



SMITH TRAVEL RESEARCH

Linking Innovation and Competitive Advantage in the Hotel Industry

By: Brandon Royal - HVS International - Canada

"Innovation distinguishes between a leader and a follower."

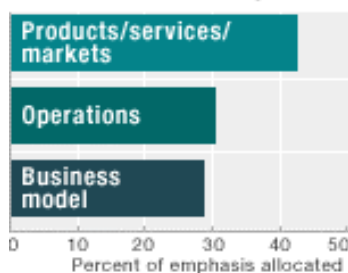
Steve Jobs, co-founder and CEO of Apple Computer

To innovate is to introduce something new and useful that somehow increases a company's performance. Today more than ever, business leaders see innovation as a key source of short- and long-term competitive advantage. Intensified competition, escalating customer expectations, and unexpected market shifts are making it important for companies to not merely adapt, but to innovate.

CEOs believe innovation to be a key ingredient in future growth. In the Global CEO Study 2006, IBM and the Economist Intelligence Unit interviewed 765 CEOs representing 21 industries on the role of innovation in their companies' future competitiveness. The results of the study are telling:

- ◆ Two-thirds of corporate CEOs say they are going to need to make fundamental changes to their business over the next two years.
- ◆ CEOs identified the most important types of innovation to be new products, new services, and identifying new markets.
- ◆ CEOs report that the best source for innovation is employees, customers, and external business partners, not in-house R&D departments.
- ◆ Unsupportive corporate culture is the most commonly reported barrier to innovation.

CEOs' innovation emphasis



Source: Global CEO Study 2006

Researching customer behavior and psychology and then using that research to guide the development of new products and services is a key technique for identifying new opportunities for growth. In addition, companies must continually monitor the market for outside innovations that could impact their businesses.

As the table below indicates, corporate innovation can take many forms, all of

which can contribute to improved profitability.

In addition, innovation in products, processes, and services can be either incremental or radical, although most are incremental. Radical innovations transform entire markets, whereas incremental innovations generally make a company more successful in a particular niche. Online booking technology and the loyalty/points reward system exemplify recent radical innovations in the hospitality industry. Companies must often persevere through long transition periods before an innovation begins to transform an industry. Automating the check-in process using kiosks is one example of an innovation that has not yet reached the tipping point. Several hotel companies, including Starwood, Marriott, and Hilton, have been using check-in kiosks for years, but because these kiosks have had difficulty

Type of Innovation	Brief Description
Business model innovation	Involves changing the way business is done in terms of capturing value (e.g. hub and spoke airlines vs. the Southwest Airlines model).
Marketing innovation	Developing new marketing methods or improving product design, packaging, product promotion, or pricing.
Organizational innovation	Creating or altering business structures, practices, and models.
Process innovation	Implementing new or significantly improved production or delivery methods.
Product innovation	Introducing a new or substantially improved product.
Service innovation	Introducing a new or substantially improved service.
Supply chain innovation	Changing the sourcing of input products from suppliers or the delivery of output products to customers.

Linking Innovation and Competitive Advantage in the Hotel Industry (Cont'd)

HVS INTERNATIONAL - Canada

connecting to the reservation system in a reliable way, they have not gained the trust of the customer. Once the technology is improved and trustworthy, automated check-in kiosks will have a radical impact on hotel service strategy. Companies at the forefront of radical innovation have a competitive advantage, so it is often worth the effort to stick out the transition period.

Hotel Companies Should Invest in Innovation

Many factors that impact operations are beyond the control of hotel companies. Hoteliers have limited power over new competition entering the market, economic downturns, social and political instability, exchange rates, labor disputes, the cost of capital, and interest rates. Hotel companies must therefore take full advantage of the areas over which they do have control.

When it comes to innovating in the more traditional areas of operations and business

strategies, experienced hotel companies generally excel. However, many hotel companies have yet to take full control over shaping "the experience" imbedded in their products and services. There are several notable exceptions to this tendency.

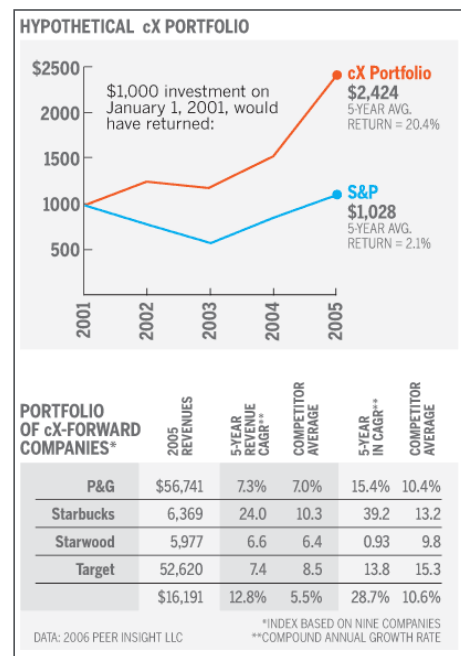
Innovation comes from questioning and re-thinking long-standing products and services and reinventing them as a brand new experience for guests. All hotels rent guestrooms with a bed and a shower, but Starwood's Westin Hotels have Heavenly Beds and Heavenly Baths with a "revolutionary" curved shower rod that offers "an extra eight inches of elbowroom." Through these incremental innovations, Westin is working toward selling a unique guestroom experience rather than just another guestroom. Each Westin guestroom is also effectively a sales room, as guests may buy Westin Heavenly amenities for their own homes, creating a new source of revenue for the company.

