Hotels

EXECUTIVE SUMMARY

The hotel industry is the lynch-pin of the UK's leisure-related service sector – a large and increasingly important sector with huge growth potential. This case study benchmarks the performance of the UK hotel industry with that of the hotel industries in the US and France.

The UK has the lowest labour productivity of the three countries studied, with output per hour worked roughly 40 per cent below France and almost 50 per cent below the US.

The UK's productivity performance is primarily driven by the age of its hotel stock and the low penetration of large chains. The UK has significantly more old hotels and somewhat fewer large chains than France or the US. The UK's hotels are not "designed for manufacturing" and impose inefficient operating procedures. This mix of hotel stock is the result of high construction costs and lack of domestic demand:

- **High construction costs**: A poorly performing construction industry, combined with planning, listing and building restrictions, make it significantly more expensive to build hotels in the UK, to the point where new entrants are priced out of the market. This also lessens the opportunities for entry by chains.
- **Lack of demand growth**: In addition to slow population and income growth in the past 50 years, the UK has been far less strong at creating "destinations" than the US or France – only one of the top 10 UK tourist attractions was built this century, compared to six in France and nine in the US.

Secondary factors driving poor productivity performance include product/service mix, and scale. Labour skills and access to capital do not appear to be significant root causes.

Going forward, we believe that a combination of demand stimulation by the broader tourist industry and Government policies to reduce the barriers to the economic building of new hotel stock will allow new hotels to displace some of the unproductive older stock. This should boost productivity and output in the hotel sector, and make the UK a more popular international tourist destination.

Hotels

INTRODUCTION

The hotel industry is a key part of the UK's leisure-related service sector – a large sector with huge growth potential. The hotel industry itself currently employs more than 300,000 people, representing about 210,000 full-time equivalents, and has created 90,000 net new jobs in the last 10 years. In 1996 it generated revenue of nearly £8 billion, and contributed over £3 billion to GDP.

Hotel productivity and performance also affects the broader economy because the industry provides infrastructure for other sectors. According to the British Tourist Authority, tourism as a whole accounts for 7 per cent of total UK employment, and creates one in five new jobs. International tourism brought over £12 billion into the country in 1996, with one third of that spent on accommodation and the rest spread over sectors such as restaurants, travel, retail and entertainment. The hotel sector also underpins the UK's attractiveness as an international business destination.

For the purposes of this report, hotels are defined as all establishments for which the principal source of income is accommodation. The analysis therefore covers guesthouses and "bed and breakfast" accommodation (in so far they are captured in national statistics). It excludes accommodation that is ancillary to other services, such as rooms in pubs or lodging provided in leisure parks.

The chosen benchmark countries are the US, as the most mature service economy with a reputation for high levels of customer care, and France, which has the highest number of international arrivals per capita of any large economy and a strong food service tradition.

The hotel industry is fragmented in all three of the countries studied: while at one end of the market a substantial and increasing proportion of the hotel industry is operated as chains or under franchise arrangements, a large part of the industry is still composed of relatively small independent owner-operators, many of whom use the hotel as their home, and may rely on unpaid family labour. It is therefore difficult to obtain consistent and complete information on the industry. To overcome some of these difficulties, this study was supported by a telephone survey of 300 hotel operators in each country, together with extensive face-to-face interviews with a wide range of operators and other experts.

PRODUCTIVITY PERFORMANCE

Labour productivity in the UK hotel sector is currently around 53 per cent of the US level and 60 per cent of the French level (Exhibit 1).

National statistics do not provide enough data to calculate capital productivity for the sector. However, given that the average UK hotel is significantly older than the average French or US hotel (see later), we believe that much of the UK's capital stock will have been fully depreciated, allowing UK operators to provide the same service offering with fewer capital inputs. We expect, therefore, that the sector should have relatively high capital productivity and low capital intensity.

Further details of the methodology used to calculate productivity are provided in the Appendix.

REASONS FOR DIFFERENCES IN PRODUCTIVITY PERFORMANCE

Exhibit 2 shows the framework with which we have analysed the productivity gap across all the sectors studied. It divides the causes for the productivity gap into three groups. At the lowest level, productivity differences are caused by differences in production processes within firms. These differences are driven, however, by factors external to the firm within both the industry sector and the economy at large.

The primary causes of the UK's productivity gap versus the US and France at the production process level are the greater age of UK hotels and less use of standardised practices because of lower chain penetration. The external level factors that influence this are building and planning regulations, a poorly performing construction industry and a relative lack of UK demand growth.

Production processes

At the production process level, the main reasons for the UK's productivity gap with France and the US are the greater age of its hotel stock and less use of standardised processes. Service mix and hotel size play a significant but smaller role in explaining the gap.

- **Age of the hotel stock.** The UK has a much higher proportion of old hotels than either the US or France – roughly 75 per cent of rooms in UK hotels are in buildings that are more than 40 years old, compared to only 35 per cent in France and less than 25 per cent in the US (Exhibit 3). This imposes inefficient organisation of functions and tasks. For example, rooms take longer to clean, and storage space and public areas are less efficiently laid out in older hotels than in new hotels or old hotels that have been substantially refurbished. Essentially, old hotels are not "designed for manufacturing," and we estimate new or fully refurbished hotels use labour up to 30 per cent more productively than old ones.

Clearly, there are some examples of hotels in old buildings that are productive despite their high labour inputs. For a number of the UK's older buildings, the age of the building is itself part of the product offering and the hotel is able to charge a price premium to capture the value that customers place on historic surroundings. At an aggregate level, however, the rates charged by UK's older hotels fail fully to reflect higher labour intensity.

¶ **Less use of standardised processes because of lower penetration by large chains:** The UK hotel sector makes less use of standardised processes than either the US or France.

