

NEW ZEALAND HOTEL INDUSTRY CONFERENCE

AUCKLAND - MAY 2008

According to last week's Wall Street Journal and I quote "heading into an economic downturn, hotels are often among the first industries to suffer as travel slows and room rates weaken. Vacancies are on the rise just as a hotel construction boom is set to add significant new rooms to supply and companies that are less real estate intensive have performed better during a recession". The comment was in relation to the United States, but in fact it could have been in relation to nearly everywhere (even China and India).

In New Zealand, the challenges were put succinctly last week by Mark Oldershaw when he said and again I quote "flat demand, particularly from overseas arrivals, and more rooms have reduced occupancy rates and revenues at properties in most major cities while a shortage of workers has reached chronic levels.

What a time to be talking about increasing profitability yet it is just at this time that we can and must focus on the real issues.

Unfortunately, I think the short term has no good news and we are about to have a reality check. Concentrating on the small top end of the market and on the so-called independent traveller who has allegedly a higher disposable income is breathtaking. They are the very people who are the most conservative and the most affected by the current aberrations in financial and exchange rate markets.

Let's quickly list some of the more dramatic short term factors:

- stagflation is coming and the New Zealand economy is not in great shape;
- all costs, not just fuel costs, are escalating including the costs of responding to our environmental responsibilities;
- over-supply particularly driven by real estate speculation and unsustainable guaranteed returns will dramatically impact value. It seems that no-one really protects the innocent people in our communities in relation to these investments;

- lack of credit;
- all feeder markets are softening;
- reduction in airline seats to and from prime markets. In this regard, the example of Darwin is important. A dramatic increase in airline services and seat availability has significantly lifted the number of tourists and has helped develop the Northern Territory as more of a year-round destination, lengthening the shoulder season and enabling the tailoring of reduced price holiday packages for shoulder season travellers;
- pressure on employment, staff turn-over and costs of training.

Some macro responses which can be considered include:-

1. a free trade agreement with China to assist and encourage more Chinese travellers to New Zealand.
2. Pacific Blue to continue expanding into New Zealand domestically.
3. Open skies agreement on the Kangaroo Route between Sydney and the United States through to Europe including encouraging Virgin on its new Sydney/LA route.
4. Keeping an eye on the Korea and China markets, for example the United States is about to introduce a visa-waiver system for Koreans which is forecast to almost double their inbound business in little more than two years whilst at the same time we are looking at a dramatic decline over the next five years for both New Zealand and Australia.

Going back to the very basics of the question, we need to keep three things very firmly in mind:-

1. The pyramid of profitability.
2. The parallel with modern aircraft in relation to the number of first class; business class; and economy class seat availability. The truth is that the economy and mid scale sectors represent the

overwhelming majority of this industry and in fact in the United States and France, economy hotels alone represent more than one quarter of the total market. We need to stop talking about the top end of the market which is the most competitive and the most fragile.

3. Governments are the largest beneficiaries of this industry and they make the smallest investments. They have a much greater responsibility to help even out these cycles without - and I repeat without – them spending on non-traditional areas. In fact, their greatest contribution is to create the right environment:-

- no shortage of money but it needs to be encouraged into an industry that employs large numbers of people and creates foreign exchange earnings
- land is expensive – zoning use etc
- infrastructure support
- level playing field – green initiatives for existing and new product
- marketing

Clearly the best way to maximise profitability is to drive demand and control costs. Even when external factors affect demand, there are still many measures to increase market share and reduce operating costs.

Starting at the beginning, the costs of land and construction have severely restricted the quantity of traditional hotel new supply on both sides of the Tasman.

Recently we announced with our partners – the CP Group – the first Pullman hotel in New Zealand which will be developed out of the Reserve Bank building here in Customs Street. This process of re-developing existing sites is one way of making hotel investment more profitable and overcoming some of the funding issues.