In a similar vein, Marriott is abandoning the traditional lobby concept for its full-service hotels in favor of "great rooms" that mix work, relaxation, and socialization in one place, replacing formal boundaries with open-concept, free-flowing service zones. Marriott is striving to make its lobbies a hip social scene rather than a waiting room. The new lobby design will increase lobby construction costs, but the company expects the upside in room rates to justify this added cost.

Recognizing the importance of innovation, Fairmont is changing its corporate structure to make the company more adaptive to the ever-changing needs of travelers. According to a recent press release, Fairmont has created a new corporate position: director of product and service strategy. The individual appointed to this role will be called upon to "research and examine information relating to product and service trends within the hospitality industry, utilize consumer insight to spearhead the company's guest product and service development, and further grow Fairmont's customer segmentation strategies." Fairmont has

thus formally recognized the link between innovation and competitive advantage.

Innovations in products and services must be implemented strategically and marketed carefully, but they can really pay off. Peer Insight compared the collective stock performance of four innovative service companies (including Starwood) with the Standard & Poors average. The four companies greatly outperformed the average. This suggests that allocating resources to innovation in products and services can improve company performance. Innovation is an investment opportunity that leading hotel companies can't afford to miss.



In my next article, I will examine the similarities between three companies that BusinessWeek Magazine ranked the most innovative in 2006 to see what lessons hotel companies can learn about becoming more innovative.

Brandon Royal is a consultant with the Vancouver Office of HVS International - Canada. He received a Masters degree from the Lausanne Hotel School in 2003. Before that, he studied architecture at UC Berkeley and received a Bachelor of Arts degree from the University of British Columbia.

What hotel companies can control.

Hotel Operations

- Customer service strategy
- Operating costs
- Sales strategy
- Revenue management
- Brand management
- Advertising and marketing
- Competitive pricing
- Renovations

Business Model/Business Strategy

- Outsourcing strategy
- Attractive loyalty programs
- Site selection and geographic diversification
- Refinancing/sale and leaseback
- Distribution strategies

The Experience: Products and Services

- Differentiating their properties from competitors
- Designing products and services according to the behavior and desires of guests in different market segments
- Creating unique experiences for guests that exceed customer expectations