- *Standardisation is typically achieved by large chain or franchise operations:* Large chains generally have standardised operating procedures, which result in quicker check-in and check-out, more efficient cleaning, and better staff scheduling. Chains and franchises also have higher productivity because they can attract and retain the best staff and achieve some economies of scale in purchasing. In addition, superior reservation systems result in chains having higher yields than non-chains. We estimate that a new chain hotel would be up to 50 per cent more productive than a new, non-standardised independent hotel.

- *There are fewer large chains in the UK:* In all three countries studied, more than half of the hotel rooms available are in independent or small chain operations. However, the incidence of large chains is somewhat lower in the UK than in France and the US. Furthermore, where chains do exist, they are generally operating older hotels, which limits the advantages they can gain from standardised procedures - while some of the benefits of standardised operating procedures can be achieved in old hotels (for example, labour scheduling, streamlined procedures for check-in and check-out), the benefits are maximised in new hotels where, for example, bedrooms are all of a similar size and shape (Exhibit 4).

  Since the age of the building itself affects productivity, it follows that UK chains are, on average, less productive than their US or French counterparts. However, where our work allowed us to compare chains on a complete like for like basis, differences in productivity levels were not material.

¶ **Service mix.** Although somewhat less important than age and chain penetration, differences in service mix across the three countries at both the macro (i.e., key departments) and micro (i.e., services provided within key departments) levels also contribute to the productivity gap.

- *Macro level:* Hotel revenue typically comes from three main sources:
  - 'Accommodation' through room rates – this typically represents at least 50 to 70 per cent of hotel revenues.
  - 'Food and beverage' through restaurants, bars and room service – this can account for up to about 40 per cent of revenues, depending on the levels of service provided.
  - 'Other services' such as sports and business facilities – these generally represent less than 10 per cent of the total revenue stream.

  Given its relative size, we have not investigated cross-country differences in 'other services.' However, our research shows that food and beverage services have inherently lower labour productivity than accommodation services, and that provision of these services is significantly higher in the UK than in the US or France (Exhibit 5).

- *Micro level:* There are also differences in service levels at the micro level between French hotels and UK/US hotels. French hotels are less likely to offer services such as porterage, and more likely to invest in equipment to help guests to help themselves in areas from buffet meals through to shoe cleaning. As a result, and in a similar way to that observed in French supermarkets in our food retailing case study, French labour productivity is boosted relative to the UK and US.

¶ **Size of hotels.** Individual establishments gain some economies of scale from reduced labour inputs per room as the number of rooms in a hotel rises. Hotels with fewer than about 20 rooms are likely to have significant diseconomies of scale if operated on a full commercial basis, and are the most likely to be supported by unpaid family labour. For larger hotels, the hours worked per room cleaned do not vary substantially, but there will be economies in nearly all other areas of operation.

The low incidence of small hotels and the high incidence of very large hotels in the US therefore yields modest further productivity gains for the US relative to the UK (Exhibit 6).

¶ **Non-differentiating factors – labour skills.** In interviews, hotel operators – especially in small businesses – repeatedly reported difficulties in recruiting and retaining skilled staff in the UK. Their concerns covered a range of skills that centred on customer care, food preparation and service and management. Tipping practices in the US were also often mentioned as making it easier to motivate front of house staff relative to the UK.

However, we did not observe any significant productivity gap between like-for-like hotels operated by the same international chains across countries, suggesting that with effective training and well designed functions and tasks, differences in entry-level skills can be overcome. We do not believe, therefore, that there is any significant inherent difference in the trainability of the hotel workforce across the three countries, although it would appear that the higher level of small independent hotels in the UK could be limiting the extent to which these skills are being developed.

Industry dynamics and external factors

A consequence of low chain penetration is that most UK operators have faced limited competition with international best practice - only about 3 per cent of UK hotel rooms are in major international chains (Exhibit 7). Levels of competitive intensity in the UK may also be inhibited by the historic lack of a widely used grading system, particularly relative to France.

To understand why the UK has more old hotels and fewer chains than the US or France, we analysed the economics of operating both old and new hotels in each of the three countries. In particular, we tried to understand why old hotels in the UK have not been replaced with modern formats, whether newly built or refurbished. Older stock dominates in the UK because high construction costs – driven by both stricter building and planning regulations and a weaker performing domestic construction industry – make it uneconomic for old stock to be renovated and/or to exit the market, and the UK has had less demand growth that would allow new hotels to dilute and displace the old stock. Construction costs primarily influence differences between the US and the UK, whereas demand growth explains differences with both France and the US.

¶ **Construction costs are higher in the UK than in the US:** US construction costs are about 70 per cent of those in the UK. UK construction costs are higher for two main reasons (Exhibit 8):

- *Product market regulations:* There are two types of regulation that impact UK performance: building regulations, and planning and listing regulations:

– *More prescriptive building regulations:* Construction costs in the UK are driven up because hotel operators must follow myriad regulations, such as health and safety and fire regulations. One report on hotel construction by Pannell Kerr Forster[1] (PKF) commented that regulations "have become increasingly specific and therefore more restrictive and potentially more expensive". Experts estimate that the UK's more prescriptive building regulations explain around one third of the difference between UK and US construction costs.

– *More stringent planning and listing regulations:* UK planning and listing requirements often impose higher cost design and construction methods. In some cases planning restrictions actually prevent new hotels from being built.

. Anecdotal evidence suggests that planning requirements in the UK are highly prescriptive, and make it hard to build or refurbish. For example, the PKF report comments: "The effect on building type and design arising from planning control can be considerable. Current powers allow local authorities to state preferences for size of development, layout and materials to be used, particularly where they influence the appearance of the building". In some cases planning restrictions prevent hotel operators from accessing the best sites on which to build new hotels, further discouraging entry by best practice operators.