The Pullman along with the proposed hotel in the Britomart precinct could well signal the end of a current development cycle in Auckland. There is a definite need for full hotel service rooms in downtown Auckland, especially when hotels introduce significant new meeting space and are targeted at the corporate traveller and MICE market.

The majority of development in Auckland over the past decade has been serviced apartments, due – in the main – to difficulties with securing finance for what I call traditional hotels.

Given that most research highlights that the two largest future growth sectors are business travel and MICE business, full-service hotels are what the market requires to maximise profitability.

While the space and facilities of an apartment might initially win market share, a business traveller who can't email a crucial contract or who doesn't get an important message, soon discovers that a SMEG oven doesn't replace good old-fashioned service.

New Zealand remains a very favourable destination, invariably selected amongst the top 3 aspirational destinations in the world.

Unlike the Where the Bloody Hell Are You? campaign launched by Tourism Australia, New Zealand's 100% Pure campaign has been universally praised and cuts across both geography and cultures.

However, as in the early 2000's, irrespective of how good your marketing, it is well-nigh impossible to compensate for international crises of the magnitude of 9/11, SARS, bird flu and recession.

Hoteliers, thus, need to look at what markets can help them compensate for the likely falls from destinations such as Japan, Korea and possibly the United States.

It is encouraging that the power of the corporate travel market is finally being realised. The regional visitor monitor (RVM) released recently highlighted the power and potential of the domestic business market. The same trend is being witnessed in Australia.

Corporate travellers are far more sophisticated and savvy these days, and want facilities and services tailored specifically to their needs. A

hotel has to be more than a bed to sleep in – it has to help take the stress out of life on the road.

If you want to win a corporate guest you can't assume that their demands will only exist from 9 to 5, which is why Pullman hotels will offer a 24 hour on-site IT support manager. We will offer web-cams so that travellers can stay connected with their families, there will be an Events Manager for MICE groups and all the restaurants will feature a *table d'hôte*, recognising that travellers want to enjoy the benefits of restaurant dining, but without some of the difficulties associated with solo dining.

Similarly in Sofitel hotels, we have created Club Sofitel concepts in major city hotels which effectively provide a hotel within a hotel. Corporate travellers want a space where they can escape the pressure of travel in a Club style atmosphere. These cannot be token executive lounge experiences, they have to be equipped and staffed to meet the specific needs of the largely business clientele.

Interestingly, the Club Sofitel lounges at the Sofitel Melbourne and Sofitel Brisbane were created out of spaces previously occupied by fine dining restaurants. While Le Restaurant at the Sofitel Melbourne won accolades for its cuisine, it lost money on the bottom line.

This upgrading of services and facilities has permeated throughout the hotel industry. For instance, our Novotel hotels have a completely new and updated look with a number of specific Novotel brand services aimed at the various sectors of the market. Even at Ibis hotels you can now expect fluffy doonas, Egyptian cotton sheeting, high-quality bedding, wi-fi and the rest of it.

There has been a fundamental improvement in the standards and services in the hotel industry over the past five years, but has this been fully translated into profitability?

To some extent, yes, but compare real rates 10 and 20 years ago that take into account inflation, and the answer is clearly no.

At last year's Hotel Industry Conference, Paul Richardson addressed the issue of dynamic pricing, along with the likes of Wotifs Graeme Wood.

Graeme said that “Dynamic pricing is working for airlines but is not yet working for accommodation. Indeed, accommodation is too price-focussed.”

The last few years have been the perfect time to demonstrate dynamic pricing’s potential benefit by ensuring that companies contracted on dynamic pricing models have absolute last-room availability when THEY need it. If you are securing a \$100 million deal and need to book a room in Sydney or Wellington tonight, what you want to be absolutely assured of is a bed to sleep in. It’s at that point that corporations really understand the benefits of dynamic pricing, even if they do suspect that it is more of an attempt to optimise profitability on the part of the hotel.

