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The European Hospitality Industry Outlook

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Contents

Foreword

Welcome to the 2023 Deloitte Hospitality Industry Outlook

In a market environment where businesses are increasingly facing pressure on resources and margins, we asked hospitality leaders in Europe and the UK about their expectations and predictions for the future.

Our results indicate that hospitality organisations saw some recovery from the effects of COVID-19 but are soon facing further disruption. With the impact of the pandemic expected to recede by Q3 2023, issues related to surging inflation are rising.

The lack of economic growth and rising costs, the inability to raise prices, and challenges related to climate change are all perceived as key risks for the industry in the near future. Meanwhile disruptions due to labour shortages are expected to increase and last beyond 2025. Taking a more defensive stance, industry priorities are shifting towards a renewed focus on managing economic pressures and talent management.

We hope you find our 2023 Deloitte Hospitality Industry Outlook useful in informing your strategic thinking and we look forward to discussing these trends with you.

Andreas Scriven
Lead Partner
Hospitality & Leisure
Deloitte

The market today

As the world moves towards a downturn, businesses are preparing for stalling revenues and sharply rising costs

After a surge in business, driven by pent up demand, the hospitality industry's recovery may lose steam this year as the hotel market is expected to slow down in the face of continued economic volatility and rising costs. The drop in, and rising cost of, doing business is likely to impair the industry's recovery, in addition to staffing shortages and supply chain disruption.

"Recessions accelerate change, there are opportunities ahead for businesses with strong balance sheets. "

Ian Stewart
Chief Economist, Deloitte UK

The economy

Global economic activity is flagging, and output is expected to contract owing to multiple factors from the slowdown in China and impact of the war in Ukraine, to rising worldwide inflation. The World Economic Outlook IMF July 2022 Report estimates the baseline forecast for global growth to drop from 6.1 per cent last year to 3.2 per cent in 2022, 0.4 percentage points lower than in the April 2022. Disinflationary monetary policy this year, is expected to result in global output growing by just 2.9 per cent, a consequence of the several shocks that have hit a global economy already weakened by the pandemic. (1)

The consumer

Consumer choices are impacted by their financial wellbeing. Prolonged pressure from rising costs and recession uncertainty are likely taking their toll. Consumer confidence has fallen in various markets including the UK, impacting demand. Globally, four in ten consumers feel their financial situation has worsened over the past year. Less than half of consumers (43%) cite having money left over at the end of the month after expenses. (2)

" Among those who said they are not planning to travel in the next 3 months, nearly two-thirds said they could not afford it. "

Deloitte Consumer Tracker, October 2022 (2)

Consumers are also increasingly concerned about their future finances. Globally, one in three are optimistic that their financial situation will improve this year. (2) This sentiment is prevalent across income groups and connected to significant shifts in spending intentions compared to 2021. Research indicates that consumers are twice more likely to delay large purchases with discretionary categories as a share of wallet having decreased compared to 2021. The sharpest declines were seen in the US, Italy, the UK, Poland, Denmark, and Germany, with all markets dropping 3 percentage points or more. (2)

Leisure travel plans across some European countries signal a decline in demand from previous months. August 2022 saw 51 per cent of UK and German consumers intending to spend on hotels, whereas in October of last year this dropped to 40 per cent and 32 per cent respectively. Among those planning to take trips, consumers will likely make compromises to squeeze travel into their budgets by opting for cheaper airline seats and hotel rooms or visiting destinations during less popular times. (2) In addition to value driven purchases, customer expectations are increasing when it comes to a seamless, connected, and personalised experience, which places further pressure on hospitality businesses to deliver.

The research

Amidst this turmoil, hospitality leaders are concerned about how their companies will be affected in the near future and what they must do next.

The Deloitte European Hotel Industry survey took place between 15 September and 7 October 2022 and represents the views of over 100 senior figures from the hospitality industry including owners, operators, lenders, developers, and investors.

Rising costs ranked as the highest risk to growth this year. While concerns around the impact of the pandemic dropped, staff productivity issues, Brexit and political tensions moved up as key risks compared to 2021. Long term risks include hotel supply and those related to climate change.