. In addition listing requirements often impose inefficient working practices on hotels. One hotel operator told us that he was prevented from knocking down any walls in the building, had to retain skirting boards, cupboards and doorknobs, and could not cut down tree branches to make his hotel sign more visible. Around, 3,000 hotels in the UK are in listed buildings.

Depending on the specific situation, experts indicate that planning and listing regulations account for between 15 and 50 per cent of the difference between UK and US construction costs.

Poor performance of construction industry and poor building design by hoteliers: The UK construction industry is widely regarded as being inefficient, with fundamental issues of reliability and quality. Additionally, the industry does not make use of many of the cost effective building methods used in the US, such as pre-fabrication. (See Box 1 for a more detailed discussion on the construction industry.)

[1] "Hotel design and construction in the UK" Panel Kerr Forster, 1998.

At the same time, UK hotel operators are typically less adept than US operators at providing easy-to-follow specifications, which inhibits the construction industry from fully standardising their practices. Depending on the specific situation, experts indicate that the inefficient construction industry and poor building design explain between 15 and 50 per cent of the difference between UK and US construction costs.

The relatively high construction costs in the UK affect the age of hotel stock in two ways:

- *Operators are less likely to refurbish their hotels in the UK than in the US:* The high cost of construction in the UK means that the breakeven point for undertaking refurbishment is higher than it is in the US, thereby making UK operators less likely to modernise their hotel. For example, in one case study we found that the owner of an old hotel was unlikely to recover the costs of refurbishment to modern format in any of the three countries studied. However, the loss in value through refurbishing rather than maintaining the status quo was significantly less in the US because lower construction costs meant that smaller increases in yield per room were needed to compensate for the renovations (Exhibit 9).

- *New hotels are less likely to be built in the UK than in the US:* High construction costs in the UK also mean that the breakeven occupancy level for new build hotels is higher in the UK than in the US - in another case study we found that a new US hotel could break even at roughly 50 per cent occupancy, whereas the equivalent figure for the UK was closer to 80 per cent (Exhibit 10). As a result, unless they can be assured of high levels of occupancy, new hotels are less likely to be built in the UK than in the US. This is particularly important in areas of fixed demand where there is already an existing operator, because it makes it less likely that a new entrant in the UK will be able either to co-exist with the existing operator or to drive the existing operator out of business. In addition, planning restrictions limit access to many sites that offer the greatest potential to achieve high occupancy rates, further restricting new build.

¶ **Relative lack of demand growth inhibits the creation of new hotels in the UK**: Given the disincentives in the UK to renovate and displace old stock with new stock, the proportion of new stock can only rise if old stock is retired or if new stock is supported by new demand. Old hotels are unlikely to exit the market for alternative uses, and the UK has experienced less growth in demand than either the US or France.

- *Old hotels are less likely to have exited the market through sale for alternative use in the UK:* The structure of a hotel building is such that it has limited alternative use (rare examples include conversion to residential dwellings or nursing homes). Thus, other than in the few cases where there is clear demand for a permitted alternative use, the value of the structure is generally simply the value of the land, and it is often more economic to keep the relatively unproductive old stock open. In general, therefore, old hotels exit a market only relatively slowly. Given the UK's planning environment, this process is made even more slow.

- *The UK's smaller proportion of new build is therefore partly a reflection of lower growth in demand for hotels in the post-War period:* Estimates based on population growth, income growth, proportion of service businesses in the economy (which are all external macroeconomic factors) and net inflows of international travel suggest that the UK has experienced domestic demand growth of only around half US levels and half or even less of French levels in the post-War period (Exhibit 11).

  Low net inflows of international travel may be partly attributable to country-specific factors, such as the UK's geography and climate (compare France with its popular ski resorts in the winter and Mediterranean beaches in the summer), but there also appears to have been less demand stimulation by the tourist industry as a whole as measured by the growth in the number of major new attractions developed in each of the countries over the past 40 to 50 years (Exhibit 12). Only one of the top 10 tourist attractions in the UK was built in the 20th century, compared to six in France and nine in the US. In fact, over the past two decades, France has built five of its top 10 destinations, the US has built three of its top 10, while the UK has built none.

Although less important than high construction costs, we examined a number of other external factors to explain the UK hotel sector's low labour productivity.

¶ **Historic performance of restaurant sector.** There is insufficient information to draw firm conclusions as to why UK hotels offer more food and beverage services than the US or France, but it may reflect historic weaknesses in the UK's restaurant sector, together with the higher proportion of older stock. A hotel operator will build a restaurant if the increased revenue, both direct from the restaurant and as a result of higher room rates and occupancy, justifies it. This is more likely to be the case if guests cannot be sure of finding meals of adequate quality and value at a nearby location. A quick examination of the restaurant sector in six small provincial towns across the three countries suggests that there are large differences in the quantity of independent restaurant services provided, lending some support to the suggestion that UK hotel operators have historically found it more difficult to rely on food provided outside the hotel (Exhibit 13).

In terms of labour productivity within the economy as a whole, a shift in provision of food services from hotels to independent restaurants would benefit the UK so long as independent restaurants are more productive than those based in hotels. While we have not carried out any analysis to prove this hypothesis, it seems likely that companies focused on restaurant operations would be more productive in providing these specific services than those with a wider range of activities. This argument is supported both anecdotally by leisure sector operators, and by the current trend to outsource hotel restaurant operations.

¶ **Labour costs.** Differences in service mix at the micro level are explained by the relatively high cost of labour in France that has forced operators to restrict the range of services they provide within a given hotel format.

¶ **Planning regulations.** The larger scale of US hotels is related to planning regulations, which in addition to raising construction costs, also make it more difficult to obtain permission to build large hotels in the UK.

