the assets business is down, the service business is flat and the customer business is up and growing. In view of this, the appropriate strategy for the future appears to be one that will create new businesses in partnership with technology, capital and joint venture interests that leverage customer equity and management networks into shareholder value.

The development community of the 1970s

But before we buy into this strategy let's take a quick look at the features of past business paradigms. In the Development Community of the 1970s, we borrowed debt and built buildings. Here our industry's development had a project orientation and a capital focus. And an easy way of telling who you are in business is by looking at the way you measure things. Remember that this was an era when ownership control meant everything. The concept of quiet enjoyment was introduced into management



contracts to ensure that owners didn't interfere with operator's rights. There was little marketing at least in the broadest sense of the word and virtually no use of technology. And the measurement system was REVPAD or revenue per available deal. Real estate developers and hotel companies by and large counted their wealth by the number of deals they closed, properties they owned and the fees they made from each deal.

The corporate community of the 1980s

Moving into the 1980s, the Corporate Community evolved in the hospitality industry and expanded operations dramatically. During this period, the industry began to have a process orientation and a corporate focus as the large businesses and chains went through the fastest growth period ever. The marketing was scattered, the technology disconnected and the measurement system involved counting how many times a room was occupied and for how much. The yardstick that still dominates the industry's thinking today—REVPAR or revenue per available room.

The service community of the 1990s

As the current decade, the 1990s, began life we were clearly in some trouble with

overbuilt markets in the US and economic recession in Europe. And into this difficult period stepped the Service Community building management systems, focusing on brand equity and delivery yield management. With a brand orientation and a competency focus, the successful companies of this period leverage skills and sell their time. They are content providers with a brand orientation. They build alliances and engage in mass marketing. They are technology-focused and if they are in the business of leveraging their brands and are in the franchising business, their measurement system is REVPAF or revenue per available franchise.

The customer community of the 2000s

And finally on to the Customer Community of the year 2000 and beyond. Here we find companies that engage in one-to-one marketing, building intimate relationships with their customers. They have alliances with other providers of both content and context and partner with technology companies to build the platforms necessary to operate in the way that they do. These are companies with a customer-orientation and an information focus. They have strong brand equity, customer information systems, network-based formats, affinity



and vendor relationships, electronic transactional mediums and access to inexpensive and plentiful public capital. And their measurement system is revenue per available customer or REVPAR. They are working for share of customer not share of market—their orientation is spatial not physical—they operate in the market space not the market place and they define their business not as food and lodging but as “Hospitality One Source”—providing their customers with an array of products and services delivered to them wherever they may be at anytime.

The Solutions

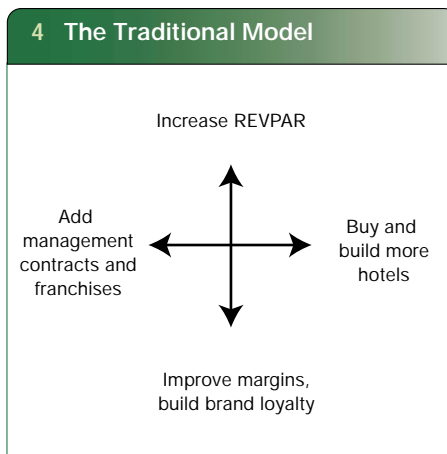
In responding to the Hospitality 2000 opportunity and the associated strategy, companies will need to build and own enterprise-wide marketing, technology and financial solutions. And these solutions will need to be arrived at in a changing competitive landscape. A landscape which is undergoing an important shift. In the current state, there is downward competitive pressure on traditional providers and servicers of hospitality product. There are too many brands competing for a defined market. There is thus the need here for context—that is to say the environment in which traditional hospitality products and services are provided—but more context means more buildings and this is the place of yesterday.

By contrast, in the future state, there will be unseen competitors—not the ones that we see around today—not even those that seem to be getting bigger and better at what they do. No tomorrow’s competitive landscape will be populated with companies that are either not in existence today or those which exist but are in other businesses. Businesses where there is a need for more content. The future is therefore in not only understanding the context within which we are delivering hospitality

products and services but also how we will satisfy the growing need for content—that is for more products and services.

The traditional model

As suggested in [Chart 4](#), hospitality companies pursuing the traditional model look to increase REVPAR, add management contracts and franchises, buy and build more hotels and improve margins while building brand loyalty. This, however, will in the future give way to a new model that is focused on building information and collecting customers with a view to creating REVPAR or revenue per available customer.