Managing inflationary pressures is the industry's top priority, and to do this, hospitality leaders intend to focus on performance improvement and cash flow management. To address labour shortages, hiring and re-staffing remain high priorities in addition to adapting to evolving consumer needs.

"Consumers are not another stakeholder but the very essence of what we do, and that has been enlarged by the pandemic."

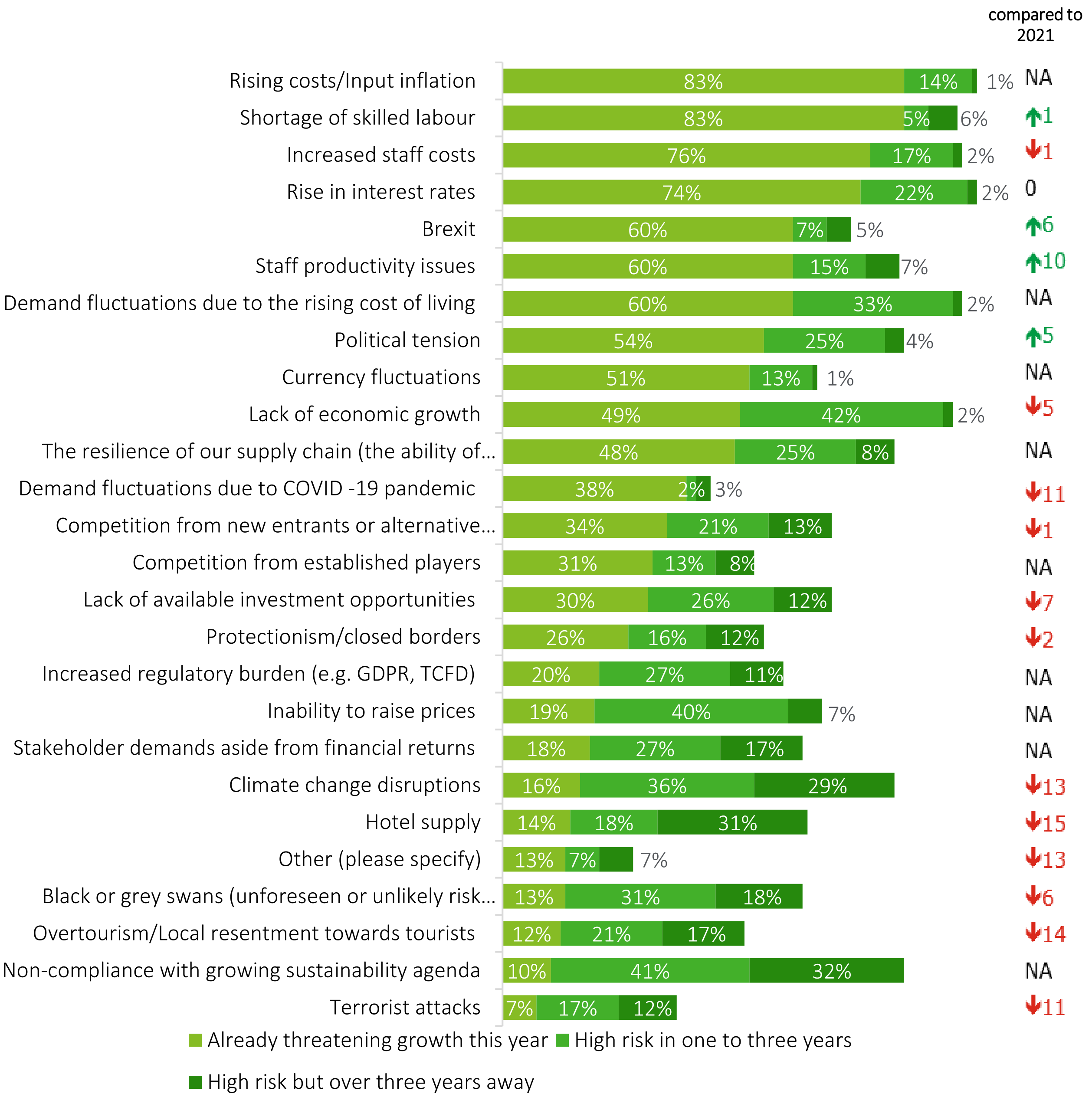
Puneet Chhatwal

CEO of Taj Hotels, Resorts & Palaces

Risks and implications

The sector faces a variety of potential risks that hotels need to contend with, particularly as they emerge from the impact of the pandemic

