GUEST EXPERIENCE DESIGN IN HOTEL INDUSTRY

by

Mari Nurminen
M.Sc., Helsinki School of Economics, 2003

PROJECT SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF BUSINESS ADMINISTRATION

In the
Faculty
of
Business Administration

Management of Technology

© Mari Nurminen 2007

SIMON FRASER UNIVERSITY

Spring 2007

All rights reserved. This work may not be reproduced in whole or in part,
by photocopy or other means, without permission of the author.
APPROVAL

Name: Mari Nurminen

Degree: Master of Business Administration

Title of Project: Guest Experience Design in Hotel Industry

Supervisory Committee:

Dr. Colleen Collins-Dodd
Senior Supervisor
Associate Professor of Marketing

Dr. Judy Zaichkowsky
Second Reader
Professor of Marketing

Date Approved: January 3, 2007
DECLARATION OF
PARTIAL COPYRIGHT LICENCE

The author, whose copyright is declared on the title page of this work, has granted to Simon Fraser University the right to lend this thesis, project or extended essay to users of the Simon Fraser University Library, and to make partial or single copies only for such users or in response to a request from the library of any other university, or other educational institution, on its own behalf or for one of its users.

The author has further granted permission to Simon Fraser University to keep or make a digital copy for use in its circulating collection (currently available to the public at the “Institutional Repository” link of the SFU Library website <www.lib.sfu.ca> at: <http://ir.lib.sfu.ca/handle/1892/112>) and, without changing the content, to translate the thesis/project or extended essays, if technically possible, to any medium or format for the purpose of preservation of the digital work.

The author has further agreed that permission for multiple copying of this work for scholarly purposes may be granted by either the author or the Dean of Graduate Studies.

It is understood that copying or publication of this work for financial gain shall not be allowed without the author’s written permission.

Permission for public performance, or limited permission for private scholarly use, of any multimedia materials forming part of this work, may have been granted by the author. This information may be found on the separately catalogued multimedia material and in the signed Partial Copyright Licence.

The original Partial Copyright Licence attesting to these terms, and signed by this author, may be found in the original bound copy of this work, retained in the Simon Fraser University Archive.

Simon Fraser University Library
Burnaby, BC, Canada

Revised: Fall 2006
STATEMENT OF ETHICS APPROVAL

The author, whose name appears on the title page of this work, has obtained, for the research described in this work, either:

(a) Human research ethics approval from the Simon Fraser University Office of Research Ethics,

or

(b) Advance approval of the animal care protocol from the University Animal Care Committee of Simon Fraser University;

or has conducted the research

(c) as a co-investigator, in a research project approved in advance,

or

(d) as a member of a course approved in advance for minimal risk human research, by the Office of Research Ethics.

A copy of the approval letter has been filed at the Theses Office of the University Library at the time of submission of this thesis or project.

The original application for approval and letter of approval are filed with the relevant offices. Inquiries may be directed to those authorities.

Simon Fraser University Library
Burnaby, BC, Canada
ABSTRACT

The purpose of this paper is to provide a business case for experience design services in the hotel industry in North America. The business case is built upon primary and secondary research that describes value chain, structure, performance measures of the hotel industry and estimates potential market for design services. Additionally, project reviews experience design discipline itself and role of participants in creation of guest experiences.

Findings of the paper include recognizing opportunities for experience design offerings in hotel industry. Challenges in current solutions include lack of guests’ perspective in design and inconsistency of the experience. Experience design creates a coherent and engaging experience by focusing on guests and their needs, and by taking into account all the experience components. It adds value to hotel industry by offering a means to differentiate, build loyalty and satisfaction, increase revenues, and eliminate amenities creep. Potential customer segments are hotel brands and owners.

Keywords: Hotel industry, Experience design, Guest experience, Experience economy
ACKNOWLEDGEMENTS

I would like to take this opportunity to thank Dr. Colleen Collins-Dodd at Simon Fraser University (SFU) for offering constant advice, guidance and encouragement throughout my project. Thank you also to Dr. Judy Zaichkowsky for her valuable comments.

Thank you to Clive Roux and Robert Karnick at Philips Design, who acted as my project sponsors. I truly appreciate the opportunity to work with them. Their passion and insights on improving customer experience through design were deep and amazing. Their support and guidance were indispensable to this project.

Thank you also to all the representatives of the hotel industry who volunteered their time to participate in the research.
# TABLE OF CONTENTS

Approval.............................................................................................................................. ii  
Abstract ............................................................................................................................... iii  
Acknowledgements ........................................................................................................... iv  
Table of Contents ............................................................................................................... v  
List of Figures ..................................................................................................................... vii  
List of Tables ...................................................................................................................... viii  

1 Introduction ...................................................................................................................... 1  
1.1 Project objective and scope ....................................................................................... 3  

2 Hotel Industry ................................................................................................................... 5  
2.1 General information ................................................................................................. 5  
2.2 Value chain ............................................................................................................... 9  
2.3 Typical guest ........................................................................................................... 13  
2.4 Hotel segments ....................................................................................................... 14  

3 Hotel Business Analysis .................................................................................................. 17  
3.1 Hotel operations ....................................................................................................... 17  
3.2 Structure of hotel ownership and management ....................................................... 20  
  3.2.1 Ownership ........................................................................................................ 20  
  3.2.2 Brand franchising ............................................................................................. 21  
  3.2.3 Management .................................................................................................... 24  
3.3 Performance measures ............................................................................................. 25  

4 Guest Experience ............................................................................................................. 29  
4.1 Experience economy ............................................................................................... 29  
4.2 Customer experience ............................................................................................... 31  
  4.2.1 Layers of experiential world ............................................................................. 31  
  4.2.2 Components of customer experience ............................................................. 33  
  4.2.3 Four types of experiences ............................................................................... 34  
  4.2.4 Phases of experience ....................................................................................... 36  
4.3 Designing experiences ............................................................................................... 37  
  4.3.1 Experience design ............................................................................................. 37  
  4.3.2 Designing memorable experiences .................................................................. 39  

5 Guest Experience in Hotel Industry .................................................................................. 42  
5.1 Main components of hotel guest experience ......................................................... 43  
  5.1.1 Technology as component of experience ....................................................... 45  
5.2 Theme strategy ......................................................................................................... 47  
5.3 Added value from guest experiences ...................................................................... 50  
5.4 Creators of guest experience ................................................................................... 52  

6 Market Potential .............................................................................................................. 59
LIST OF FIGURES

Figure 2.1  U.S. Hotel Industry Mix of Revenues 2005 .................................................. 7
Figure 2.2  Tourism Value Chain .................................................................................. 10
Figure 2.3  Hotel Industry Value Chain ........................................................................ 13
Figure 3.1  Hotel as an Open System ............................................................................ 18
Figure 4.1  Shaping the Breadth of an Integrated Experience ......................................... 33
Figure 4.2  The Experience Realms ................................................................................ 35
Figure 4.3  A Multi-Channel Customer Experience Architecture .................................... 41
Figure 5.1  Theme-Scheme Typology ............................................................................. 48
Figure 6.1  Demand and Supply Mechanism in Different Phases of Industry Cycle .......... 60
Figure 7.1  Guest Experience Creation in the Hotel Industry without Experience Design ........ 66
Figure 7.2  Guest Experience Creation in the Hotel Industry with Experience Design ........ 67
LIST OF TABLES

Table 2.1 Key Metrics in Hotel Segments................................................................. 15
Table 3.1 Portfolio Composition of Major U.S. Brands in 2003............................... 23
Table 4.1 Economic Distinctions............................................................................ 30
Table 6.1 U.S. Property and Room Breakdown 2004 and 2005.............................. 59
Table 6.2 Total U.S. Active Development Pipeline of Rooms................................. 62
Table 6.3 Renovations and Renovations Plans in U.S. Hotels................................. 62
Table 6.4 Hospitality Fees and Percentage of Work by Category............................ 63
Table 6.5 Lodging Project Fees and Number of Projects of Top 20 Companies........ 64
Table 6.6 Segments Served by Top 20 Companies.................................................. 64
1 INTRODUCTION

It is suggested that the world has moved to a new phase of economic development. The new economy, whether it is called an attention economy, emotion economy, entertainment economy, a dream society, or experience economy, uses experiences as a means to differentiate brands and escape from the commoditization trap (Gilmore & Pine, 1999, p.1; Schmitt, 2003, p.15; Pullman & Gross, 2004, p.551). The main drivers behind this are the focus on added economic value, enabling technologies, increased affluence of consumers, and intensified competition (Gilmore & Pine, 1999, p.5). The creation of economic value has evolved from commodities to goods and services and finally to experiences. For example, the U.S. Consumer Price Index (years 1913-1997) show that experiences (in terms of admissions to recreational events such as movies, concerts, sports) were able to increase the price of their offerings much faster than other commodities, goods, and services (Gilmore & Pine, 1999, p.13-14). Moreover, the compound annual growth rate (CAGR) of employment and nominal GDP statistics (years 1959-1996) support the rise of the experiences as a creator of economic value. The employment compound growth rate in experience industries was the highest 5.3%, while the rate for the second highest, services, was only 2.7%. Experiences contributed 8.9% to the CAGR in GDP, while services contributed 8.5%, goods 6.4% and commodities 5.6%. (Gilmore & Pine, 1999, p.14-15)

Moreover, making a good product or providing flawless service is not sufficient anymore for differentiation or even to survive in the marketplace (Pullman & Gross, 2004, p.551; Gilmore & Pine, 1999, p.1). Product and service features can be easily and quickly copied, information technology is available to everyone, a global marketplace only digests one "low-cost provider,"
one "world's largest", and one brand leader, and quality of the offering is only the price of entry to the global market (Moore, 2003, p.66). This drives companies to continuously search for means to differentiate. As their offerings become more identical, margins diminish, customers loyalty fades, and customers make purchase decisions based on price only (Pullman & Gross, 2004, p.551; Gilmore & Pine, 1999, p.1; Clark et al., 2006, p.47). The basis for differentiation is moving from expected product or service quality and usability and to “multi-sense triggered emotional connections for the customer” (Clark et al., 2006, p.47). It is suggested that the customer experience is one of the few means of differentiation that is not eroding (Moore, 2003, p.66).