Using technology to one-to-one market

But in order to do this, a new information technology platform will be required—one that collects customer information. And to get there, we will need to transform the traditional central reservation systems that tend to take a fractionalized share of a distributed rooms inventory. Such systems must interface with property management systems to produce an integrated single image system that not only allows anyone anywhere and at anytime to access a hospitality

company’s rooms inventory, but will also allow information on customer behavior and attributes to be collected in data warehouses for use in one to one marketing strategies.

Technology, however, is in a relatively sorry state in the hospitality industry today—there are a multitude of different operating systems operating in closed architectures that preclude the kinds of massive economies of scale that will be needed to get to this vision of tomorrow. We will clearly need to ensure that uniform industry-wide standards are developed and adopted so that disparate systems can operate in an integrated fashion. With the era of network-centric computing just around the corner where data collection, information processing and system application occurs in cyberspace, the hospitality industry seems singularly unprepared for this revolution.

Six components for success

This notwithstanding, we need to integrate the key components of success into a solution that can actually deliver on the promises of tomorrow. There appear to be six:

- The first component of success is strong brand equity—without this our customers have very little to relate to. Successful companies will continue to develop global brands. And this will be facilitated by the consolidation that should eventually take place in the industry. Creating the image of being a “one-source” provider is also to be integrated into the brand strategy.
- The second component of success is a customer information system. Here the enterprise invests in an integrated single image property management and central reservation system with distributed data warehousing. Technology investments are organized through strategic partnerships with technology companies and channels are leveraged through other systems to provide



greater context for the information that is collected.

- The third component of success is a network-based format. In a networked organization, the enterprise approaches its customers where they currently do business. Existing assets are rendered more productive and access is leveraged to allow customers to migrate to the company's products and services.
- The fourth component of success are **affinity and vendor relationships**. Such relationships use others brands (through co-branding for example) to extend the customer relationship. New products and services are distributed. Everything is on offer anywhere and at anytime. And the leverage here is against other vendors' offerings.
- The fifth component of success is an **electronic transactional medium**. Here transactions are facilitated while information is collected creating leverage against the customer. Smart cards in this environment replace cash and traditional credit and debit cards. And as customer knowledge is collected, there may also be an opportunity for franchising the knowledge itself.
- With the five components of success in place, the enterprise is ready for the sixth and final component—that of **capital**. And in tomorrow's environment, we can expect the public markets to play a critical role in the hospitality industry. There are of course some compelling reasons for us to look to the public for our funds—public markets are efficient, they are relatively inexpensive, investor research presents a focused agenda and the market generally values brands and customers very highly. In summary, the integrated solution is one that moves our focus from place to space using information to get there. From our products to their products or others products using vendor networks and affinity relation-

ships and from real cash to electronic cash using industry solutions with uniform standards and integrated open-architecture technology platforms.

Marketing, financial and technology architectures

In creating a structure for this, there are three principle architectures that must be designed—first and foremost a one to one marketing architecture, supported in

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Changing the organizational paradigm

And in support of the new structure, the organization of the future will have to take on some different forms. The hierarchical /matrix style organization will need to give way to a networked, virtual structure; managers that control their employees will need to empower them; management that plans will instead need to anticipate the future; management that directs its organization using rules will instead coach employees using values; the rigid culture in a conforming organization will give way to a flexible one in a learning organization; a product orientation with a bias to analysis will be replaced with a market orientation with a bias toward risk; analysis is foregone in favor of creativity, internal competition substituted

with internal cooperation and the classic pyramidal shape replaced with an organic structure.

The Proofs

Having outlined the opportunity, the strategy and the solutions that will be needed for success in the 21st century, how do we know that any of this will apply and where is the foundation for this thinking? There are two bodies of proof that are worth considering.

Financial market analysis shows value migration

The first involves financial market research that confirms higher valuation multiples for customer-rich branded companies than for those with physical assets. In fact, in the US where this research has been concentrated of late, the best performers in the Standard and Poors 500 Index reduced their assets significantly over the last ten years. In analyzing performance, we related the extent of asset intensity to stock price valuation multiples. And the best performers (that is those who fell in the top half of the index) reduced their asset intensity by 24 percent over the last ten years while the worst performers reduced their asset intensity by only 9 percent. And those companies that saw the greatest valuation improvement (we call them Quadrant One companies)—they increased their share of total capitalization of the S&P index from 19 percent to 35 percent over the ten year period—a near doubling of market value share. These companies are clearly doing



something right—and what is it? Well we believe that it is the steady reduction of their asset focus and its replacement with an orientation to the customer, to knowledge-based businesses and to those supported by technology.

