INSIGHTS

2009 Hotel Negotiations: What to Expect

Will the economic slowdown mean lower rates for corporate buyers?

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Will history repeat itself? A downturn in the economy has always meant fewer heads in hotel beds and in the past, properties have raised rates more slowly or even cut them, hoping to stimulate demand. Many travel buyers remember the rate slashing that occurred after 9/11 and are wondering whether the current economic context will make negotiations easier. They may be in for a surprise.

A tough year for the global economy

The past year has been a tough one for the global economy as crisis in the financial sector, a severe credit crunch and record-high oil prices have impacted performance in many industries. The worst could be still to come. According to the International Monetary Fund[1], global GDP will grow only 3.9 percent by the end of 2008 and 3 percent in 2009, compared to 5 percent in 2007. This trend is particularly marked in the United States, where GDP is estimated to grow only 1.6 percent in 2008 and 0.1 percent in 2009, compared to 2 percent in 2007. Meanwhile, the Middle East—the only region that is continuing to accelerate—is expected to experience a softening next year.

This gloomy economic outlook, combined with steeply rising airfares, is prompting some companies to cut back on their travel. The cuts are particularly noticeable in the hardest-

[1] *World Economic Outlook Update*, International Monetary Fund, October 2008

hit sectors like financial services, but the mood is cautious in many other sectors as well. A survey published in June 2008 by the U.K. and Ireland Institute of Travel Management found that approximately 20 percent of the 175 surveyed travel managers and procurement professionals had already frozen travel or were prepared to do so if the economy continued to worsen at the present rate. Similarly, a survey of 131 companies published by the Association of Corporate Travel Executives in September revealed that a third of respondents plan to spend less on travel in 2009.

Caution in the hotel sector

Hotels are also applying caution. For them, that means holding back on rate cuts. In fact, while occupancy is dropping in the world's most developed regions, average room rates continue to rise and often by double digits, as shown in the table below. (The exceptional three-digit rate increase in Beijing is due to the Olympic Games.) This is enabling hotels to protect their revenue per available room (RevPAR), even though fewer rooms are being filled.

Rate increases are widespread even though occupancy is falling

Year-over-year percentage change in occupancy, room rates and revenue per available room (RevPAR) – August 2008 vs. August 2007

		Year-over-year % change		
City	Current occupancy	Occupancy	Average (ADR) daily rate	Revenue per available room (RevPAR)
Beijing	59.5	-15.9	286.9	224.5
Berlin	74.6	-1.8	13.0	11.0
Buenos Aires	64.3	2.6	11.2	14.1
Cairo	77.2	-4.3	10.9	6.2
Dubai	77.1	-7.9	4.5	-3.7
Hong Kong	77.9	-10.7	16.5	4.1
London	82.8	-0.2	-3.0	-3.1
Los Angeles	78.6	-4.1	4.1	-0.2
Madrid	44.3	-8.3	8.5	-0.5
New York	89.2	1.4	7.8	9.3
Paris	70.2	-9.5	7.9	-2.4
Rome	54.6	-13.6	2.8	-11.2
Sydney	75.5	-3.7	5.6	1.7
Tokyo	78.0	-5.9	17.4	10.6
Toronto	77.1	1.5	-1.8	-0.3
Region				
Asia Pacific	64.9	-11.0	27.2	13.1
Central America	68.9	-3.5	12.5	8.5
Europe	68.4	-5.1	5.7	0.3
Middle East	72.9	-0.5	19.4	18.8
North America	67.8	-3.3	2.8	-0.6
South America	67.4	2.1	23.4	26.0

Source: CWT Travel Management Institute
Based on *The Hotel Review* published by Smith Travel Research and STR Global

In fact, it is not unusual for average daily rates to rise even when occupancy falls, as shown in the following graph of U.S. hotel performance. But when they rise more slowly than inflation, they become cheaper in real terms.