Commoditization is increasingly common in the hotel industry, which is the industry focus of this project. According to Gilmore and Pine, (2002, p. 88-89) as hotels become increasingly similar in terms of the underlying concepts guiding operational procedures and physical design, their services are purchased mainly based on price. Therefore they recommend managing hotels as experience venues, instead of just properties, to overcome the commoditization trap. (Gilmore & Pine, 2002, p. 88-89)

In the hotel industry flawless service and memorable experience are two different things. Gilmore and Pine (2002, p. 88) define the customer or guest experience in the following way:

A guest obtains a memorable experience when a company intentionally uses services as the stage and goods as props to engage individual customers in an inherently personal way. (Gilmore & Pine, 2002, p. 88)

They suggest that almost all services in the hotel industry can be used to stage or design a memorable and more compelling experience. Thus, innovative experience design will become more and more a vital core competence of any winning hotel management company (Gilmore & Pine, 2002, p. 88-89).
Experience design is “an approach to create emotional connection with customers through careful planning of tangible and intangible service elements” (Pullman & Gross, 2004, p.551). Its popularity has increased, especially in many hospitality businesses, since it offers a way to enhance guest loyalty through designing, innovating and managing the guest experience (Pullman & Gross, 2004, p.551). As with other areas of design, experience design, helps companies to obtain a sustainable competitive advantage and differentiate themselves from competitors (Kotler & Rath, 1984, p.16).

Traditionally the hotel industry has emphasized customer satisfaction, operational efficiencies, and return on investments not the memorable guest experience that makes guests stay longer, visit more often, and become more loyal – and hence provide stronger return on investments (Gilmore & Pine, 2002, p.96). There is not much research done on how the hotel industry has adjusted to the experience economy. Moreover, the process of experience creation for the hotel guest, the participants in the process, and possible gaps in the experience creation value chain have remained unexplored. The current paper tries to fill this gap. It will research the question “are there opportunities to create value in the hotel industry by offering experience design services that help create and enhance guest experiences?”.

1.1 Project objective and scope

The objective of this project is to create a business case for Experience Design services in the hotel industry in North America. This includes identifying and describing the hotel industry value chain, structures and performance measures of the hotel industry, experience design in hotel industry, participants and their roles in the creation of guest experiences, and the opportunities for offering experience design services to the hotel industry.

The academic scope of the research project is three-fold. The first objective is to build understanding of the hotel industry and experience creation in the industry. This is done through
researching how value is created in the experience economy and analysing the hotel industry especially in the U.S. and its value chain. Second is to understand the participants and their role in the guest experience creation process. The third objective is creation of a business case for experience design in hotel industry.

Both primary and secondary research are used in the project. Primary research is conducted through interviews with representatives of hotel brands. These include brands under companies such as Starwood Hotels and Resorts Worldwide, Marriott International, Global Hyatt Corporation, Intercontinental Group, and Hilton Hotels Group. Secondary research of academic literature, journals and internet is conducted in the following areas: experience economy and products, hotel industry and customers, hotel brands, interior design companies, and architects.
2 HOTEL INDUSTRY

2.1 General information

Travel and tourism industry is significant in the North America. The current paper will discuss especially the industry conditions in the U.S., which is the leading country in the world in terms of the absolute size of its travel and tourism economy (AH&LA, 2005). In 2006 travel and tourism economy in the U.S. is expected to represent 10.9% of the total employment (15,604,000 jobs), account for 10.5% of GDP, and generate $1,652,646 million of economic activity (World Travel & Tourism Council, 2006). The industry is the nation’s largest service export industry and third largest retail industry after automotive and food stores (AH&LA, 2005). In 2004 it generated $600 billion in sales (excluding spending by international travellers on U.S. airlines) and paid $99.5 billion in federal, state, and local taxes (AH&LA, 2005). It is estimated to grow by 3.4% per annum (in real terms) in 2007-2016. The expected growth for 2006 is 3.7%. With this growth rate the country is ranked only as 157th in long-term (10 years) growth among the 174 countries studied by World Travel & Tourism Council (2006).

The lodging industry, as part of the tourism industry, has been performing well during past couple of years and recovered from the 2001-2003 recession. The good performance is expected to continue in upcoming years and the industry is moving towards peak performance.

The industry had about 1.8 million hotel property workers and 47,590 properties with 15 or more rooms at the end of year 2005 (AH&LA, 2006). The total amount of guestrooms was 4,402,466 with an average occupancy rate of 63.1% in 2005 (AH&LA, 2006). The occupancy rate for U.S. hotels increased by 2.9% from 2004 but the growth is expected to slow down to 1.5% in 2006 (PKF Hospitality Research, 2006b).
The average daily rate, ADR, was $90.88 in 2005 and it presented a 7.4% increase from previous year (AH&LA, 2006; PKF Hospitality Research, 2006b). According to Ernst & Young The 2006 U.S. Lodging Report (2006) the two main drivers behind strong ADR are corporate travel and limited supply growth. Corporate travel has increased due to improved economic conditions. Growth of lodging supply has been limited or even reduced during past years. The growth was approximately 1.0% in 2004 and 1.3% in 2003 and it is expected to be less than 1% in 2005. The main reason is that hotels are exiting the market or converting rooms into residential units. ADR is expected to increase by 4.7% in 2006 (PKF Hospitality Research, 2006b).

Revenue per Available Room, RevPAR, in all hotel segments experienced growth from 1990s onwards with a peak in 2000 (Ernst & Young, 2006). The RevPAR level started to grow again in 2004 and the growth is expected to last at least into 2007 (Ernst & Young, 2006). The RevPAR increased to $57.36 in 2005 from $52.90 in 2004 (PKF Hospitality Research, 2006b; AH&LA, 2006).

The total industry revenue was $122.7 billion in 2005 and $113.7 billion in 2004 (AH&LA, 2006). The industry grossed $22.6 billion in pre-tax profits in 2005 (AH&LA, 2006). The profits of hotels in the U.S. experienced an increase of 15.5% in 2005. 2005 was the second year in a row that the industry experienced a double-digit growth in profits. The distribution of revenues in hotel operations in U.S. in 2005 is presented in Figure 2.1. The room revenues experienced an increase of 10.4% from 2004 (PKF Hospitality Research, 2006b).
Even though the strong economy with increased demand benefits hotels in terms of revenues, operating costs have escalated. According to PKF Hospitality Research (2006b) the expenses increased to a level that was more than twice the rate of inflation in 2005. The costs of operating a hotel in U.S. increased by 6.5%. The most significant increase in expenses was created by utilities with 13.6% growth. The largest increase in expenses of the revenue-generating departments was the rooms, whose expenses increased by 7.3% in 2005. Some of the increase can be contributed to increase in volume. However, some of the increase was due to amenity creep that impacts operating expenses of the rooms department. Amenity creep is the need to provide enhanced or free amenities such as upgraded bedding, in-room guest service technology, enhanced bathroom products, and free wi-fi without being able to increase the room rate in order to remain competitive. The largest cost centre of hotels continued to be labour and related expenses, which grew 5.1% in 2005. Despite the increase in operating costs the good operating performance of hotels is expected to continue in the near future (Ernst & Young, 2006). PKF Hospitality Research (2006b) estimates that the expected total revenue growth for 2006 is 7.6% and 4.1% for 2007. The profits are expected to increase 14.9 % and 7.0 % respectively. This
would lead to about $14,800 profit per-available-room in 2006 and $15,800 in 2007. This is more than the profit $15,674 generated at the last peak of the industry cycle in 2000. Even though the profit estimations appear very attractive, profits in real dollars are still about 20% behind the level they were in 2000. Profits may fully recover by the end of this decade (PKF Hospitality Research, 2006b).