¶ **Non differentiating factors – access to capital.** There has clearly been less investment in recent years in the hotel industry in the UK than in France or the US. However, as explained above, we believe that this reflects rational decision making by both managers and capital markets. We found no evidence to suggest that hotel operators in the UK find it harder to access capital given a certain level of return than operators in the other countries studied.

FUTURE OUTLOOK AND RECOMMENDATIONS

There is significant room for improvement in the UK hotel industry. Not only does the sector suffer from poor labour productivity, output is also low. Output per capita in France is 25 per cent greater than the UK, and output is more than twice as high in the US. There are a number of actions the Government and the hotel industry can take to attempt to tackle both of these gaps.

Difficulties in obtaining hard data on individual segments of the hotel market has meant that the reasons given for poor productivity have focused on the sector as a whole. However, in terms of future outlook and recommendations for the industry, specific segments of the market provide a better basis for implementing solutions. Hence, in addition to detailing recommendations relevant for the whole sector, we outline specific recommendations for three key segments: London, provincial tourist destinations and non-London business destinations.

The overarching message in all sectors is the same – the UK needs to encourage the creation of modern, productive hotels and encourage the economic reduction of old, less productive stock. Promoting the construction of new hotels in new destinations is a key to diluting the average age of the UK hotel stock. This will require a combination of the tourist industry working to stimulate demand and Government policies that lower the cost of construction. Because of the lack of exposure to best practices and the difficulty of new entry, UK hotels have been somewhat protected, and, furthermore, may not have felt the competitive pressure to aggressively market themselves to stimulate demand.

We believe that these actions should help boost productivity and output significantly, although they are unlikely to close the gap fully. Lower income levels and country specific factors such as poor weather and geographic factors such as size of the country will clearly limit what can ultimately be achieved (Exhibit 14).

General sector outlook and recommendations

The global tourist industry is projected to grow prodigiously over the next 20 years, and the UK will certainly benefit from that growth. However, if there is no improvement in the hotel industry, it is likely that the UK will slide down the world rankings of tourist and business service destinations. There will be some improvement of the industry as chains continue slowly to penetrate the market, for example the current trend by companies like Whitbread to open chained budget inns across the country. However, this will not be enough for the industry to achieve its full potential.

To further improve productivity in the industry, hoteliers must therefore attempt to stimulate demand and aim to realise the benefits of a single, country-wide grading system.

¶ **Stimulate demand within the industry:** The industry itself could go some way to improving productivity within the existing stock by developing more sophisticated marketing techniques to stimulate demand (e.g., cross-sectoral alliances, loyalty schemes). These programmes are much more prevalent in the more competitive US and French hotel markets, and they help to build customer loyalty and increase visits. In the leisure sector, demand may be stimulated by offers such as weekend breaks and external health club memberships; in the business market it would involve investing in more facilities and services to host business events.

¶ **Realise the benefits of a single grading system:** The industry should closely monitor the introduction of the new unified standards for accommodation in England, and take steps to improve their uptake and efficacy as necessary. A ratings system does not mean that there has to be a set of 'minimum' standards that all hotels must meet. It simply ensures that consumers understand exactly what they are getting when they decide to stay in a hotel.

The hotel industry itself can go a long way to improving productivity, but if the Government does not help change the terms of the game, productivity boosts will be seriously constrained. The Government needs to evaluate the impact of the planning and listing regulations, as well as continue to aid efforts to improve the construction sector and the skills of incoming workers.

- **Consider the impact of planning and listing regulations**: As a minimum, the Government should ensure that the current review of the planning system leads to faster decision making and greater certainty of outcome. In addition, the Government should ensure that planning decision makers are aware of the economic implications of their decisions. The current thinking behind planning policies in the hotel industry serves to protect inefficient, old stock, for which consumers are unwilling to pay the additional costs implied. In addition, the hotel industry is protected from competitive pressure and best practice operators, which has likely led to less demand stimulation.

- **Continue to support efforts to improve the construction sector:** Government should actively support the current efforts being made to improve the performance of the construction sector. These are important not only for the hotels sector, but for all industries looking to develop new formats (e.g., retailing, leisure complexes) and so are key to the economy as a whole.

London outlook and recommendations

The London hotel market suffers from significant under-capacity, particularly in the budget sector, driven by extremely restrictive planning and listing regulations, in addition to poor infrastructure. Without changes to regulation, there is unlikely to be any significant improvement. Government must therefore look to find socially acceptable ways to loosen these regulations and encourage new hotels.

- **Without change, undercapacity will continue:** Occupancy rates in London are significantly higher than the rest of the country, and are also higher than other major European cities. In recent boom times, as demand has increased and supply has remained fixed, hotel operators have been increasing prices. It appears unlikely that future demand will be met.

- In 1995, the London Tourist Board set a goal of 10,000 new hotel rooms in London by 2000, and said it thought 20,000 would be needed. While there has been some progress in meeting these targets, it still appears that there will be a significant shortfall (Exhibit 15). Almost 8,000 rooms have either been built or are under construction, with about 7,000 rooms considered “probable.” Even if all of the probable rooms are built, the 5,000 room short-fall represents roughly 5 per cent of total London hotel stock, so that there still will be under-capacity.

- London is not considered an attractive market by international hotel chains thinking of expanding. When 11 international chains were asked where they were looking to build additional rooms in Europe over the next few years, London was placed eighth, behind cities such as Dublin and Berlin (Exhibit 16).

¶ **Planning and building restrictions prevent new hotels**: The Unitary Development Plan for Kensington and Chelsea, for example, makes no provision for hotels, making the outcome of applications less certain and more likely to fail; over 30 per cent of Westminster is declared a Conservation Area, substantially restricting opportunities for new hotels and refurbishment. Even in Earls Court, where many commentators agree the current stock of hotels is of very poor quality, residents will not allow new hotels to drive out old stock.