Risks to the hotel industry



Q: What are the key risks to the European and UK hotel industries and on what timescale?
Figure 1: European Hotel Industry Conference Survey conducted between 15 September - 7 October 2022 [3]

Hospitality leaders are aware of the various risks they face and need to evaluate the implications of these on their businesses. When asked what the key threats are to the hotel industry this year, our survey respondents ranked rising costs and shortage of skilled labour as the highest short-term risks (Figure 1). Non-compliance with the sustainability agenda came up top as a growing risk in the long term, followed by increased staff costs and rising interest rates, with 76 per cent and 74 per cent of respondents respectively referring to these as significant risks this year, though less than a quarter expect these to remain at this level over the next three years.

83% stated rising costs and labour shortage as key risks to growth this year

Hotel operators and owners alike will need to brace themselves for a myriad of short-term operational and financial challenges, driven by economic pressures.

After an unprecedented rise, recent figures from the Office for National Statistics (ONS) showed that inflation in December 2022 fell for the second month in a row to 10.5 per cent, indicating a slight ease in inflationary pressures, however pressure on households remained intense as the cost of food and non-alcoholic beverages was 16.8% higher than a year earlier. [(4)] Until interest rates are lowered and consumer spending increases, operational costs are likely to remain a concern.

The rise of staff shortages is a result of the pandemic, where many furloughed or laid off hospitality employees moved to other sectors or out of the labour force entirely. As demand for labour rises while supply is scarce, hoteliers will have to compete against other sectors to attract new talent. Hotel operators will need to take a hands-on approach to cash management and managing their cost base, as passing costs onto the consumer through price and rate increases will be difficult going forward.

The importance of understanding how operational cash flow is impacted on the back of rising interest rates will be top of mind for hospitality investors. As debt becomes more expensive, the resulting additional interest payments will reduce net income and cash flow, which will in turn reduce investors internal rate of returns. This will force the industry to rethink and restructure their operational and financial models. Changes to the debt market are likely as well. Investors are more likely to be in favour of fixed rate debt given concerns around future rises in interest rates and lenders are more likely to offer lower leverage options to mitigate valuation fluctuations.

42% expect the lack of economic growth to remain a concern over the next three years

In the medium-term, the lack of economic growth and the inability to raise prices are expected to remain a risk over the next three years. The blend of high inflation, which lowers the real value of earnings, and mounting interest rates, which increase the cost of debt, have led to an unprecedented tightening of household income.

"The future is going to continue to be employee constrained. We will solve some by technology and people doing less of the work or multi-tasking, and not paying different rates for different roles."

Stephen Walker
Private Equity firm KSL Capital Partners

"The most important thing is to make the sector more attractive and treat people better."

Dermot Crowley
Dalata Hotel Group

"In the back drop of a likely recession and increasing interest rates, we look for businesses that have a little more resilience. "

Krysto Nikolic

Global Head of Real Estate, ICG

Investment activity will possibly slow down over the medium term as hospitality investors adopt the wait-and-see approach. There is a strong focus on interest costs, reducing the amount of debt on assets, and managing cash flows, particularly around utilities, staffing, and food and beverage. This indicates that the senior lending market may not be as competitive as it once was. Operators will likely reprioritise their capital investments and focus on technology to improve operational agility and protect margins.

In the longer term, non-compliance with growing sustainability agendas and climate change disruption are growing concerns with more than a third expecting it to be a high risk over the next three years and beyond.

The pandemic and the subsequent economic consequences have underscored the risks of dismissing and overlooking 'grey rhino' events such as climate change disruptions. In the long term, acute and chronic climate risks such as extreme weather events and droughts will likely have financial ramifications for hotels, such as, increased operational costs and damaged infrastructure. Stakeholders will need to consider potential climate change perils when investing and incorporate such risks into their long-term growth strategy.

"The challenge as a financial sponsor is how ESG is measured, we are pretty far back in the journey as an industry."