The lodging industry is expected to offer the greatest returns in the real estate sector in the next 10 years. The unleveraged average annual returns for hotels are anticipated to be approximately 12.1% while other real estate investment alternatives are expected to offer returns ranging from 5% – 8%. (Ernst & Young, 2006)

Even though hotels have long been considered to be the riskiest real estate class, they have started to approach the other classes such as office and industrial real estate in the capitalization rates. This reduction in the cap-rate spread is due to tempered supply growth, improved demand outlook for hotels, decrease of other real estate classes’ fundamentals, and improved transparency of performance data and analysis of the hotel industry. The hotel capitalization rates have been historically low. For example top-tier upscale properties in major markets were in the 7-8% range and the mid-tier hotels just under 10% in 2005. The decrease in capitalization rates has increased the supply of capital to the hotel real estate. The trend of decreasing cap rates is expected to continue although at a slower pace. The four key reasons for the trend are the lesser impact of Fed rate on hotel real estate than other classes, improving lodging fundamentals, entrance of new lenders, and limited amount of available hotel real estate deals. (Ernst & Young, 2006)

To summarize, the financial outlook for the hotel industry is expected to be positive into 2006 on all key industry measures, occupancy, ADR, RevPAR, and profits, with demand exceeding supply growth (Ernst & Young, 2006; PKF Hospitality Research, 2006b). However,
the industry is suggested to be approaching the peak of the current cycle and the pace of growth is expected to slow down. The lodging industry, as any other form of real estate, follows cyclical patterns. At the moment the industry is moving from recovery phase to the peak performance. The peak performance is expected to continue through the next few years.

2.2 Value chain

A value chain model presented by Porter (1986, p.13-15) describes the activities that create value and competitive advantage of companies. If the company is performing these activities with lower cost than its competitors it has advantage over the competitors. The other option is to differentiate through conducting these activities, or at least some of them, differently than the competitors and thus, creating greater value to the buyer. Porter argues that activities in any company in any industry can be placed in nine categories. Under these activity categories companies perform discrete activities depending on their particular industry and strategy. The primary activities are activities that are needed for physical creation, delivery, marketing, and after sales support of the product or service. The supporting activities are input or infrastructure that makes the primary activities possible. These include company infrastructure, human resource management, technology development, and procurement. These activities stretch throughout the entire value chain giving support to every primary activity. It should be noted that the activities in the value chain are linked and a company’s value chain is linked to the value chain of its suppliers, channels, and possible customers. These linked value chains create a value system for the industry. (Porter, 1986, p.13-15)

The hotel industry value chain is part of a larger value system; the tourism industry value chain (Yilmaz & Bititci, 2006, p.380-381; Brathwaite, 1992, p.43-45). Figure 2.2 presents the tourism industry value chain from the perspective of the customer. The customer-oriented approach is critical since customers see a tourism product as one seamless product. From their
perspective, the value chain starts from the information search and ordering the product. They can do this with help from tour operations and travel agents, or do it by themselves. The pre-delivery support includes activities like obtaining detailed information about the destination and handling visa requirements. In delivery phase the product provided by tourism suppliers is consumed.

Travel agents are used in arrangements related to transportation to and from airport and hotel, and daily excursions or other activities. In post-delivery support phase, customer satisfaction is measured and corrective actions are taken if needed. (Yilmaz & Bititci, 2006, p.380-381)

Figure 2.2 Tourism Value Chain.

The products in the value chain are distributed through several intermediaries that link producers with consumers. The producers in the tourism industry are lodging places, carriers, attraction ventures, restaurants, car rentals and other destination based tourism companies. The wholesalers in the tourism industry are the tour operators while the travel agents are more like retailers. The tour operators buy products like hotel rooms and airline seats in bulk and package them while travel agents sell these packages to the consumers. Agents do not carry any stock and their main role is providing a convenient network of sales locations for the travellers. The agents
can be further divided into outgoing travel agents who are located in traveller generating countries and to incoming travel agents who are at the destination. (Yilmaz & Bititci, 2006, p.376-380)

Due to the nature of the product the value chain is highly dependent on its each player. A tourism product has three main characteristics that affect its value chain. First, the product is intangible thus; it cannot be usually physically touched or seen before the purchase. Even though its intangibility makes the product easier to distribute, it is harder to buy. Consumers expose themselves to risk when buying vacations. Consequently, the industry is dependent on descriptions and representations in printed or audio-visual form i.e. travel information given by the producers and experience and word of mouth by agents. Another characteristic is that the product is perishable. Hotel beds or airplane seats cannot be stored. This creates a marketing challenge to the value chain that has to stimulate demand so that producers are running at full capacity as much of time as possible. Third, because tourism is a service product, its production and consumption occur simultaneously. Customers are an essential part of the service process and they experience the production of the service directly. If the service does not fulfil the expectations of the customer the future business might be damaged immediately (Yilmaz & Bititci, 2006, p.376-380).

The interdependence among different players; travel organizers, producers, national and regional destination organizations, and consumers, is critical for the success of the service or experience. For example the accommodation industry not only relies on travel organizers to provide them with customers but it also needs to rely on transport industry to transport guests to and from the accommodation. Failure in one part of the value chain will affect the overall quality of the service from the customers’ perspective. The linkages in the value chain are critical to add value and deliver the service to the customer (Yilmaz & Bititci, 2006, p.380-381). Moreover, it should be noted that is the customer who perceives value in the product or service and places
value on the experience through that perception. The goal of the different entities in the value chain should be in delivering the highest possible value of the total experience of the customer throughout the value chain. (Brathwaite, 1992, p.43-45)

Brathwaite (1992) identifies each link between the sectors in the tourism value chain as an experience point and each of these points have potential to create value to the customers. The importance of these experience points to the customer varies. To efficiently manage the value chain and the value the experience brings to the customer, all the sub sectors should be taken into account. For example a hotel manager should be concerned about the experience the guest obtains at the airplane or taxi. (Brathwaite, 1992, p.41-45).

The value chain for hotel industry is presented in Figure 2.3 (European Commission, 2002, p. 15). Some of the key value activities are listed below the activity categories. The current paper will mainly concentrate on the first and second activity set, since hotel construction, design and major renovations belong to these categories. However, it should be noted that even though the guest experience itself will stretch through the entire tourism value system, the current paper examines only the experience gained at the hotel industry value chain.
2.3 Typical guest

In the United States about 50% of guests travelled for business and another 50% for leisure in 2004 (AH&LA, 2005). A typical business room guest is male (67%) age 35–54 (52%). They are in a professional or managerial position (50%) with an average annual household income of $81,100. On average these guests pay about $96 per room night. 37% of all business travellers spend three or more nights, 24% spend two nights and 39% spend one night per stay. A typical leisure room involves two adults (51%) age 35–54 (45%). The average annual household earnings for these guests is $72,600. 90% of the typical leisure travellers make reservations and 74% travel by car. On average these guests pay about $89 per room night. 27% of all leisure travellers stay in the hotel for three or more nights, 28% two nights, and 45% one night per hotel stay. (AH&LA, 2005)

The number of international travellers to the United States was 49.4 million (including overseas, Canada and Mexico) and they spent $104.8 billion for travel and passenger fees in 2005 (U.S. Department of Commerce, 2006). Even though the number of visitors has increased since
2004 after three years of decline it has not yet obtained the level it was in 2000. The total of overseas travellers was 20.3 million in 2004 and 16 million of them stayed in a hotel or motel in 2004 (AH&LA, 2005).

### 2.4 Hotel segments

Hotel segmentation is challenging since there is no worldwide classification system in place. According to a study conducted by World Tourism Organization and International Hotel and Restaurant Association (2004, p.79) the classification standards are created by consumer bodies, travel professionals, governments, professional bodies, and private enterprises depending on the country. Examples of different classification standards or criteria are (WTO & IH&RA, 2004, p.79):

- Consumer guides (Michelin, RAC, AAA etc.)
- Global Distribution Systems (GDS) (Amadeus, Galileo, Sabre etc.)
- Computer Reservation Systems (CRS) and brokers
- Major voluntary chains and consortia
- Major hotel chains
- Major hotel franchisors
- Tour Operators
- ISO (International Organization for Standardization).

The study suggests that all systems divide the accommodation into three to four major bands which are usually luxury, superior, mid-market and budget/economy (WTO & IH&RA, 2004, p.3). In the U.S. some of the common classifications are created by U.S. Official Hotel Guide, the American Automobile Association (AAA) and petrochemical company Mobile (WTO & IH&RA, 2004, p.74-75). For the purpose of this research the segmentation by Ernst & Young will be used. Their classification has six main segments (Ernst & Young, 2006, p.24-34):

1. Luxury
2. Upper Upscale
3. Upscale
4. Midscale with food and beverage
5. Midscale without food and beverage
6. Economy.

All these segments have experienced the upswing of the industry. In 2005 they were able to increase total revenues and obtain a double-digit growth to their bottom-line profits (PKF Hospitality Research, 2006b). The key metrics for different segments are presented in Table 2.1.