¶ **The Government needs to consider the potential negative impact of no change**: Visitors to London are currently more likely to report being unhappy with their hotels than visitors to the rest of the UK. If action is not taken to meet consumer demand, the problems are likely to get worse.

Tourist destinations outlook and recommendations

The UK’s record in developing new leisure attractions has been relatively poor – only one of the top 10 tourist destinations in the UK has been built in the past 50 years (Alton Towers). Again, experts point primarily to the role of restrictive planning and poor infrastructure. Several experts said it would be next to impossible to get planning permission to build a site the size of EuroDisney – especially because poor infrastructure effectively limits the number of sites that can support such parks. Another example of the difficulty obtaining planning permission is demonstrated by the ongoing legal battle that The Rank Group has faced in creating its Oasis holiday village in Kent.

Tourist destinations can be a boon to both output and employment, and the Government needs to balance these goals with the goal of protecting the environment. At the same time, there are actions hotel operators can take to help create and improve tourist destinations:

- **Increase intermediation to better target existing tourist spots:** There are still many areas in the UK that could serve as "destinations" with increased intermediation. A focus on these areas by companies such as travel agents and tour operators, as has happened in a number of foreign holiday destinations, would help to increase demand and hence the need for more hotels. In addition, a unified rating system could eliminate variable quality and also increase demand.

- **Act with other providers to help create demand:** Hotel operators need to act in alliance with other leisure/travel providers to create new destinations such as leisure complexes and theme parks. CenterParcs is an example of a new format that could serve as a tourist magnet.

Non-London business outlook and recommendations

The UK currently houses only 4 per cent of total European conference and exhibition space compared to 17 per cent apiece for France and Italy and 38 per cent for Germany (Exhibit 17). This suggests that there is considerable potential for growth in this area. Exhibition space can be an enormous boon to hotel operators, as it draws in large groups of people who need hotel accommodation.

In looking to boost UK exhibition space there needs to be an integrated effort from hotel operators working with Government and other public and private sector bodies to enhance and develop the UK's reputation as a conference destination.

Appendix: Methodology for productivity calculations

To compare the performance of the UK hotels sector with that of other countries we investigated output, labour inputs, and labour productivity.

¶ **Output**: Output was defined as value added per capita for the hotel sector as provided in each country's national statistics. This was converted to a common currency using a PPP constructed in three stages:

- An accommodation only PPP was established by matching room rates of a sample of pairs of hotels offering similar services across the three countries.
- Given that the OECD PPP for the 'hotels and restaurant' sector is made up predominantly from restaurants, we took this number to represent a PPP for food and beverage services provided within the hotel sector.
- We then aggregated the accommodation PPP with the food and beverage PPP, in the ratio of estimated revenues earned from accommodation and food and beverage services respectively to provide an overall hotels sector PPP.

¶ **Labour inputs**: Labour inputs were defined as number of hours worked in the sector in each country taking into account the proportion of part time workers, self employed, length of working week and annual leave. Anecdotal evidence suggests that labour inputs may be undercounted in France and, to a lesser extent, the UK, relative to the US. If this is the case, the true productivity gap between the France and the UK is less than that described, but the gap between the US and the UK is slightly higher.

¶ **Labour productivity**: Output divided by labour inputs.

Box 1

UK CONSTRUCTION INDUSTRY

While we have not studied the construction industry in detail, expert interviews suggest that the industry is performing relatively poorly compared to the US. This view was supported by an independent report by Sir Michael Latham in 1994 which suggested the industry could increase its productivity by about 30 per cent, and proposed the formation of a "Construction Task Force," which was subsequently chaired by Sir John Egan.

The task force released its preliminary findings in February 1998, suggesting that there is widespread room for productivity improvements, of the order of 10 per cent a year. The task force said: "The construction process, particularly when viewed as a whole, is inefficient in the use of labour and prone to waste." It went on to state that the industry should look to achieve

50 per cent reduction in defects on handover every year

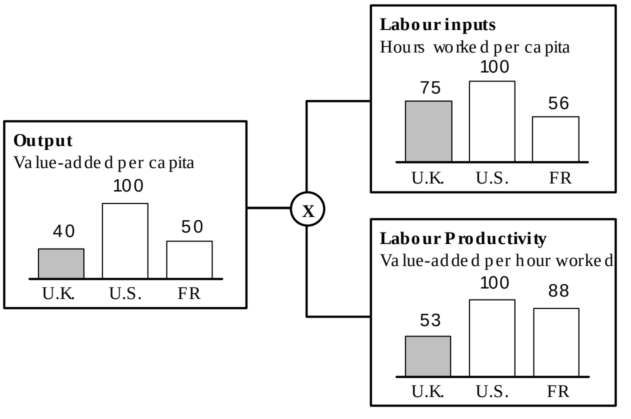
50 per cent reduction in construction time within five years

80 per cent reduction in accidents within three years.