Krysto Nikolic
Global Head of Real Estate, ICG

32% said non-compliance with sustainability agenda is a growing concern

As the sustainability agenda grows, government regulations such as the Paris Agreement, and environment initiatives like SBTi (Science Based Targets Initiative) Net-Zero Standard are now commonplace. With regulation and reporting requirements becoming more complex, the risk and cost of non-compliance increase. Additionally, the costs of implementing ESG initiatives involve a whole new set of skills. Finance professionals for example, will need to understand the impact of global and local sustainability challenges and may require more complex ESG specific skills, such as climate scenario analysis or modelling.

"ESG will not be necessarily powered by the consumer, as they might be as confused as the rest of us. "

Federico González
CEO, Radisson Hotel Group

71% stated that government regulations are the key driver of sustainability innovation

The most important impetus of sustainability innovation within the hospitality industry is government regulation, with other drivers including pressure from investors and demand from consumers. [3] ESG is now an important consideration for stakeholders and there is a need to evaluate potential sustainability-related risks and opportunities. Failure to commit to sustainability goals such as the retrofit of existing hotels and the development of new sustainable buildings, has the potential to decrease asset value and increase operational costs, all while dampening consumer demand. Given the large lead time necessary to impact pipeline and retrofit buildings, as well as the ever-increasing regulatory requirements, the time for the hotel industry to act is now.