Table 2.1 Key Metrics in Hotel Segments.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxury</td>
<td>68%</td>
<td>70.6%</td>
<td>71.7%</td>
<td>$251</td>
<td>$269</td>
<td>$177</td>
<td>$193</td>
</tr>
<tr>
<td>Upper Upscale</td>
<td>69%</td>
<td>70.8%</td>
<td>71.9%</td>
<td>$140</td>
<td>$150</td>
<td>$99</td>
<td>$108</td>
</tr>
<tr>
<td>Upscale</td>
<td>69.1%</td>
<td>70.7%</td>
<td>71.2%</td>
<td>$104</td>
<td>$109</td>
<td>$73</td>
<td>$78</td>
</tr>
<tr>
<td>Midscale with f/b</td>
<td>57.2%</td>
<td>58.9%</td>
<td>60.1%</td>
<td>$77</td>
<td>$80</td>
<td>$46</td>
<td>$48</td>
</tr>
<tr>
<td>Midscale without f/b</td>
<td>64.1%</td>
<td>66.5%</td>
<td>68.5%</td>
<td>$76</td>
<td>$80</td>
<td>$51</td>
<td>$55</td>
</tr>
<tr>
<td>Economy</td>
<td>54.6%</td>
<td>56.4%</td>
<td>57.5%</td>
<td>$50</td>
<td>$52</td>
<td>$28</td>
<td>$30</td>
</tr>
</tbody>
</table>

Data Source: Ernst & Young (2006). Note: * Estimation.

According to Ernst & Young (2006, p. 24-34) the luxury segment has experienced significant increase in all three metrics. The segment has lately welcomed many new luxury hotel brands due to the strong demand. Guests in the luxury segment have become more sophisticated and introduction of new products such as independent luxury hotels, spa/boutique hotels, vacation homes, and time-shares has occurred. The segment is becoming increasingly property-specific and the importance of destination is decreasing. The Upper Upscale segment including brands like Marriott, Hilton, Sheraton, Westin, Hyatt, Doubletree, and Embassy Suites has benefited from the revival in corporate, convention, and leisure demand. The increase in corporate profits and solid belief in economic recovery has increased demand in the group and corporate travel. The Upscale segment has been one of the fastest growing segments in the past five years. This has resulted in entry of new price-conscious life-style brands like ‘aloft’ by Starwood, NYLO Hotels and Hyatt Place. The Midscale With Food and Beverage segment has not been able to take part in the recovery as strongly as other segments. The number of hotels in this segment has
decreased due to operational inefficiencies. If not closed, the hotels have been turned into properties without food and beverage or economy hotels. This is rational since the operating performance in the Midscale Without Food and Beverage segment, which includes brands like Holiday Inn Express, TownPlace Suites, Hampton Inn, and Fairfield Inn, has been exceptionally good in the past several years. This segment is among the fastest growing segments in the U.S., not only because of conversions from full-service midscale properties, but also because of new construction. Brands in this segment are actively improving their product and service quality, image and awareness, and distribution. The economy segment, which has brands like Econo Lodge and Rodeway Inn, possesses reduced pricing power compared to other segments due to its highly price sensitive target customers. The brands in this segment are not affiliated with the largest brands in the industry and thus, they are not able to attract guests that are participating in increasingly popular loyalty programs of the brands in other segments. This has led to fierce competition and closing of under-performing properties in the segment. (Ernst & Young, 2006, p. 24-34)
3 HOTEL BUSINESS ANALYSIS

3.1 Hotel operations

Hotel operation can be seen as an open system where the major input is customers who are looking to satisfy their needs and the desired output is satisfied customers (Mullins, 1993, p.7-8). In an open system, inputs are transformed through a series of activities in the system and returned to the environment as outputs. The outputs are expected to accomplish certain goals like profits, customer satisfaction, and level of sales. Thus, in a hotel the guests are entertained, rested, and refreshed in a proper way to provide them with a memorable experience. Guests should have the greatest influence on the series of activities involved in this transformation process. Success of the transformation process and the achievement of the organizational goals are evaluated with certain metrics. As an open system, a hotel is also affected by its environment. The influence of the environment can be for example economic activity, social attitudes, government policies, trade unions, guests, legal authority inspectors, culture, hotel and catering training company, international relationships, competitors, climate, chamber of commerce, shareholders or finance providers, suppliers, and technical innovations. (Mullins, 1993, p.7-11)

The current paper will give special attention to the conversion process in a hotel property as one part of the overall guest experience in hotel industry. A hotel as an open system is presented in Figure 3.1.
Goals of a hotel can be defined as “broad, overall aims of the organization, the end points an organization hopes to reach” (Geller, 1985, p.77). In his study of 27 hotel companies, Geller (1985, p.80) identified ten key goals in the hotel industry. These are profitability and return on investment, growth, development of best management, greatest market share, guest satisfaction, shareholder wealth or value, employee morale, maximization of cash flow, brand loyalty, and financial stability. Other goals can be improved productivity, reputation, high standards, and satisfying social responsibilities (Mullins, 1993, p. 9).

The hotel operations or the transformation process can be considered to be built up from independently functioning departments (Mullins, 1993, p.12). These different departments or
functions can be further divided into corporate level and property level activities (Dube at al., 1999, p.18). The main corporate level activities are business development, corporate level management, design and architecture, controller, marketing, and sales. Activities that are presented in both corporate and property level are food and beverages management, human resources management, information technology and systems, and rooms division and operation management. The key activities in the property level are general management and sales and marketing. (Dube at al., 1999, p.18)

The critical success factors, CSFs, which help hotels to obtain set goals, were found to be fairly universal in a study conducted by Geller (1985, p.80-81). The most common ones are employee attitude, guest satisfaction or guest service, and superior product (physical property). All these three are highly linked and contribute to overall idea of guest satisfaction. The employee attitude is natural CSF since the hotel industry is always been considered as people business. The physical product is considered critical in terms guests’ acceptance of the style, appeal, and convenience of the property. The location is also often mentioned as a CSF. The challenge is that the location is fixed in a short and medium term (Piccoli et al., 2003, p.65). Other CSFs were maximizing revenues, controlling costs, growing market share, increasing customer price-value perception, and achieving market segmentation (Geller, 1985, p.80).

To be able to create critical success factors hotels need to make several strategic level decisions. These are related to at least to hotel size, service orientation (from economy to upscale), competitive strategy, ownership arrangements (franchised versus company-owned) and management arrangement (independent management, independent management company, or branded management company). Some of these decisions are made at a corporate level and some of them at a property level. Thus, the general managers engage in strategic decision-making. The owners and corporate executives present individual properties with “wiggle room” that allows
them to adapt the hotel to local circumstances. Strategic decisions are also made both before and after the hotel are opened. (Brown & Dev, 1999, p.26)

Finally, Geller (1985, p.81) found that the key measures used in the hotel industry to monitor CSFs are related to the employee attitude and guest satisfaction. Even though occupancy rate, ADR, and RevPAR do not directly measure these aspects there is an indirect link found. (Geller, 1985, p. 81) The measures will be discussed in more detail in Chapter 3.3.

3.2 Structure of hotel ownership and management

Ownership and management structures of the hotel industry can be described as complicated. Hotels are rarely owned and managed by same organization and the success of a hotel or brand usually depends on cooperation among several parties: an owning entity, a management company, and a brand franchisor (Dube et al., 1999, p.18). A typical structure is following (Labentsoff, 2003, p.57):

- The physical building is owned by an organization or individual(s)
- The hotel has a franchising agreement with a brand franchise company
- The hotel is managed by a management company.

3.2.1 Ownership

The physical building is usually owned by an entity whose main focus can be commercial real estate instead of just the hotel industry. The owner can be an individual, a company, or a group of investors. In addition to holding title to the asset, the owner provides capital for the hotel operations and is responsible for example, for mortgage payments (Piccoli et al., 2003, p.67-69).

Typically the owners do not operate the hotels but use a separate management company that is responsible for day-to-day operations of the hotel (Piccoli et al., 2003, p.67-69; Labentsoff, 2003, p.57, 61). In these contracts the owner retains ownerships of the building, site, equipment, furnishing, and inventories (Guilding, 2003, p.181-182). The separation in ownerships and
management in the U.S. leads back to historical development of Real Estate Investment Trusts, REITs, which inhibited many of the owners from operating their own hotels (Piccoli et al., 2003, p.67-69). Even though the owner uses management companies, most of the hotel staff is employed by the owner. The exceptions are usually the general manager and the financial controller, who are employed by the management company. This makes it easier for owners to switch the management company if needed and saves the management company from legal obligations of being an employer (Guilding, 2003, p.181-182).

The owner decides whether it wants to enter into a franchising agreement with a brand franchise company and which brand particularly (Labentsoff, 2003, p.57, 61). The owners can have many different brands in their portfolio of properties (Piccoli et al., 2003, p.67-69). Thus, an owner can have different hotel properties which all are branded differently and managed by different companies.

In addition to single owner structure there are so-called strata-titled hotels. In these hotels individuals buy square footage or a guestroom of the hotel as an investment (Labentsoff, 2003, p.57).

The business model for the owners is a commercial real estate investment and their return-on-investment, ROI, comes from profits not from the revenues of the hotel (PKF Hospitality Research, 2006a). In addition to this typical structure, some hotels are leased to the management companies. In this case, the revenue for the owner will be based on the lease amount and not on the performance of the hotel (Piccoli et al., 2003, p.67-69; Labentsoff, 2003, p.57).