Exhibit 1

HOTEL SECTOR LABOUR PRODUCTIVITY*, 1996

Output per hour worked; Indexed to U.S. = 100



* Converted at constructed PPP

Source: National Accounts; EIU; WTO; McKinsey analysis

Exhibit 2

CAUSALITY FOR PRODUCTIVITY DIFFERENCES

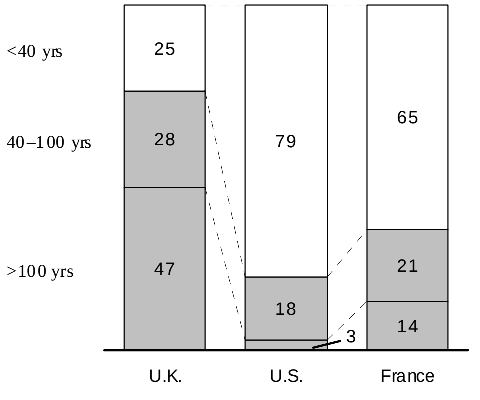
● Important (>10 points of gap)
○ Secondary (3-10 points of gap)
\- Undifferentiating (<3 points of the gap)

		U.K. vs. U.S.	U.K. vs. FR
External factors	• Fiscal and macroeconomic environments	○	○
	• Product market		
	– Trade/FDI barriers	-	-
	– Product regulations	●	●
	• Labour market		
	– Labour rules/unionism	-	-
	– Relative labour cost	-	○
	– Education	-	-
	• Capital market		
	– Corporate governance/government ownership	-	-
	– Access to capital	-	-
	• Other external factors		
	– Other industries /up and down stream	●	○
	– Country specific factors	○	○
Industry dynamics	• Competition with best practice	●	●
	• Domestic competitive intensity	-	-
Production process	• Mix of products and services/marketing		
	– Product category mix	○	○
	– Value added within category mix	-	-
	– Product proliferation	-	-
	– Pricing structure/marketing	-	-
	• Production factors		
	– Capital intensity/technology	●	●
	– Scale	○	-
	– Front line skills/trainability	-	-
	– Matching capacity to demand	-	-
	• Operations		
	– Organisation of functions and tasks	●	●
	– Design for manufacturing	●	●
	– Suppliers and supplier relationships	-	-
	Productivity performance (comparison country = 100)	53	60