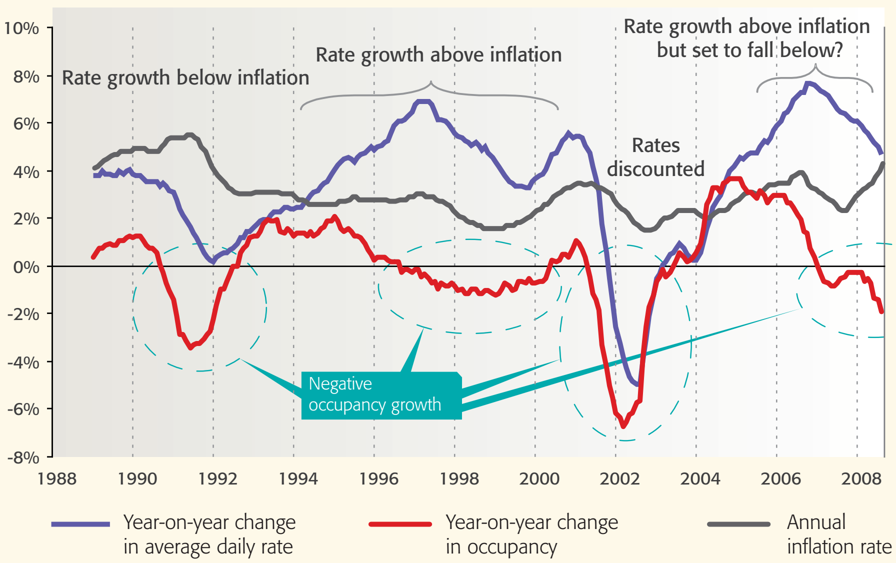
This chart highlights three periods when occupancy growth was negative in the United States. Average daily rates performed differently in each case:

- Early 1990s: rate growth slowed and was below inflation
- Late 1990s: rate growth slowed but was higher than inflation
- Early 2000s (post 9/11): rates were cut well below inflation

This chart also indicates the current downward trend in rate growth, which stood only just above the rate of inflation in August 2008.

Negative occupancy growth does not always mean lower rates

Year-over-year changes in occupancy and average daily room rates in the United States, January 1998 – August 2008 (12-month moving averages*)



* Twelve-month moving averages mean that the occupancy for January 2008 is the average occupancy from February 2007 – January 2008 and the year-on-year change is the difference between the annual average for January 2007 and for January 2008

Source: CWT Travel Management Institute
Based on U.S. hotel performance data provided by Smith Travel Research and STR Global

Three important points are worth highlighting:

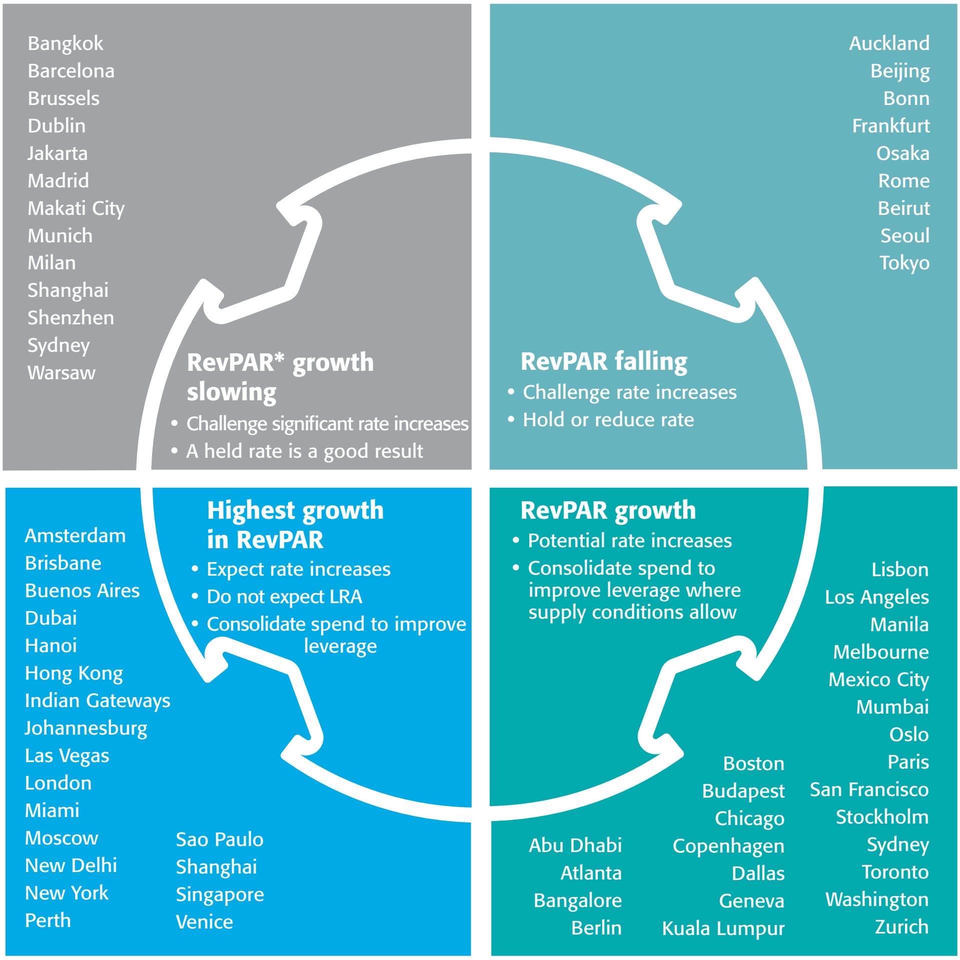
- **First, hoteliers say they are keen to learn from mistakes made in the past** and notably the post-9/11 downturn when heavily discounted rates failed to attract significantly larger volumes of business. Today, they would rather sacrifice some occupancy than reduce rates and risk squeezing value from the market. In effect, if one hotel discounts rates, others are likely to follow, thus eliminating any competitive advantage. Moreover, hotels cannot be sure they will stimulate enough volume to compensate for lower rates.
- **More importantly, the situation is not yet desperate for hotels.** Whereas occupancy fell to under 60 percent in some cities after 9/11, it has remained high overall in 2008—in the mid-60 to low-70 percentile range in every region and between 70 and 89 percent in 11 of the top 15 cities tracked by Smith Travel Research.
- **The "crunch point" may arrive soon in some markets**. Hoteliers say they do not plan to make major rate cuts but the true test will come if occupancy continues to fall. Falling oil prices could soften the downward trend but the latest financial crisis in the United States will not help.

What can companies expect from 2009 hotel agreements?

Buyers should not expect to hold all the bargaining chips in this year's negotiations. **The strongest-performing markets are likely to remain tough** with continued rate increases. Very high demand will continue in leading business centers despite new supply coming onto the market. **In "softer" markets such as Tokyo and Frankfurt, however, some properties may flatten or lower rates.**

The chart on Page 13 provides examples of how different cities are performing in terms of revenue per available room. This chart also indicates the kind of deal companies could consider favorable, although this will vary between properties.

Market strength and impact on corporate rates



* RevPAR: Revenue per available room, which takes into account room rates and occupancy. RevPAR is considered the most important indicator of hotel performance although other revenue streams—for example, conferences, restaurants and leisure facilities—can be significant.

Source: CWT Travel Management Institute

How should buyers approach this year's negotiations?

Although market conditions are evolving, the basic principles of negotiating effectively with hotels remain the same:

- **Know the market.** Hotels generally remain a tactical buy. To get the most out of negotiations, it is critical to understand the market city by city and property by property. Buyers must take into account the strength of market supply and demand, as well as each property's approach to corporate deals—in other words, whether they are likely to offer flat rates or dynamic pricing deals, or whether they will propose last room availability. (See below.)