3.2.2 Brand franchising

Owners of the property can enter to a franchise agreement with a brand franchise company. Brand promotes a number of lodging facilities under a single brand, provides brand

- Increased negotiating power with suppliers and travel wholesalers
- Improved research for the purposes of product development and acquisition of new clients, both directly and through development of new operation and information systems
- Development of marketing activities to optimize booking services, improve brand visibility and communications; this includes, for example, customer loyalty clubs
- Implementation of initiatives defining standards for service.

A franchising agreement offers the hotel a consumer brand but it also requires hotel and its operations to be in compliance with the brand standards (Piccoli et al., 2003, p.67-69). Table 3.1 presents portfolios of major U.S. brands. The figure shows that most of the major brand companies own only a small portion of their branded properties. In 2003 Starwood Hotels and Resorts Worldwide owned about 19.3% of their total properties while Hilton Hotels Corporation, Six Continents and Marriott International owned only 4.1%, 0.5%, and 0.3% respectively (Piccoli et al., 2003, p.67-69).
Table 3.1 Portfolio Composition of Major U.S. Brands in 2003.

<table>
<thead>
<tr>
<th>Parent Company</th>
<th>U.S. Brands</th>
<th>Total Properties</th>
<th>Company Owned</th>
<th>Franchised Licensed</th>
<th>Mgmt Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cendant Corp.</td>
<td>Days Inns</td>
<td>1,943</td>
<td>0</td>
<td>1,943</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Ramada</td>
<td>1,005</td>
<td>0</td>
<td>1,005</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Super 8</td>
<td>1,933</td>
<td>0</td>
<td>1,933</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Howard Johnson</td>
<td>425</td>
<td>0</td>
<td>425</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Travelodge</td>
<td>475</td>
<td>0</td>
<td>475</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Knights Inn</td>
<td>226</td>
<td>0</td>
<td>226</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Villager Lodge</td>
<td>118</td>
<td>0</td>
<td>118</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>6,125</strong></td>
<td><strong>0</strong></td>
<td><strong>6,125</strong></td>
<td><strong>0</strong></td>
<td><strong>0</strong></td>
</tr>
<tr>
<td>Six Continents</td>
<td>Holiday Inn Hotels</td>
<td>1,056</td>
<td>5</td>
<td>1,004</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>Holiday Inn Express</td>
<td>1,083</td>
<td>0</td>
<td>1,078</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Crowne Plaza</td>
<td>77</td>
<td>6</td>
<td>51</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,216</strong></td>
<td><strong>11</strong></td>
<td><strong>2,133</strong></td>
<td><strong>72</strong></td>
<td><strong>20</strong></td>
</tr>
<tr>
<td>Hilton Hotels Corp.</td>
<td>Hampton Inns</td>
<td>1,094</td>
<td>1</td>
<td>1,081</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>Hilton Inns/Hotels</td>
<td>230</td>
<td>40</td>
<td>171</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Doubletree</td>
<td>153</td>
<td>10</td>
<td>49</td>
<td>59</td>
</tr>
<tr>
<td></td>
<td>Embassy Suites</td>
<td>155</td>
<td>6</td>
<td>75</td>
<td>57</td>
</tr>
<tr>
<td></td>
<td>Homewood Suites</td>
<td>89</td>
<td>14</td>
<td>59</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,721</strong></td>
<td><strong>71</strong></td>
<td><strong>1,435</strong></td>
<td><strong>175</strong></td>
<td><strong>16</strong></td>
</tr>
<tr>
<td>Marriott International</td>
<td>Marriott Hotels</td>
<td>277</td>
<td>4</td>
<td>39</td>
<td>234</td>
</tr>
<tr>
<td></td>
<td>Courtyard</td>
<td>493</td>
<td>1</td>
<td>236</td>
<td>256</td>
</tr>
<tr>
<td></td>
<td>Fairfield Inn</td>
<td>464</td>
<td>0</td>
<td>412</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>Residence Inn</td>
<td>362</td>
<td>0</td>
<td>242</td>
<td>116</td>
</tr>
<tr>
<td></td>
<td>Renaissance</td>
<td>53</td>
<td>0</td>
<td>22</td>
<td>31</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,649</strong></td>
<td><strong>5</strong></td>
<td><strong>951</strong></td>
<td><strong>689</strong></td>
<td><strong>31</strong></td>
</tr>
<tr>
<td>Starwood Hotels and Resorts Worldwide</td>
<td>Sheraton</td>
<td>189</td>
<td>40</td>
<td>105</td>
<td>44</td>
</tr>
<tr>
<td></td>
<td>Westin</td>
<td>57</td>
<td>22</td>
<td>10</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>Four Points</td>
<td>105</td>
<td>6</td>
<td>84</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>351</strong></td>
<td><strong>68</strong></td>
<td><strong>199</strong></td>
<td><strong>84</strong></td>
<td><strong>15</strong></td>
</tr>
<tr>
<td>Hyatt Hotels Corp.*</td>
<td>Hyatt Hotels &amp; Resorts</td>
<td>120</td>
<td>18-36</td>
<td>4</td>
<td>80-98</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>120</strong></td>
<td><strong>18-36</strong></td>
<td><strong>4</strong></td>
<td><strong>80-98</strong></td>
<td></td>
</tr>
</tbody>
</table>

Data Source: Piccoli et al. (2003). Note * Hyatt Hotels Corp. is privately owned and a precise classification of ownership is not available. Range estimations were provided directly by company representatives.

The franchising revenues to the brands consists of application fees, certain percentage of the gross room revenue for marketing and other related expenses, certain percentage of gross room revenue as a franchise royalty fee, and other fees depending on the brand (Labentsoff 2003, p.61).
3.2.3 Management

There are two main options for arranging the management of a hotel: the owner manages the hotel or the hotel is franchised and the owner hires a third party management company.

In owner-operated hotels the management reports directly to the owner. These independent hotels do not have the benefits rising from branding. Many of them belong to organizations, which act as marketing body for a group of independent hotels like Small Luxury Hotel of the World (SLH). These organizations usually require member hotels to meet certain criteria in order to be able to use the logo and have access to their services such as directories, website, advertising, and central reservation office. There is usually a fee to become a member of these kinds of organizations, which can be, for example, a fixed annual fee plus commission such as a percentage of the room rate. (Labentsoff, 2003, p.61-61)

The more common method is to hire a management company that takes care of day-to-day operations of the hotel (Piccoli et al., 2003 p.67-69). These management companies usually have a portfolio of different brands and properties from different owners (Piccoli et al., 2003, p.71). The role of the management company is not only to react to the daily needs of the customers but also deliver the service promise made by the brand in a profitable way (Dube et al., 1999, p.18). The benefits of a management company are for example enhanced buying power, advanced training capabilities, career progression for talented employees, and an extensive referral system (Guilding, 2003, p.181-182). The main challenges in this arrangement are related to capital budgeting since the wealth and the operations creating the wealth are separated. The owner and the management company can have different time perspectives. The former emphases more discounted future cash flows and immediacy while the former is motivated in building long-term customer relationships and franchise brand (Guilding, 2003, p.182).
The agreement between the owner and the management company can be viewed from the agent theory perspective. The agent, management company, pays all the operating expenses from the cash flow of the hotel, charges a management fee, and gives rest of the cash flow if any to the owners. The principle, owner, supplies the property including land, building, fixtures, furniture, equipment, and working capital. The principle also assumes full legal and financial responsibility. (Guilding, 2003, p.181-182)

There are various ways management companies are compensated. The most common way is that the management company gets a percentage of gross revenues generated by the hotel (Labentsoff, 2003, p.61). Two main components of management fees are the base and incentive fees (PKF Hospitality Research, 2006a). The base fee is typically a percentage of total revenues and the incentive fee is based on a percentage of the profits. The incentive fee is usually paid to the management company if a set profit threshold is achieved. The main use of the incentive fee is that it makes management more aware of the bottom-line profits. This is critical to owners since they get their ROI from profits. In addition to the management fees, the management companies usually also get reimbursement for training costs, marketing services, accounting fees, and travel costs by company executives. (PKF Hospitality Research, 2006a)

3.3 Performance measures


- Guest satisfaction
- Occupancy rate
- Average daily rate, ADR
- Revenue per available room, RevPAR
- Annual return or profit
• Capitalization rate.

Guest satisfaction is used in the industry especially by the hotel management companies and brands. It is often defined based on guest surveys, feedback forms, questionnaires, and interviews in a property level. The surveys can be highly detailed and the results are followed in a weekly basis. Brands usually rank the properties based on the results and require explanations for changes in performance. Furthermore, this is the measure the industry mainly uses to evaluate the guest experience (Pullman & Gross, 2004, p.571).