Exhibit 3

AGE OF HOTEL BUILDING

% by rooms

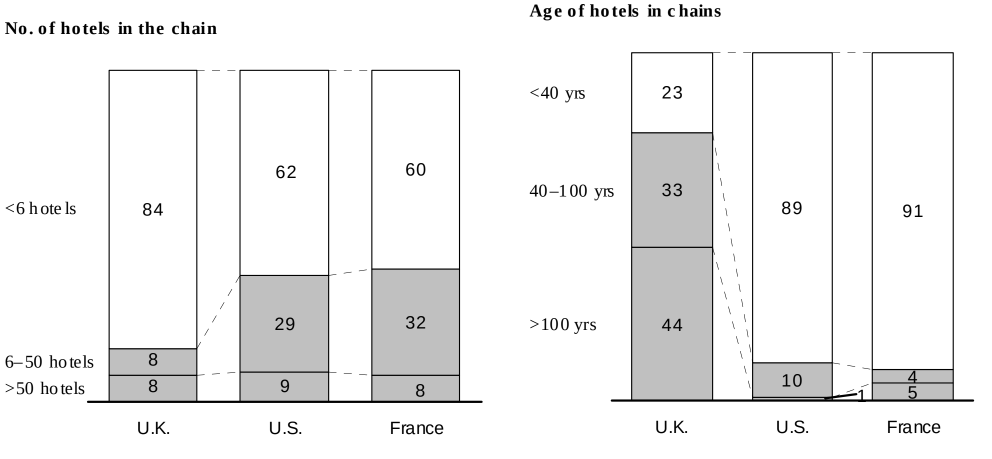


Source: McKinsey survey

Exhibit 4

CHAIN HOTELS

% by room

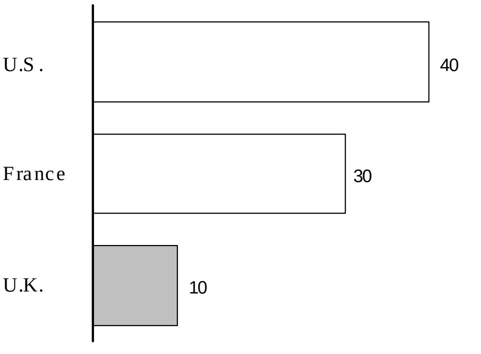


Source: McKinsey survey

Exhibit 5

HOTELS WITHOUT A RESTAURANT

% by rooms

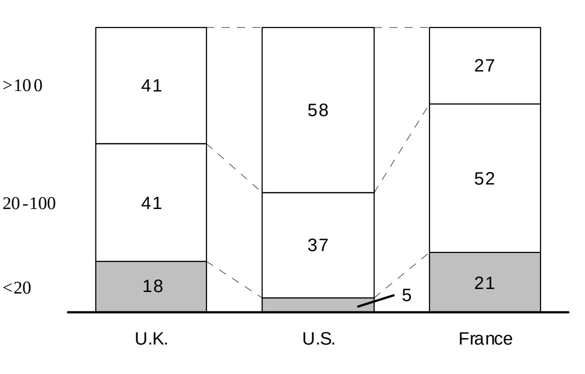


Source: McKinsey survey

Exhibit 6

SCALE OF HOTELS

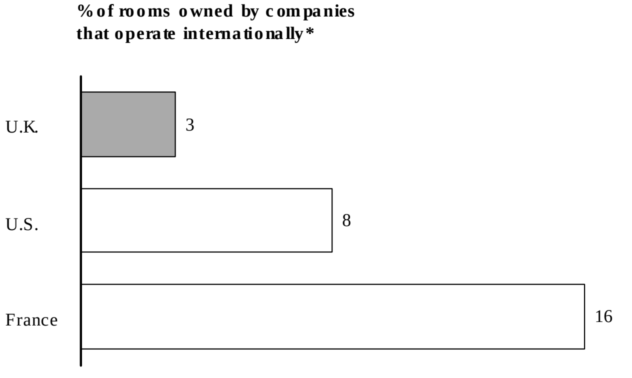
% by rooms



Source: McKinsey survey

Exhibit 7

NATURE OF COMPETITION

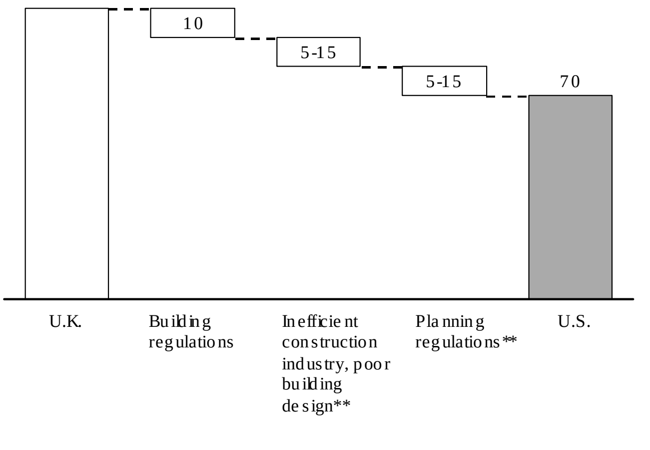


* Defined as having more than 5% of the rooms in the quoted market in one of the other countries in the study

Source: Kleinwort Benson; McKinsey analysis

Exhibit 8

ESTIMATED DIFFERENCES IN CONSTRUCTION COSTS*



* Both countries show regional variations in costs which are greater than the difference indicated. The figures shown here are estimated national averages

** Both the construction industry and planning regulations have significant impact on construction costs; however, the impact varies by case

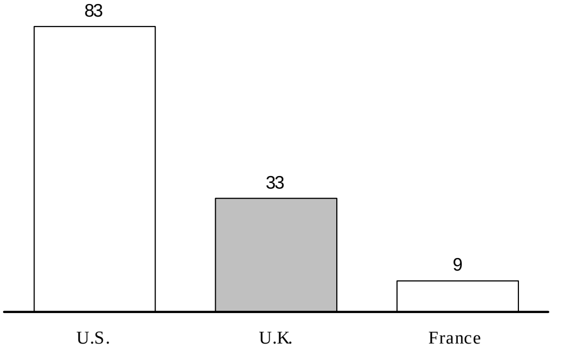
Source: Interviews; McKinsey analysis

Exhibit 9

VALUE OF REFURBISHED HOTEL*

EXAMPLE

Indexed to value without refurbishment = 100



* Assumes 50% increase in yield/room as a result of refurbishment to modern format

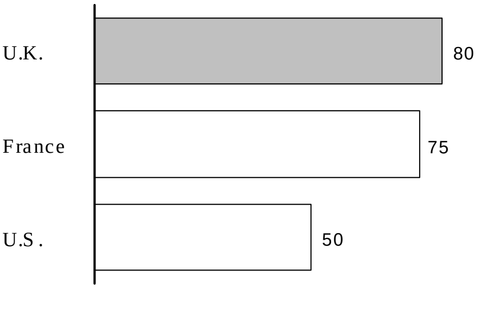
Source: McKinsey survey; interviews; McKinsey analysis

Exhibit 10

ESTIMATED BREAK-EVEN OCCUPANCY FOR NEW HOTEL*

EXAMPLE

%



* Based on mid market hotel

Source: McKinsey analysis

Exhibit 11

DEMAND DRIVERS

ESTIMATE

Source: ONS; U.K. Tourism Survey; British National Travel Survey; Statistical Abstract of the U.S.; Direction du Tourisme; McKinsey analysis

Exhibit 12

TOP TOURIST ATTRACTIONS, U.K., U.S., AND FRANCE

Yearly attendance, m

U.K.

Name	Const. Date	Attend. (m)
Blackpool Pleasure Beach	1896	7.5
British Museum	1847	6.2
National Gallery	1838	5.0
Palace Pier	1899	4.3
Alton Towers	1970s	2.7
Madame Tussauds	1884	2.7
Tower of London	1100 (1660)	2.5
Westminster Abbey	1200 (1700)	2.5
York Minster	1220	2.5
Eastbourne Pier	1882	2.3

FRANCE

Name	Const. Date	Attend. (m)
EuroDisney	1992	11.7
Tour Eiffel	1889	5.5
Musée du Louvre	1500 (1793)	5.0
Cité de Sciences	1986	3.9
Versailles	1600s (1837)	2.9
Parc Futuroscope	1987	2.8
Parc Aquaboulevard	1984	2.2
Musée d'Orsay	1900 (1837)	2.1
Parc Astérix	1989	1.7
Parc Marineland	1970	1.2

U.S.

Name	Const. Date	Attend. (m)
Disneyland	1955	14.1
Magic Kingdom, FL	1971	12.9
Epcot Center	1982	10.7
Disney Studies, FL	1989	9.5
Universal Studios, FL	1990	8.0
Sea World, FL	1973	5.0
Universal Studios, CA	1964	4.7
Statue of Liberty	1886	4.2
Six Flags, NJ	1974	4.0
Busch Gardens, FL	1959	3.8

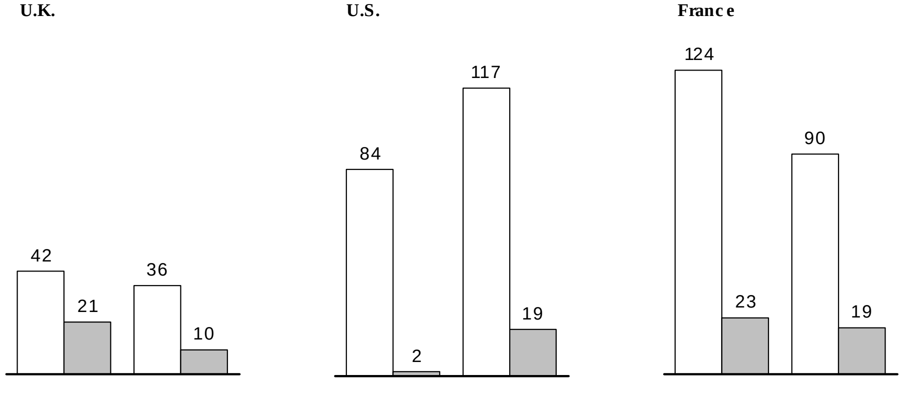
Source: Literature searches, company representatives; Memento du tourisme 1997/98; BTA; McKinsey analysis