Hospitality 2000 research confirms the direction

As to the second body of proof—it lies within the findings of our global research study—Hospitality 2000. This is a study that documents some of the long-range trends within the industry and provides us with some insight as to why the strategy outlined makes sense.

Firstly the status of the customer is confirmed by this research with close to one half of respondents ranking customers as the top priority for the future as compared to only six percent for buildings. Notwithstanding the customer orientation, hospitality executives believe that their customers buying decisions are mainly influenced by location (92%), followed by service quality (89%), reputation (87%), price (82%), product type (81%), and finally by brand (64%).

There is however, a broad acknowledgment of the role of branding in the future. There will, the industry claims, be a strong preference for brands. 84 percent of respondents agree that business travelers will express a strong preference for branded hospitality products while only 64 percent thought the same would be true of leisure travelers.

Understanding the customer, however, remains a somewhat insular affair. Market research tends to be reactive rather than proactive. Hospitality 2000 research confirms that there is still a significant reliance on guest comment cards despite all of their weaknesses. Surveys are used by over two thirds and in-house research by just over half. Outside research and focus groups which tend to give better insights are used by less than half our respondents but at least they plan to use more of these methods in the future. In

the meantime, the marketing priorities appear clear—at the top are service improvements, followed by global distribution, yield management, direct sales, product innovation and the internet.

On the subject of growth plans, creating alliances was the most preferred strategy, followed by mergers/acquisitions, management contracts, franchis-

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ing, joint ventures and finally new development. This suggests that the idea of partnering with others has finally achieved a prominence that probably gives recognition to the reality that in a globalizing single market place, it is not possible to be everywhere with everything all the time. It is thus with partnering and co-venturing that meaningful growth can take place.

The research goes on to confirm that franchising in the future will be dominated by a few multi-branded conglomerates reliant upon international growth in a globalizing economy and that such franchisors will become a vehicle for new products and services.

By contrast, management contracts will in the future have fees based on profits not revenues, be of shorter term, will generally favor owner interests and will align owner and manager interests. This suggests of course that service companies that rely on managing for a fee rather than building brand equity will probably see their fortunes decline in the years to come. They are essentially flat businesses today and there is nothing

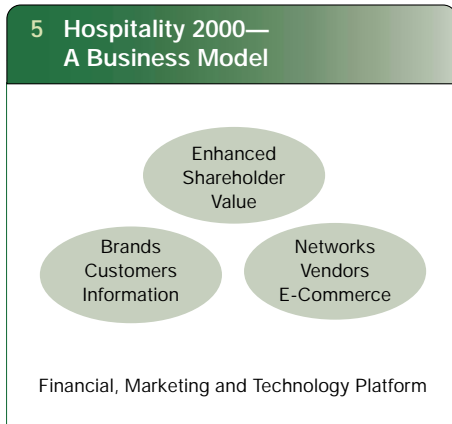
about their outlook that suggests any encouragement.

With such opinions, it is not surprising that Hospitality 2000 respondents confirm the view that global chains will dominate the hospitality scene in the future. According to 72 percent of respondents, it is this group that will see the fastest growth, followed by franchisors and regional chains.

For those with a long range plan (only 72 percent), the planning priorities, however, suggest a low level migration to a customer way of thinking. Expansion is evidently the top priority for just over half of the respondents, followed by the upgrading of equipment, a focus on the core business, retraining, financial restructuring, acquisitions, joint ventures and alliances. Clearly there is a long way to go in our industry if we are going to see any significant migration to a customer mentality.

While there may have been some disappointment in how people plan for the future, most are quite focused on where to find capital. The importance of the public markets in the future was confirmed as well as the continuing significance of pension funds, foreign capital and commercial banks.

To all concerned the role of technology in the future was significant. Especially in the provision of more products and services as well as providing the basis for service improvements. Whether technology should support the business plan or be the key driver in its formulation



remains unanswered—it is likely, however, to be the latter. In the meantime, for those companies keen to stay ahead, the formula is fairly straightforward. Enhanced shareholder value is achieved by

building a financial, marketing and technology platform upon which to build brands, customers and information using networks, vendor relationships and electronic commerce. For those that embrace this business model in the future, a place on the Second Curve can be assured but for those that do not—there is the prospect of becoming a Point B enterprise.

The Hospitality 2000 Business Model is best illustrated in **Chart 5** where the financial, marketing and technology platforms are designed to support value-enriched companies that have focused on the six key components of success—brands, customers, information, networks, vendors and electronic commerce.



Roger S. Cline
Chairman and CEO
Roundhill Hospitality

85 Roundhill Road
Roslyn Heights NY 11577

p 516.621.4499
f 516.625.9282
e roger@roundhillhospitality.com