We have a guest satisfaction score. A selection of guests is sent a very extensive survey. These are collected and viewed on a weekly basis. We rate everything from arrival experience to conformability of the room, and to actions of the staff. Then we are ranked among the 500 Residence-Inns around the world on each question and the overall satisfaction core... It is a very formal process and mandatory. (Susan Labentsoff, Residence Inn by Marriot, 2006)

It is a very clear correlation, we have a lot of statistics, we measure the customer satisfaction within the properties and you know its no secret that ones that do the best job (in guest satisfaction) are also the most profitable. (Victor Burt, Starwood Hotels and Resorts Worldwide Inc., 2006)

The three most often followed and used productivity metrics in the hotel industry are occupancy rate, average daily rate (ADR), and revenue per available room (RevPAR) (Brown & Dev, 1999, p.25; O'Neill & Mattila, 2006, p.146-147). These three are followed by most of the participants in the industry. Occupancy rate indicates the number of occupied rooms out of the total number of available rooms. Hotels have a target occupancy rate or budget for occupancy and room prices are used as one of the mechanism to ensure the targets are met. Thus, the occupancy rate is used to determine room prices not the hotel performance. While occupancy rate is a more operational measure, the average daily rate, ADR, indicates the financial returns of the hotel on a daily, monthly, and yearly basis. ADR is the average amount the hotel was able to charge for a guestroom on a specific date. ADR is the total guestroom revenue for one night divided by the total number of guestrooms that were occupied that night. It is argued that everything else being equal, occupancy rate has a larger contribution to hotels' bottom-line than ADR. Thus, hotels
with higher occupancy rate are more profitable than the ones with relatively higher ADR (O’Neill & Mattila, 2006, p.153). Revenue per available room, RevPAR, is a performance indicator that is usually calculated in a monthly or yearly basis. RevPAR is ADR multiplied by occupancy rate. RevPAR averages revenues over all rooms that were available while ADR takes into account only the occupied rooms. (Labentsoff, 2003, p.79-82)

There are two main limitations to these metrics and especially RevPAR as it is a combination of the first two. It does not take into account other revenues the hotel generates for example revenues from food and beverage, and other departments. Furthermore, it does not include costs related to providing the required service level for example costs related to special amenities like spa or guest-service employees like concierge (Brown & Dev, 1999, p.25).

The annual revenues and profit measures try to tap into these challenges since they provide the total dollar amounts related to productivity not just a room profit percentage (Brown & Dev, 1999, p.25). Revenues and profits are mainly followed by hotel operators and owners. The operator (often a management company) is more interested in the revenues since their fees are mainly based on that and the owners are naturally looking into the bottom-line profits where they get their return on investment. (PKF Hospitality Research, 2006a; Guilding, 2003, p.181-182)

Another measure followed by the owners is the capitalization or cap rate. It is the ratio of operating income on a property level to asset price (Corgel, 2005, p.18-19). It indicates how soon the owner will get the investment back. Thus, it is the foundation for investment and financing decisions in hotel industry. The challenge is that due to the nature of the industry the fluctuations in the numerator and denominator and consequently in the cap rate can be sudden and significant. This makes the interpretation of the measure difficult. (Corgel, 2005, p.18-19)
Based on the secondary research and interviews there are also some metrics that are specifically related to the hotel design and construction. One of them of interest to all the participants in the hotel construction or renovation is the budget per room (Gibeault, 2006, p.58). One of the key cost items in this metric is the cost of furniture, fixtures, and equipments (FF&E). The cost of FF&E can vary, based on hotel brand and number of modifications done to the room prototype. Another metric especially for hotel operators and owners in construction is the maximization of floor area for guest rooms and minimization of non revenue-generating space (Ruter & Penner, 2001, p.78-80).

A study conducted by West and Huges (1991, p.379) on UK hotel design practices found that brands use two key metrics to evaluate the success of a hotel design project. These are cost and the effect on revenue and profit. Common ones are also comments received from customers, needed maintenance, and operational ease. Durability, look of the finished product, and personal preferences of the hotel operators or directors are also used to evaluate the design work done by contract designers. (West and Huges, 1991, p.376)

Hotels typically go through capital investment cycles with the cost associated with for instance carpet, wallpaper, and the furniture and those types of things. You generally get 5-7 years of life for them and you want to be very sure that what you design the colours, quality the fabrics, etc. are going to be classic and are not going to be things that are trendy one moment and they go out of style 2 in years down the road, because those can be very expensive things to change. (Victor Burt, Starwood Hotels and Resorts Worldwide Inc., 2006)

It should be noted that the current paper concentrates on experience design, which is different from traditional hotel construction or renovation. The guest experience and experience design in hotel industry will be discussed in more detail in Chapters 4 and 5.
4 GUEST EXPERIENCE

4.1 Experience economy

It is suggested that the world has moved to a new phase of economic development. The new economy, variously called an attention economy, emotion economy, entertainment economy, a dream society, or experience economy, uses experiences as a means to differentiate brands, and escape the commoditization trap (Gilmore & Pine, 1999, p.1; Schmitt, 2003, p.15; Pullman & Gross, 2004, p.551).

One of the main drivers behind this development is the nature of economic value and its progression. The creation of economic value has evolved from commodities to goods and services and finally to experiences (Gilmore & Pine, 1999, p.5). Gilmore and Pine (1999, p.1) give an example of these different levels of economic value through a basic commodity, a coffee bean. As a commodity, the coffee beans bring revenue of $1 per pound to companies that harvest or trade coffee in futures market (which is about one or two cents a cup). For a manufacturer that packages and sells the same beans in a grocery store the price of the good is around 5 to 25 cents a cup. Selling coffee in a corner coffee shop is a service that sells coffee at about 50 cents to 1$ per cup. The highest level of economic value, however, comes from selling the same coffee in a five star restaurant or espresso bar. In these places the ordering, preparation, and consumption of the cup of coffee involves a totally different experience. Due to the value of the experience, customers are willing to pay anywhere from $2 to $5 for each cup. Thus, the same coffee beans can be a commodity, good, service or experience based on the business model (Gilmore & Pine, 1999, p.1).
Goods are facing a threat of commoditization and so are services. The main challenges faced by service industry are (Gilmore & Pine, 1999, p.11):

- Internet enhances commoditization of services due to price comparison.
- Companies change the value chain of the industry by connecting directly with their end-customers e.g. Dell Computers, Southwest Airlines. This leads to decrease in the demand for intermediaries.
- Many service jobs such as telephone operators and bank clerks are being increasingly automated.
- The professional services are being embedded in software.

This creates a need for a new economic output, experience, which engages the customer at an emotional, physical, intellectual or even spiritual level. Even though the work of the experience provider perishes immediately, the memories obtained by the customers remain. For example, the value of family memories of a visit to Walt Disney World, is hard to measure (Gilmore & Pine, 1999, p.11-13).

The main characteristics of the different levels of economic value, commodities, goods, services, and experience, are presented in more detail in Table 4.1.

<table>
<thead>
<tr>
<th>Economic Offering</th>
<th>Commodities</th>
<th>Goods</th>
<th>Services</th>
<th>Experiences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>Agrarian</td>
<td>Industrial</td>
<td>Service</td>
<td>Experience</td>
</tr>
<tr>
<td>Economic function</td>
<td>Extract</td>
<td>Make</td>
<td>Deliver</td>
<td>Stage</td>
</tr>
<tr>
<td>Nature of offerings</td>
<td>Fungible</td>
<td>Tangible</td>
<td>Intangible</td>
<td>Memorable</td>
</tr>
<tr>
<td>Key attribute</td>
<td>Natural</td>
<td>Standardized</td>
<td>Customized</td>
<td>Personal</td>
</tr>
<tr>
<td>Method of supply</td>
<td>Stored in bulk</td>
<td>Inventoried after production</td>
<td>Delivered on demand</td>
<td>Revealed over a duration</td>
</tr>
<tr>
<td>Seller</td>
<td>Trader</td>
<td>Manufacturer</td>
<td>Provider</td>
<td>Stager</td>
</tr>
<tr>
<td>Buyer</td>
<td>Market</td>
<td>User</td>
<td>Client</td>
<td>Guest</td>
</tr>
<tr>
<td>Factors of demand</td>
<td>Characteristics</td>
<td>Features</td>
<td>Benefits</td>
<td>Sensations</td>
</tr>
</tbody>
</table>

Data Source: Gilmore and Pine (1999).
4.2 Customer experience

A customer experience (Gilmore & Pine, 1999, p.11) “occurs whenever a company intentionally uses services as the stage and goods as props to engage an individual”. Experiences are memorable, personal, and long lasting, and they include sensation of change. Experiences can be memorable in a good or bad way. For example poor service creates a negative experience (Gilmore & Pine, 2002, p.87-88). Experiences engage individuals in an emotional, intellectual, physical or even spiritual level that is unique for each person (Gilmore & Pine, 1999, p.12-13). Experiences, even though they are perishable upon their performance, last in individual’s mind. The value of the experience for the guest is revealed as time passes e.g. family trip will be discussed months or even years after. Experiences also include sensation of change. Individuals are conscious of and involved in the change as it happens. This alteration can occur in individuals’ environment, bodies, minds, spirits, or any other aspect of them that can sense change (Diller et al., 2006, p.18-19).

The notion of customer experience has been around for a long time. In 1955 economist Lawrence Abbot argued that people really desire satisfying experiences not products. The products are wanted because they render the experience-bringing services people are looking for (Moore, 2003, p.66). From a design and marketing perspective an experience is an engagement created with the customer. This engagement is delivered through an integrated system of ‘touch points’, which are e.g. products, packaging, message, and customer service (Diller et al., 2006, p.19). Thus, companies no longer offer just products or services but resulting experiences that are created with customers (Gilmore & Pine, 1999, p.12-13).