Exhibit 13

NUMBER OF FULL SERVICE RESTAURANTS AND HOTELS IN 'TYPICAL'* TOWNS

Restaurants**

Hotels and guesthouses



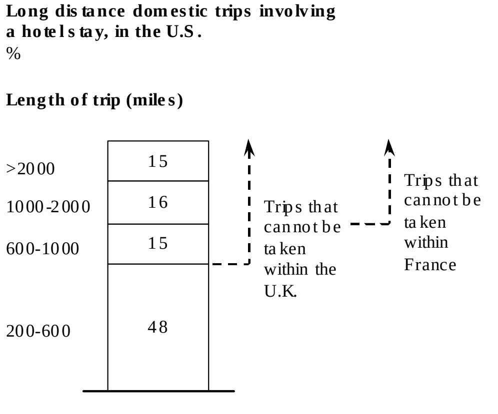
* Population 60,000; no major leisure or business attractions

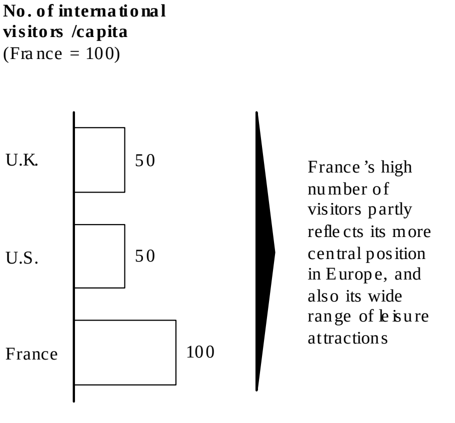
** Excludes bars and fast food outlets as they are unlikely to be able to provide food services consistent with the hotel guests' requirements. Excludes outlets defined as pubs in the U.K. because, historically, they are unlikely to have provided significant amounts of food service

Source: Yellow Pages; Tourist Boards; Phone Disc, 1998; McKinsey analysis

Exhibit 14

GEOGRAPHICAL CONSTRAINTS

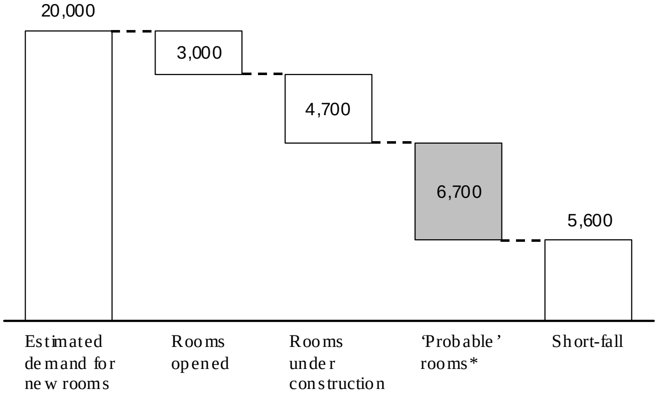




Source: WTO; BTA; Rushmore

Exhibit 15

ESTIMATED NUMBER OF NEW HOTEL ROOMS IN LONDON BY 2000



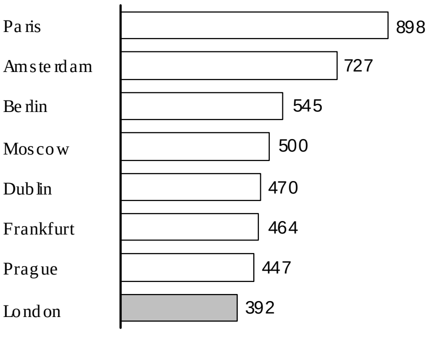
* Rooms that either have full or outline planning permission

Source: London Tourist Board, Hotel Development Log; McKinsey analysis

Exhibit 16

PROPOSED ADDITIONS BY MAJOR INTERNATIONAL CHAINS*

No. of rooms

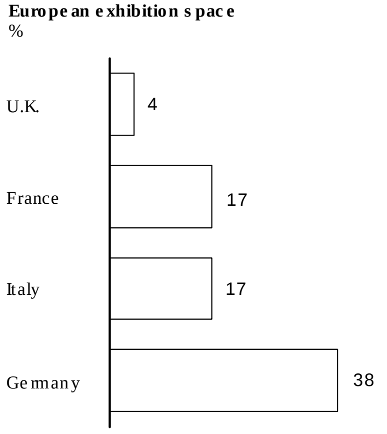


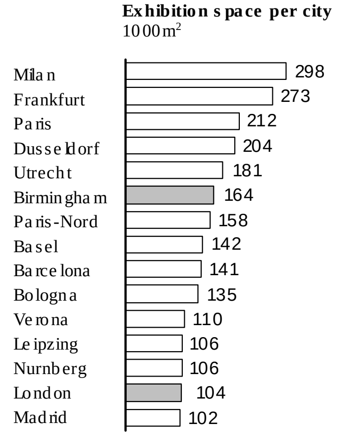
* Based on a survey of 11 international brands (Four Seasons, Hilton, Holiday Inn, Hyatt, Inter-Continental, Marriott, Le Meridien/Forte, Radisson, Sheraton, Sol Melia, Westin)

Source: Christie Consulting International; McKinsey analysis

Exhibit 17

CONFERENCE AND EXHIBITION MARKET





Source: Deloitte and Touche; Press reports; European Major Exhibition Centres Association; McKinsey analysis