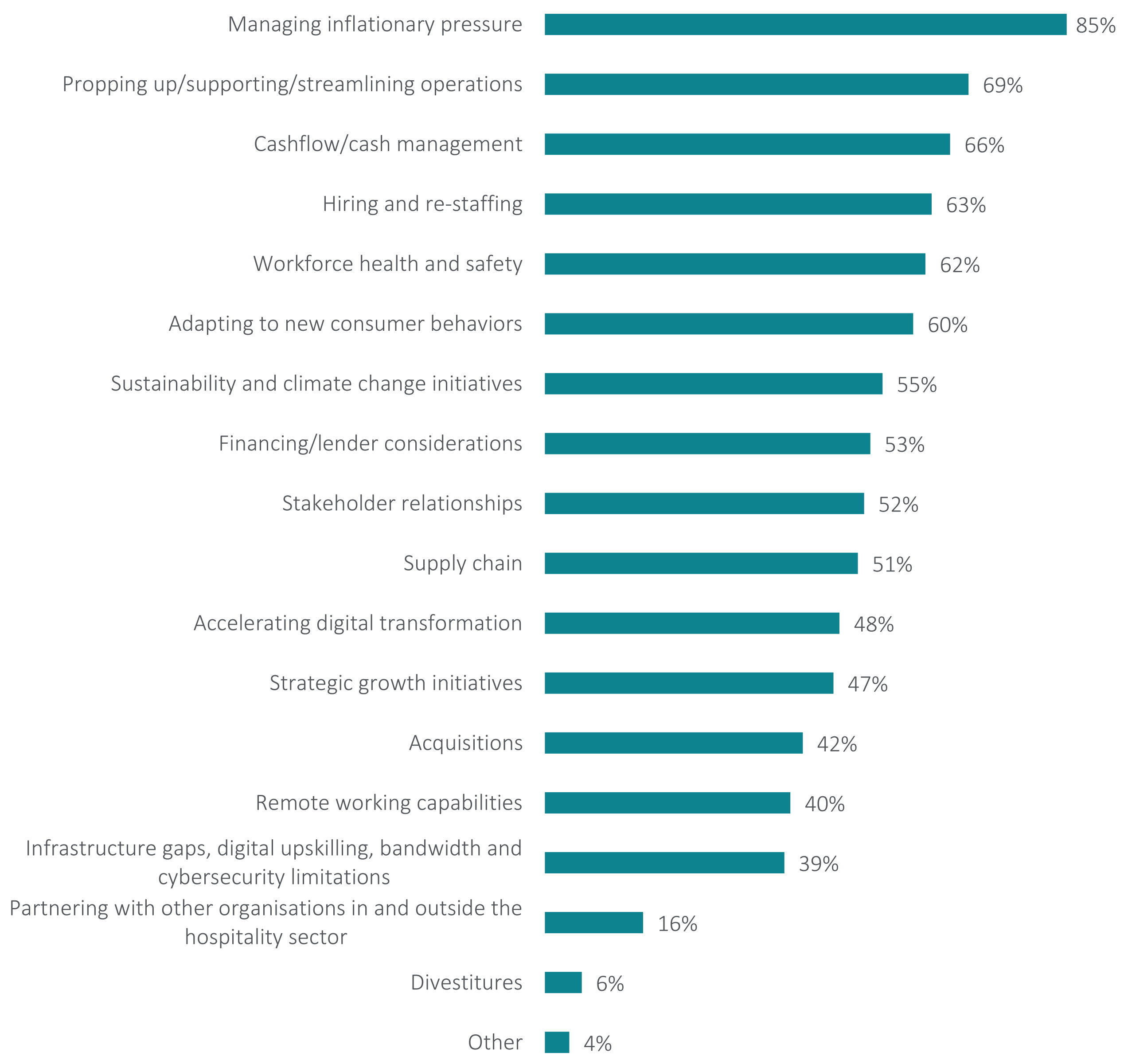
Key considerations

- Invest in initiatives to improve operational margin and financial stability
- Evaluate and review current operating models and performance of assets
- Promote agility to be able to rapidly adapt to changing consumer priorities and behaviours
- Leverage technology to improve consumer experience and reduce reliance on people
- Go beyond carbon and consider regeneration, circularity, and resilience
- Consider circularity in new constructions and retrofitting to meet net zero targets

Industry priorities

Businesses need to rethink their priorities to be better equipped to navigate the changing marketplace

Key priorities



Q: What are your organisation's key priorities in the near and more distant future?
Figure 2: European Hotel Industry Conference Survey conducted between 15 September - 7 October 2022[3]

When asked what their key priorities are the majority of respondents (85%) stated 'managing inflationary pressures' as their main focus (Figure 2). Streamlining operations is the second highest priority at 69 per cent. Hotels have been able to absorb increased costs so far because of their ability to raise room rates driven by pent-up demand, but now they will need to prioritise efficiencies beyond energy and create value across areas such as payroll and supply chain.

Cash management and controlling the cost base is the next key priority. Considerations include tax deferrals, liquidity and borrowing as well as the cost of financing and interest rates. Businesses will need to consider debt restructuring and renegotiations with lenders as well as evaluating the performance of assets.

Efforts towards retention of skilled staff are being made, with hoteliers planning to offer more flexibility, pay and incentives, and ensure clear communication. Companies are also working to improve the work environment, with leaders stating workforce health & safety (60%) and remote working capabilities (40%) as a high priority.

Catering to a more price-sensitive, digital savvy consumer with changing demands and behaviours, increases the cost pressure on businesses to not only digitise but also deliver value. More than 60 per cent of respondents cited that adapting to the evolving needs of consumers is a key priority, and nearly half consider it important to accelerate digital transformation. For example, businesses now have greater flexibility around their policies on cancellations, refunds, payment methods to cater to a seamless experience for consumers.

"The hotel industry needs to focus on business fundamentals during any industry slump. Focus on excellence, digitalization and on the acceleration of that. Companies also need to focus on increasing the skill sets of their employees."

Puneet Chhatwal
CEO of Taj Hotels, Resorts & Palaces

Looking to the future

2023 presents new challenges for the hotel industry as high costs and labour shortages persist. Constrained consumer budgets and lower spending intention on discretionary categories, such as holidays, add further pressure on a sector already operating in a volatile environment. However, the hospitality industry is resilient, adapting to its new reality and finding opportunities in times of difficulty. The UK hotel market remains confident albeit less so than in the previous year, with nearly three-quarters of hospitality leaders feeling optimistic about the long-term future.

The hospitality industry will need to find new and creative ways to encourage travel, manage finances prudently and adapt to evolving consumer needs. This year will constitute a challenging time for the sector, but the industry leaders in our survey are committed to both their customers and employees, while working towards a more promising future.

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Endnotes

1. World Economic Outlook Update: Gloomy and More Uncertain, IMF, July 2022
2. Global State of the Consumer Tracker, Deloitte Global, October 2022
3. European Hotel Industry Conference Survey, Deloitte UK, November 2022
4. Consumer price inflation, UK, The Office for National Statistics (ONS), December 2022