Interestingly, reports from America suggest that the push for dynamic pricing has lost its momentum because of the economic downturn and the perceived fears of room oversupply. As, ideally, dynamic pricing agreements for larger companies need to be negotiated on a global basis, this could cause problems for our market, though I believe with the tight supply situation, if dynamic pricing is better explained then more companies can still be willingly converted.

We might have to be more flexible with our dynamic pricing models. We overcame resistance with some wholesalers by offering a blended approach – some static and some dynamic pricing. It is obviously more relevant in high-demand markets, but less relevant where supply is plentiful and alternatives easily available.

No one really complains about airlines offering completely different prices for the same seat on the same route at different times of the same day, but it seems that it is only during major events that hotels have convinced the travelling public that a bed should be priced differently according to the circumstances.

The 2011 Rugby World will be more than a test of nerves on the playing field. You will face an equally challenging time in the lead up to the Cup when it comes to hotel pricing.

It was during the 2003 Rugby World Cup in Australia that Accor really decided to put our necks on the line regarding the issue of hotel pricing.

At that time tour operators and companies, both locally and internationally, were more than happy to push our hotels for lower prices

based on market conditions, but as soon as we began to talk about charging “market rates” during the World Cup – which obviously meant higher rates – there was an outcry.

I believe Accor did the wider industry in this part of the world a great service by sticking to our guns on the issue, despite one English paper running a huge headline saying “Ned Kelly Lives!” in response to rates that we charged during the 2003 Rugby World Cup.

Ironically, this comes from a country where special event pricing has been in place for decades. Obviously the journalist who wrote the headline has never had to pay for strawberries during Wimbledon, when charging three times the street-price is considered ‘normal’.

Why should the hotel sector effectively subsidise the event when so many other industry sectors charge full market rates?

Even with dynamic pricing it doesn’t have to be all or nothing. A blend of both static and floating rates offers a bit of both worlds to corporations, Hotel companies can go with fixed negotiated rates in areas where corporations can commit to room volume and dynamic pricing for less sought-out locales.

The cost of distribution is obviously a key factor in hotel profitability. Moving bookings to the net isn’t the magical answer to reducing distribution costs, but it is certainly a factor. We must recognise that the majority of group inbound business will continue to be booked through ‘traditional channels’ and it is interesting to see that rather than dying out, travel agents in America have just changed their emphasis.

A large proportion work from home, have a specialised clientele list and preferred suppliers who they can rely on. For long-haul destinations such as New Zealand and Australia, they will remain crucial for the foreseeable future.

However, America also leads the way in terms of on-line media and the development of new social networking sites, and Tourism New Zealand’s innovative deal with YouTube last year was a very positive move. Interestingly, Tourism Australia has just followed suit, signing a deal with MySpace last week.

Will new media be able to overcome the hurdles of US recession and the falling value of the US dollar? Possibly not, but Tourism New Zealand's initiative is to be commended for thinking out of the square.

Marketing in America via traditional channels – as I'm sure most of you here today know only too well – is prohibitive, and given that New Zealand has built its strong tourism results over the past decade through strong visual messages, sites such as MySpace, Facebook and YouTube might offer far greater potential for getting to new markets than through expensive 'traditional' media such as print and TV.

Getting the right message across as well as reducing the cost of sales are key reasons why I believe that franchising will have an increasing impact on the New Zealand market.

60% of New Zealand hotels are still independently operated, and while many of these are extremely well managed, the cost of sales and day to day operations is increasing.

This is where becoming part of a global brand with the support of a global sales, marketing and distribution network comes into its own.

Franchising is currently in its infancy in this part of the world, where as in America the system is well understood. Over the past three years we have signed 40 franchising contracts in Australia and New Zealand, and I have to say that it has been a learning experience on both sides.

A franchisee wants to see immediate results, expecting that the connection with a brand will instantly produce results. To some extent it can, especially when we can instantly deliver over 250,000 Accor Advantage Plus members in Asia Pacific as well as a host of products that they can be part of.