CANADIAN LODGING OUTLOOK
HVS INTERNATIONAL - CANADA

September 2006	Number of Rooms	Occupancy Rate (%)		Average Room Rates (in \$CAD)		RevPAR (in \$CAD)		Room Supply % chg	Room Demand % chg
		2006	2005	2006	2005	2006	2005		
Nova Scotia Area	1,350	74.4%	72.7%	\$102.09	\$93.03	\$75.95	\$67.63	2.0%	4.4%
Halifax, NS	3,162	88.7%	85.9%	\$143.31	\$136.12	\$127.12	\$116.93	0.0%	3.3%
Montreal Downtown	9,721	81.5%	83.4%	\$158.34	\$165.94	\$129.05	\$138.39	2.7%	0.3%
Montreal Area	4,991	74.5%	76.1%	\$103.92	\$101.55	\$77.42	\$77.28	0.4%	-1.7%
Quebec City, QC	3,749	75.2%	75.8%	\$155.17	\$150.58	\$116.69	\$114.14	0.0%	-0.8%
Quebec Area	5,578	66.2%	63.8%	\$124.17	\$118.13	\$82.20	\$75.37	0.6%	4.3%
Toronto Downtown	13,472	84.5%	87.7%	\$197.25	\$184.53	\$166.68	\$161.83	0.5%	-3.2%
Toronto North/East	6,269	76.1%	78.5%	\$120.12	\$114.22	\$91.41	\$89.66	3.2%	0.1%
Toronto Airport/West	7,952	75.9%	74.1%	\$114.00	\$111.60	\$86.53	\$82.70	5.8%	8.3%
Ottawa, ON	6,359	80.6%	78.9%	\$135.86	\$130.74	\$109.50	\$103.15	0.0%	2.1%
Ontario East	3,906	73.3%	72.7%	\$108.58	\$101.68	\$79.59	\$73.92	0.3%	1.2%
Windsor/ Ontario SW	2,997	55.5%	57.9%	\$97.40	\$95.46	\$54.06	\$55.27	1.1%	-3.1%
London/ Kitchener	5,896	72.4%	70.6%	\$104.83	\$99.88	\$75.90	\$70.52	1.9%	4.6%
Ontario North/ Thunder Bay	1,678	79.3%	76.1%	\$88.47	\$82.50	\$70.16	\$62.78	0.0%	4.3%
Ontario NC/ Sudbury	4,134	74.1%	70.7%	\$110.74	\$109.22	\$82.06	\$77.22	1.8%	6.7%
Niagara Falls, ON	8,375	74.6%	75.4%	\$147.94	\$143.10	\$110.36	\$107.90	4.0%	2.9%
Ontario Central	3,148	68.2%	67.8%	\$108.97	\$100.30	\$74.32	\$68.00	5.2%	5.7%
Mississauga, ON	5,512	72.3%	68.3%	\$110.58	\$104.32	\$79.95	\$71.25	2.4%	8.5%
Winnipeg, MB	3,940	71.5%	65.9%	\$98.51	\$92.23	\$70.43	\$60.78	0.0%	8.4%
Regina/Saskatoon, SK	4,186	74.1%	67.4%	\$101.09	\$95.35	\$74.91	\$64.27	0.0%	10.0%
Calgary, AB	8,376	85.7%	81.7%	\$133.87	\$117.48	\$114.73	\$95.98	0.4%	5.3%
Edmonton, AB	7,307	79.8%	72.2%	\$110.83	\$102.44	\$88.44	\$73.96	1.8%	12.6%
Alberta North Area	2,412	83.7%	83.8%	\$167.02	\$145.96	\$139.80	\$122.31	1.0%	0.9%
Alberta South Area	6,357	73.9%	75.9%	\$157.74	\$155.37	\$116.57	\$117.93	2.9%	0.2%
Vancouver Downtown	7,949	85.7%	89.0%	\$179.79	\$176.06	\$154.08	\$156.69	0.0%	-3.8%
Vancouver/ Burnaby Area	2,139	84.1%	81.8%	\$121.79	\$114.29	\$102.43	\$93.49	0.0%	2.8%
Richmond-Surrey/ East Area	5,573	76.8%	75.9%	\$112.36	\$100.88	\$86.29	\$76.57	-3.5%	-2.4%
British Columbia Area	6,187	41.8%	62.7%	\$121.66	\$117.82	\$50.85	\$73.87	1.8%	-32.1%
Kamloops/ Kelowna Area	4,413	68.6%	68.4%	\$111.25	\$102.26	\$76.32	\$69.95	1.8%	2.0%
Vancouver Island	3,810	76.6%	73.6%	\$144.61	\$142.77	\$110.77	\$105.08	0.8%	4.9%
Provinces									
Alberta	24,452	80.7%	77.7%	\$136.09	\$126.14	\$109.82	\$98.01	1.7%	5.7%
British Columbia	29,420	68.8%	76.1%	\$139.39	\$133.74	\$95.90	\$101.78	0.8%	-8.9%
Manitoba	4,849	70.3%	64.7%	\$95.89	\$89.81	\$67.41	\$58.11	0.0%	8.6%
New Brunswick	3,507	72.3%	69.0%	\$114.01	\$110.53	\$82.43	\$76.27	0.6%	5.4%
Newfoundland	1,751	76.0%	69.6%	\$125.83	\$121.03	\$95.63	\$84.24	1.1%	10.4%
Nova Scotia	4,512	84.4%	82.7%	\$132.46	\$127.03	\$111.80	\$105.05	1.2%	3.3%
Northwest Territories	66	INS	INS	INS	INS	INS	INS	INS	INS
Ontario	69,698	75.9%	75.8%	\$135.86	\$129.84	\$103.12	\$98.42	2.1%	2.2%
Prince Edward Island	939	76.0%	72.9%	\$132.46	\$126.03	\$100.67	\$91.88	0.0%	4.3%
Quebec	24,039	75.5%	76.3%	\$139.73	\$141.30	\$105.50	\$107.81	0.8%	-0.2%
Saskatchewan	5,729	71.7%	64.8%	\$96.86	\$89.51	\$69.45	\$58.00	0.4%	11.0%
Yukon Territory	585	69.2%	62.6%	\$95.80	\$92.61	\$66.29	\$57.97	0.0%	10.5%
Canada	169,547	70.8%	69.8%	\$116.86	\$110.11	\$82.74	\$76.86	1.3%	2.7%

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CANADIAN LODGING OUTLOOK HVS INTERNATIONAL - CANADA

DEFINITIONS

Occupancy:	Rooms sold divided by rooms available.
Room Revenue:	Total room revenue generated from the sale or rental of rooms.
Average Daily Rate (ADR):	Room revenue divided by rooms sold.
Room Revenue Per Available Room (RevPAR):	Room revenue divided by rooms available (occupancy times average room rate will closely approximate RevPAR).

*If you have any questions regarding this publication please send a message to bmacdonald@hvsinternational.com
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SMITH TRAVEL RESEARCH

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