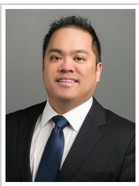
HVS

Hotel Demand Segmentation 101: Identifying Demand Segments and Understanding How They Relate to Property Performance

December 17, 2009 / *By Brian F. Bisema*



As the developer behind a new hotel build or conversion, you first need to establish what kind of patrons you seek to court and what demand base you need to target: Corporate and government representatives on long-term business? Leisure travelers? Families? Larger groups?

Identifying the market segmentation, or the percentage breakdown of traveler "types" for your area, is vital in answering these questions. Hotel demand in most markets can be described by three primary demand segments: commercial, meeting and group, and leisure. Subdivisions under each (in some cases under all) of these categories include extended-stay patrons, government travelers, airline crews, sports teams, military personnel, truck drivers, and cruise ship passengers, among others.

Individual market segments exhibit unique characteristics relating to future growth potential, seasonal aspects of demand, average length of stay, rates of double occupancy, facility requirements, price sensitivity, and other factors. Thus, knowledge of market segmentation gives consultants and developers a means of gauging the profit potential for a hotel, as well as avoiding costly mistakes by building a property aimed at capturing demand that the market does not supply.

Once you know the concentration levels of primary demand segments in your market, the decision as to what type of hotel is best suited to capturing that demand becomes much clearer. Moreover, once room-night demand has been quantified by market segment, and the individual characteristics of each segment have been defined, you can more accurately forecast future demand by making separate projections for each segment. The positive impact on planning, sales, and profitability at your hotel is substantial.

Some unique characteristics of the three primary demand segments are described below.

The Commercial Segment

The commercial segment consists of individuals who travel to a market to conduct business. Not surprisingly, commercial demand tends to be heavy from Monday through Thursday, congruent with the business hours of local firms, and fall sharply through the weekend. The typical length of stay for commercial guests ranges from one to three days, and the rate of double occupancy is a low 1.2 to 1.3 people per room. In other words, commercial travelers typically do not share rooms, a trend that can result in a higher contracted rate for commercial accounts. Commercial demand is relatively constant throughout the year, although some declines are noticeable in late December and other holiday periods.

The cornerstones of the commercial segment are individual business travelers and high-volume corporate accounts. Lodging choices are heavily influenced by brand loyalty, and frequent traveler programs in particular. Loyalty rewards programs are popular with commercial travelers, who often collect the "points/rewards" for personal use. A location convenient to businesses and amenities also greatly increases the appeal of a hotel to commercial travelers. High-volume corporate accounts are generated by local companies; demand in this sub-segment may include employees of the firm or its affiliates, often consisting of training groups. These companies typically designate certain hotels as "preferred" in return for discounts from the hotels' published rates. The more room nights a corporate account or individual traveler commits to, the deeper the discount.

The stability of commercial demand generators is key to gauging commercial demand in the market. Are any company mergers taking place? Are there new developments in the market that could add or reduce a significant

Summary

From economy to luxury hotels, existing and proposed, knowing the sources, habits, and prevalence of future patrons is crucial to success.

Comments

FILED UNDER CATEGORIES

Sales & Marketing

Valuations & Market Studies

Economic Trends and Cycles

North America

number of employees? Are any corporations entering or leaving the market? Answers to these questions will help you determine the potential for future levels of commercial demand. Economic and demographic trends also have an influence on commercial lodging demand; changes in FIRE (financial, insurance, and real estate), service, wholesale trade, and total employment; occupied office space; and air passenger counts provide the most direct correlations.

The Meeting and Group Segment

Corporate groups and those described as SMERFE (social, military, ethnic, religious, fraternal, and educational) make up the bulk of meeting and group demand, which consists of seminars, conventions, trade association shows, and similar gatherings of ten or more people. Demand in this segment is highest in the spring and fall, with activity slowing in the summer months. Travelers in this segment typically prefer hotels with extensive meeting space, business technology, food and beverage outlets, and the miscellaneous components required to host meetings and banquets.