- **Think local as well as global.** When dealing with chains, the best deals are usually made at a property level. Even if a global deal is on the table, it can be worth negotiating further with key properties depending on how important they are within the hotel program. Chains, like independent hotels, offer discounts based largely on room-night volume at the property level.
- **Negotiate flat-rate deals wherever possible and approach dynamic pricing discounts with caution.** As explained in the article "Dynamic Pricing: Signs of a Trend," published in *CWT Vision - Global Edition* Issue 4, hotels tend not to provide the data companies need to evaluate dynamic pricing deals. On the other hand, a negotiated flat rate sets a ceiling price regardless of market conditions while allowing companies to use lower rates that may be available at the time of booking. This said, chain-wide dynamic deals can be attractive if a flat rate is unattainable.
- **Obtain a last room availability (LRA) clause if possible.** This ensures travelers can book at the negotiated rate even if it is the last room available at the property. LRA is invaluable in high-demand cities but can be difficult to obtain. Companies should bear in mind that rates negotiated with LRA are usually higher than those negotiated without.
- **Negotiate amenities.** Hotels may be willing to offer breakfast and services such as high-speed Internet or parking within the negotiated rate, especially in softening markets.
- **Consider an opportunistic approach to new suppliers vs. incumbents.** In North America, for example, CWT recommends that some clients take a dual approach whereby they automatically renew contracts with hotels that are willing to hold prices flat and ask other suppliers to rebid. In either case, it is necessary to drive traveler compliance with changes to the hotel program.
- **Leverage the travel management company (TMC) throughout the process.** Your TMC will help you benchmark market conditions, negotiate effectively with properties and analyze rate offers.

CWT offers further advice to consider throughout the year:

- **Optimize travel policy and compliance.** Many companies are integrating a wider choice of mid- or lower-category hotels into their program to give cost-conscious travelers the opportunity to spend less. Another way to achieve savings is to clearly mandate booking through the travel management company (agent or corporate online booking tool). According to CWT research, *Playing by the Rules: Optimizing Travel Policy and Compliance*, CWT offers travelers rates that are on average 20 percent lower than those obtained directly through hotels or Web booking sites. One reason is that hotels often fail to apply the negotiated rate when travelers book outside the travel management company.

- **Audit rates.** Check that preferred properties have correctly loaded negotiated rates into global distribution systems (GDSs) and that other hotels are not "squatting" the space intended for hotels in your program. Errors are common, so regular auditing and communication with hotels can help ensure travelers are not paying more than they should. In addition, companies can ask the travel management company to check LRA clauses are being respected.

- **Further consolidate your sourcing where market conditions allow.** Companies can leverage larger room-night volumes by aggregating business from different incoming countries and regions. As described in the CWT publication *Global Horizons: Consolidating a Travel Program*, local to regional consolidation can lead to a 60 percent increase in room nights allocated to preferred hotels in the program, while regional to global consolidation can add another 30 percent. In addition, economies of scale can be achieved by coordinating the request for proposal process at a regional or global level, although local relationships remain critical for successful negotiations.

- **Integrate meetings and events (M&E) into your managed program.** Some CWT clients have achieved double-digit savings after designing a hotel program for M&E, leveraging meeting volumes with transient spend during supplier negotiations and making processes more efficient. For many companies, integrating M&E represents their next major savings opportunity.

- **Allow enough time for next year's negotiating season.** How much time is required varies for each company's program but is often underestimated. For key properties, especially in high-demand cities, it can pay to conduct several rounds of negotiations.

- **Ask about "green" credentials during the request for proposal process.** Many hotels are promoting environmentally friendly practices such as reducing energy consumption, using ecological products and recycling waste. Although comparing the "greenness" of different suppliers remains a challenge, companies can identify hotels that share their concern for sustainable development.

At the time of writing, hotels appear unlikely to make any sudden moves in this year's negotiations, although time will tell. What is certain is that opportunities will evolve differently between cities and properties, and a sound knowledge of local markets, coupled with strong relationships at the property level, will help companies make the most of them. ■