4.2.1 Layers of experiential world

An experience always occurs in a context. Pullman and Gross, (2004, p.554) argue that context is the most critical concern for experience design and management in service operations.
They propose that context has two main components: physical and relational. The physical component is all the facilitating goods and supporting facilities. It also includes sensual and psychological benefits linked with the service. The benefits can involve sensory things like sights, sounds and smells, or feelings of security, privacy, or status. The relational context refers to interactions. Two main types of interactions are: interaction between service provider and customers, and interaction between the customers and the other customers. (Pullman & Gross, 2004, p.554-556)

Schmitt (2003, p.62-65) agrees that the experiential world of customers is not just the experience they encounter with the product; it has broader layers including the context. The layers are experience of the product or brand, product category experience, usage and consumption situation, and finally the socio cultural or business context. The most specific layer is the experience with the product and service or brand. The second and broader layer is product category experience. For example a product such as razor blades give customers a certain experience in a product or brand level based on how it looks and feels in the customers’ hand when they are shaving. This brand experience is, however, driven by the product category it belongs to and the experiences related to that category. Both these experience layers are embedded in the usage and consumption situation of the particular product e.g. shaving in the morning. The broadest layer is the socio-cultural context in consumer markets or business context in B2B markets. Customers’ socio-cultural context can include activities that are related to their broader experience, e.g. customers’ professional life where shaving enables them to “appear professional” (Schmitt, 2003, p.62-65). The layers in a hotel guest experience could be the hotel as a product and the service the guest gets in the hotel, a hotel stay as a category, the consumption situation e.g. travelling for business, and finally the socio-cultural context of the guest e.g. appearing as tech savvy Generation X business traveller.
4.2.2 Components of customer experience

To better understand how companies can design experiences, a deeper look needs to be taken into the most specific experience layer. Diller et al. (2006, p.92) offer a model that can be used to create this understanding (Figure 4.1).

Figure 4.1 Shaping the Breadth of an Integrated Experience.

Diller et al., 2006, p.92.

Diller et al. (2006, p.92) define five main components that create customer experience at this level. These are product, service, brand, channel through which the offering is delivered, and promotional activities. Depending on the company’s capacity and category there can be
additional components such as the communications media, customer support, alliances, and retail presence. It is critical that all these components are inline with the experience the company is offering. Thus, to be able to design a coherent, memorable, and successful experience the company needs to take all these components into account. (Diller et al., 2006, p.90-98)

4.2.3 Four types of experiences

Gilmore and Pine (1999, p.30) argue that there are four different types of experiences or experience realms. Experiences occur along two different dimensions. These are guest participation and connection between a guest and the event. One end of the guest participation dimension is passive guest participation where customers do not directly influence the event. The other end is active participation in the event where customers actually affect the event. The second dimension describes the kind of connections or relationships that bond customers with the event. One end of the dimension is absorption. The experience occupies person's attention by bringing the experience into the mind of the individual. The other end is immersion where person becomes virtually or physically part of the experience itself. (Gilmore & Pine, 1999, p.30-31)

These two dimensions create the four realms of an experience. These realms, aesthetic, escapist, entertainment, and education are presented in Figure 4.2. The first form of experience is aesthetic. The guest immerses himself in an environment or event but has little effect on it. The event or environment is static and remains untouched. Examples of aesthetic experience are visiting an art gallery or standing on the edge of Grand Canyon. Escapist experience completely immerses the guest who is actively participating in the experience. The guest is not a passive couch potato that just watches others act; they are the actor influencing the performance. Theme parks, virtual communities, and casinos are examples of escapist environments. The guest can also travel to specific places to engage in an experience e.g. vacationers don't just lie in the sun but they go sky surfing. In this realm, people are looking to be part of a community and connect
with other people. The third realm, entertainment, is an experience where people passively absorb the experience using their senses. This is different from the aesthetic experience in the degree of involvement in the experience. Usually this occurs when watching a performance, reading for pleasure or listening to music. Entertainment experience is one of the oldest forms of experience but also the most ordinary and familiar today. Finally, in an education experience guests are active participants in the experience, absorbing events unfolding before them. To be successful, an education experience must actively engage the mind and/or body of the person to increase the individual’s knowledge. (Gilmore & Pine, 1999, p.31-35)

Figure 4.2  The Experience Realms.

![Diagram of Experience Realms]


To summarize, guests taking part in an aesthetic experience just want to be there while guests participating in escapist experience want to do. Guests in an educational experience want to learn while guests partaking in an entertainment experience mainly want to sense (Gilmore & Pine, 1999, p.35). It should be noted that companies can improve the realness of experiences by
blurring the boundaries between different realms and combining them in the experience provided to the guests. It is suggested that richest experiences have aspects of all these four realms.

(Gilmore & Pine, 1999, p. 38-39)

4.2.4 Phases of experience

Experiences have four main phases (Diller et al., 2006, p.98-101). These are initiation, immersion, conclusion, and continuation. Initiation is the phase where guest encounters some of the components of the experience for the first time. These can be, for example, promotion in magazine, news, or seeing other use the service or product. In this phase it is critical that the company is able to offer cohesively designed components that present the experience effectively. It should be an appealing sample of the experience that will attract guests to the actual experience. The next phase, immersion, is a phase where the core of the experience occurs e.g. staying in a hotel. The last two phases are interrelated. Conclusion is the end of the particular interaction with the service or product. How the experience ends is critical since it will determine how guests classify the experience and what they expect from the experience in the future. For example, hotels that treat check-out as a less important part of the experience than the arrival, can turn the impression of the guest into a negative one even though they might have enjoyed the stay in general. It should be noted that the experience continues after a particular encounter has ended. Each new immersion will deepen customers’ trust in the authenticity of the experience provided by the company. (Diller et al., 2006, p.98-101)

Long (2004, p.60-67) also emphasizes trust in the customer experience. He suggests that experience, especially in an online environment, has four hierarchy levels: trust in the company; competence of oneself and the company; control over the experience, and creativity and relatedness in the experience. Trust is the base for the experience. It is created through visual and behavioural cues, and familiarity. The higher value a product has, the more difficult it is to create trust. Second, customers need to feel competent in the experience and they need to consider the
organization providing the experience competent as well. Third, customers need to feel that they have a certain level of autonomy and control in the experience. Finally, the highest level of experience is creativity and relatedness in the experience. At this level customers are co-designing the offering and the benefits for the company are increased customer loyalty, deeper customer knowledge, and possible new innovations. (Long, 2004, p.60-67)

4.3 Designing experiences

4.3.1 Experience design

Experience design is defined by Pullman & Gross (2004, p.551):

an approach to create emotional connection with guests or customers through careful planning of tangible and intangible service elements. (Pullman & Gross, 2004, p.551)

The American Institute of Graphic Arts defines the term ‘experience design’ as design that accommodates every user in an adaptive and purposeful way. The following points are their guidelines for experience design (Clark et al., 2006, p.49):

• An approach to design that goes beyond traditional boundaries, striving to create experiences - not just products or services;
• Looking at a product or service throughout its lifecycle from the customer's viewpoint - from before he or she perceives a need for that product to when he or she discards it;
• Creating a relationship with individuals, not targeting a mass market;
• Concerned with invoking and creating an environment that connects on an emotional or value level to the customer;
• Builds upon traditional design disciplines in the creation of products and services, as well as of environments.

Experience design has become more popular especially in many hospitality businesses because it offers a way to enhance customer loyalty through designing, innovating, and managing the guest experience (Pullman & Gross, 2004, p.551). The goal of experience design is to enable
a company to be consistent in its value proposition and expressions in every connection with customers (Diller et al., 2006, p.19).

As in other areas of design, experience design helps companies to obtain a sustainable competitive advantage and differentiate themselves from competitors (Kotler and Rath, 1984, p.16). Gilmore and Pine (1998, p.102) argue that experience design will become as significant contributor in the business sector as product and process design have. Still, according to Kotler and Rath (1984, p.17) companies give significant attention to the product functioning, pricing, distribution, sales, and advertising and much less attention to environment, product, information and corporate identity design.

Goel et al. (2005, p.26) further propose that designing experiences should not be driven by operations or marketing management practices. These practices are not sufficient since they do not take into account the customer goals. Among these different practices the goals, tools, measures, and interaction are different. The goal in the experience is customer satisfaction and retention while in operations it more in improving the processes and operational efficiency. Tools for designing a service from the marketing perspective are e.g. demographic data and sales forecasts while experience perspective uses tools that are typical to the product design discipline. Clark et al., (2006, p.49) suggest that these tools are mainly related to observational and ethnographic research. Examples of the tools can be personas, breakpoint analysis, and ‘day in a life’ observational research. Measures vary as well. The experience perspective is interested in the quality of the experience while the operations usually give attention to time and costs, and marketing to sales (Goel et al., 2005, p.26-27).

According to Pullman and Gross (2004, p.554-556) a good experience design not only uses the physical context elements but also relational elements when creating the experience. In their study on experience design in a VIP tent they found that loyalty behaviour on the guests’
part was mainly created through interaction with the entertainers not by expensive special effects (Pullman & Gross, 2004, p.570-571).