Corporate groups can boost a hotel's profit in two ways. First, during times of national economic prosperity, corporate accounts tend to exhibit limited price sensitivity and book in large blocks, leading to higher margins. Though the current economic crisis has resulted in fewer corporate bookings and lower negotiated rates, corporate group demand continues to be higher-rated than SMERFE groups. Second, corporate groups often sponsor banquets and other events that generate revenue for the host hotel. As with individual commercial travelers, demand from corporate groups is strongest on Monday through Thursday nights. By contrast, budget-conscious SMERFE travelers show a strong preference for weekend and summer meeting times, when rates are generally lowest.

Meetings and events are booked months or even years in advance. Hence, it's possible for meeting and group demand to remain strong at the outset of a negative economic event such as the current recession, even as commercial and leisure demand show an almost immediate decline, because funds had already been committed prior to the downturn. The other side of this coin shows a decline in the number of meetings and events being booked during the recession itself, leaving us likely to see slower meeting and group activity even as the economy—and commercial and leisure demand—begin to strengthen in 2010/11.

Many decision makers have accepted a cancellation penalty as more cost-effective than following through with large planned events during the recession. With the souring of political and public sentiment toward recipients of federal bailout money, many high-profile businesses have cancelled events for fear of suffering scrutiny or even legal repercussions. These businesses comprise one of the meeting and group segment's most powerful drivers, and prohibitions on special events, meetings, and conferences that they would otherwise host have impaired demand levels significantly. This is particularly true in markets such as Las Vegas, Orlando, and other convention-dependent cities. Lower-profile and local meetings, social events, and conferences, however, have been less negatively impacted, and demand within the entire segment is expected to gain momentum as the economy begins to recover in 2010 and beyond.

The Leisure Segment

Unlike the weekday prominence of commercial and meeting and group demand, the leisure market segment tends to fill rooms on Friday and Saturday nights. Leisure travelers also book weekday stays during holiday periods, when commercial demand is traditionally down. Leisure demand in markets is primarily generated by attractions such as amusement parks, shopping malls, outlet stores, and museums. Events such as college graduation ceremonies or visits among families and friends also provide incentive for leisure travel in a market.

Leisure travelers typically stay from one to four days, with the rate of double occupancy ranging from 1.8 to 2.5 people per room. This figure can be meaningful in the case of a full-service hotel, where restaurants, spas, gift shops, and other revenue-generating facilities stand to profit from the extra traffic that double occupancy brings through. Depending on the type of hotel, average rate can move up or down the spectrum. If you run an all-suite property with inclusive food and beverage, for instance, you'll tend to attract less price-sensitive guests, while highway properties with limited amenities are often obliged to offer discounted leisure room rates.

Leisure demand depends heavily on disposable income. Just like group meetings and business trips, vacations can be canceled in a bad economy as a cost-cutting measure to try to salvage the bottom line. Unemployment, which has reached alarming levels over the past twelve months, likewise negatively impacts leisure demand. This is not to say that owning or developing a hotel that caters to leisure demand is a bad idea, even in the current economic climate. You just need to be well-advised on where your demand is coming from (demand from within a region, for example, usually proves more stable than inter-regional or international demand) and, if necessary, how to diversify your demand base to shore up occupancy until leisure travel rebounds.

Conclusion

Thorough knowledge of demand segments helps you establish your bearings as a hotelier. The factors and trends that chart the past and help forecast future dynamics of these segments in specific markets are complex, but essential in determining the suitability of the improvements and amenities for proposed projects and in projecting future hotel usage. All in all, demand segment analysis always proves worthwhile before you venture into a new hotel project.

About Brian F. Bisema

Brian Bisema is a Managing Director and Partner with HVS Boston. Brian brings over 15 years of hotel expertise, delivering appraisals, valuations, and consulting services that provide clients with credible results to make confident investment decisions. He has completed hotel valuations and appraisals on hotel real estate with an aggregate value of over $20 billion. For more information, contact Brian at +1 (781) 454-8930 or .