But where the system hasn't worked is when the franchisee isn't prepared to fully deliver the brand promises, whether that be in-room services, collateral or specific seasonal offerings.

Customers don't really care whether it is a franchised hotel, managed or fully-owned, if they select a hotel because it is part of a brand – and that must be the objective of the franchisee – then they must expect to be delivered the brand promise.

Reducing the cost of sales and increasing market share might be the highest priorities for potential franchisees, but there are other significant benefits.

For instance, by joining the Accor group a hotel can access the benefits of our global insurance policy and access to training through our Academie Accor.

The hidden cost of retraining and recruiting line staff is estimated at \$5-8,000 per staff member – and that is a conservative estimate. By being part of a larger group there is far greater staff loyalty, especially if the provision of training is a major element in the job offer.

Acadamie Accor is now using the online tool Centra session to provide entry level training hence providing a cost effective way of delivering training.

With seasonality a considerable factor in affecting hotel performance, the ability to source staff at peak times is a major asset, and we work closely with our Base Backpackers team because they have a well-established casual labour division that understands our needs and provides a cost-effective way of attracting staff.

Procurement is another major cost-saving benefit of joining a network such as Accor, with a small hotel able to access discounts and subsidies that are only available to such a large network.

Unfortunately, I think that many hotel groups go into negotiations with franchisees with the simple message that they will boost their bookings, when really the agreement is offering a suite of benefits that COMBINED will really make the agreement beneficial. Otherwise, what often happens is that the owner looks at what the hotel group has delivered directly through its reservations system and this is used to discredit the initial promise of the hotel group.

Hotel owners must accept their side of the brand bargain and constantly invest in their hotels to maintain brand standards.

Novotel Gardens Queenstown recently completed an \$18 million upgrade, which has seen a total transformation of the hotel. There could have been a temptation to do a cosmetic upgrade because it has always been one of the destination's best performing hotels, but the owners

took the view that they had to invest in the long-term future, and already they are attracting major rate increases from tour operators who have seen the upgrade for themselves and accept that the hotel warranted the rate increases.

One area that owners may question in terms of hotel profitability is meeting environmental and community social responsibility brand standards.

They often merely see it as an increased cost rather than a positive investment that will deliver business.

This is a social imperative and I want to debunk that view today. Investing in these areas can deliver results to the bottom line.

We are seeing more and more government departments, companies, and large tour operators such as Kuoni, require proven details of a hotel's environmental and CSR commitments. Basically, if you can't prove your commitment, you lose the business. Soon bankers and investors will demand the same.

If the industry applies its mind, it can bring about significant improvements in various stages. It doesn't have to be done overnight, but I think this should be part of the philosophy of the industry and before it is imposed on the industry.

This can apply from construction of hotels to the operations.

At all our Novotels here in New Zealand previously installed shower heads had a flow rate of 18 litres of water per second. By installing new shower heads the flow was reduced to 9 litres per second. A reduction of 50%.

PMS systems for airconditioning / blinds.

And with all these measures, the aim is to reduce both the cost of operating hotels and the cost of the environmental damage.

I'd like to finish on a positive note. While New Zealand is considered well advanced in the tourism cycle, and the short term is going to be challenging, the medium outlook for hotels is very good. We are all going to have to be smarter, better communicators and more prudent with

costs, but Brand New Zealand is still very strong, and hotels are delivering unparalleled levels of facilities and services.

Nature has given New Zealand and Australia an amazingly complementary range of fantastic experiences. In a world of tension, overcrowding, and pollution, our attractiveness is unique and we must work ever more closely together.

It is always a challenge, but an exciting one and in the long term has incredible opportunities. New Zealand has a proven record of innovation and achievement and I am sure that the New Zealand hotel industry will continue this fantastic record.

Thank you.