4.3.2 Designing memorable experiences

Experience is not about entertaining customers it is about engaging them. Thus, designing experiences is not about adding entertainment to the offering (Gilmore & Pine, 1999, p.30).

Diller et al. (2006, p.63-67) link the designing of an experience to a general innovation process of a company from opportunity identification to concept development and testing to launch. Designers, marketers and developers are all involved in this five-phase process (p.63-67):

1. Identify the opportunity. Involves defining how, where, and when people want or need to connect to new or deeper experiences. Defining market, competitors and potential customers.
2. Frame the business idea. Involves creating a project plan, team, budget, deadlines, and other aspects of execution. Defining the scope of the project.
3. Shape the experience concept. Involves conceptualizing the experience. Conceptualization methods vary from brainstorming to more analytical ones and with or without customer input. Define what is the wanted experience and the mechanism to evoke it.
4. Refine the experience. Involves testing all the interaction points with the customer and making sure that the target customers understand and appreciate the experience.
5. Expressing the experience. Involves finalizing the offering, launching and continuously developing the experience to adjust to change in customer’s needs, competitive situation, available technologies, trends etc.

Gilmore and Pine (1998, p.102-105) have also identified five key experience-design principles. There are: theme the experience, harmonize impressions with positive cues, eliminate negative cue, mix in memorabilia, and engage all five senses. A well-defined theme gives guests something around which they can organize impressions they come across. This enables a lasting memory. An effective theme is compelling and to the point. It does not have to be publicly stated but the theme must be behind all the design elements of the experience. (Gilmore & Pine, 1998, p.102-105)
Impressions need to be harmonized with positive cues. Impressions fulfill the theme through cues. Cues affirm the nature of the experience to the customers while impressions are the ‘takeaways’ of the experience. Cues must be inline with the theme to support it and enhance the experience. The experience can be unpleasant just because unplanned or conflicting visual and aural cues are confusing the customer e.g. difficulty to find hotel room even after getting directions from the front-desk. Positive cues are not enough. Negative cues, anything that might reduce, distract, or conflict with the theme should be eliminated. A poor service or over servicing can easily create unpleasant experience. For example, in hotel rooms a huge amount of service reminders can be considered as annoying negative cues. Reminders could be offered for example through an interactive television channel to improve the guest experience. (Gilmore & Pine, 1998, p.103-104)

Use of memorabilia is critical. Memorabilia are goods that are bought mainly because of the memories they convey. They are sold above the price point of similar goods that do not symbolize the experience. Examples of memorabilia are t-shirts, post cards, caps, and mugs. They are a physical reminder of an experience and their price point is attached to the value buyers get from remembering the experience. (Gilmore & Pine, 1998, p.103-104)

Finally, experience needs to engage all five senses. The more senses that support the theme experience engagement, the more memorable it probably is. Examples of this can be grocery stores directing bakery smells into the store, and restaurants using sound and light effects. (Gilmore & Pine, 1998, p. 104)

In addition to these design principles it is suggest by Clark et al. (2006, p.48) that to be successful, design must take into account not only what occurs in an event or in usage but also in all the phases of the experience such as of consideration, purchase, and after care (Clark et al., 2006, p.48). Moreover, all the different channels used in these phases should be inline with the
experience. The interaction with the customer is a continuum from advertising, to using website or purchase, to customer support (Moore, 2003, p.70). Moore presents (2003, p.73) a model for designing a customer experience that is coherent throughout the company and all the channels the customer might encounter or use. The four steps in the model are described in Figure 4.3. The first step is positioning: determine the brand value, customer segmentation, and defining how the company differs from its competitors. It would be valuable to give attention to wanted theme as well. The company needs to determine how the differentiating factors translate into a desired customer experience. After that the company should incorporate the customer experience plan across its businesses and ensure that management systems, operations, training, processes, and technologies support it. Finally, based on segmentation the company should be able to plan and deliver the desired customer experience for each target group in each channel. (Moore, 2003, p.73-74).

Figure 4.3 A Multi-Channel Customer Experience Architecture.

Based on Moore, 2003, p.73.
5 GUEST EXPERIENCE IN HOTEL INDUSTRY

It is suggested that the customer experience is one of the few means of differentiation left for companies to use in current competition (Moore, 2003, p.66). This is true for hotel industry as well since as many other service offerings they need to find new ways of achieve a competitive advantage and they can do it by focusing on customer experience design and management (Pullman & Gross, 2004, p.551). Gilmore and Pine (2002, p.88-89) suggest that managing hotels as experience venues, instead of just real estate, helps them to conquer the commoditization trap.

The need to differentiate through experiences become clear also in the interviews conducted for the paper (Appendix). It was suggested by the interviewees that having a good product (hotel) is not enough. A good product is just a minimum requirement to get into the game. Another fundamental point that emerged in most of the interviews was that guests should be the focus point of all actions since without them the hotel business simply does not exists. It was pointed out that hotels however, often forget this fundamental issue.

Even though, a definition for guest experience varied among the interviewees, there were at least three common elements. These were the emotions related to the experience, rooms including its amenities, and service provided to the guest. The experience was described by using emotions or feelings like happiness, enjoyment, having good time, feeling loyal, not being surprised, getting what was expected, feeling like home, and feeling comfortable and welcome. The rooms were almost always mentioned when a guest experience was defined or described. It was noted that hotels couldn’t have traditional rooms anymore to be able to create a memorable experience. Finally, the interviewees often mentioned service offered to the guests when they described the guest experience. It was pointed out that no matter how great a product the hotel is, the most important part of the experience is still the service and people delivering that service.
Thus, they suggested that the experiences should be also viewed from the employees’ perspective. To be able to create a successful experience for customers, the employees need to feel proud and good about working for the brand.

Thus, based on the definitions given by the interviewees it seems that the hotel industry, at least in the general manager or individual hotel level, is talking about the guest experiences from a slightly different perspective than the academic research. Concepts of themes and motifs, and different levels of experiences were not used by the interviewees. Moreover, the hotels seem to still have a service mindset rather than experience mindset. The focus is in providing service and getting customers in and out of the hotel as satisfied as possible rather than in trying to get the guest to spend as much time in the hotel as possible (Pine and Gilmore, 2002, p.90).

5.1 Main components of hotel guest experience

The hotel guest experience has several different components and current literature and interviewees define them mainly based on functional areas of a hotel. Brathwaite (1992, p.44) argues that there are three parts in the hotel experience in the travelling experience value chain. These are occupying the hotel room, and hotel check-in and check-out activities. Occupying the room is a high value experience while check-in and check-out are ranked as low-value experiences. Another division of experience based on different functional areas is given by Dube and Renaghan (1999, p.93). In their study they found that there are eight key functional areas that contribute to the benefits customers get from a hotel stay. These are quality standards of various services, marketing to customers, physical property, value for money, general atmosphere, brand name and reputation, personnel, quality standard at check-in and check-out, and guest room design and amenities.
A study conducted by Hotel & Motel Management among 1,500 general managers in the leading hotel brands in U.S. provides similar results. The main hotel facilitates that contribute to the guest experience were (H&MM, 2005a):

- Knowledgeable hotel staff
- Special bedding, linens, pillows etc.
- Free breakfast
- Kid’s activities
- Amenities
- Free high speed internet connectivity
- Unlimited long-distance calls
- Coffee maker in room
- Irons and ironing boards
- Kiosk check-in and check-out.

The knowledgeable hotel staff was ranked as most critical contributor by 72.9% of the respondents (H&MM, 2005a).

Gilmore and Pine (2002, p.87-89) argue that service and the product components should be used together to create the experience. An example they give is the wake-up call. A clock is a tangible good that performs a timekeeping function. However, this good is used to provide an intangible service of telling another person what time it is. This time keeping service can be turned into a memorable experience. However, this does not occur by improving the functionality of the wake-up call. It is done through creating an enjoyable experience on top of the existing service. For example a hotel can have a wakening call recorded by the stars that have stayed there. (Gilmore & Pine, 2002, p.87-89)

In the interviews the main components of the experience that were repeatedly mentioned were the rooms and their content, personnel or service of the hotel, and the brand. The main aspect mentioned related to the room was its cleanliness. Products that were mentioned related to
the rooms were for example LCD TV screens, beds, fog free mirrors, rain showers, and window blinds. Rest of the physical surroundings such as conference facilities, restaurants, spas, and workout rooms were not emphasized as much. The service provided to the customers by employees was critical part of the experience. The emphasis was in the front desk and arrival experience. Critical in the service is that employees deal with the customer naturally, genuinely, and in a personal level. Service that is too scripted or robotic was mentioned to be damaging to the experience. Moreover, it was noted that how employees feel about the brand and property reflects directly to the experience of the customer. The brand contributes to the experience by creating the expectations for the guest, while the service and property deliver that promise. It was often emphasized that the property and service should reflect local characteristics. For example Westin in Whistler and Westin in Maui should be different from both the property and service perspective. This issue will be discussed in more detail in the Chapter 5.2 when different theme strategies for hotels are presented.

5.1.1 Technology as component of experience

As found in the previous chapter, the hotel industry does not necessarily consider technology as critical component in a successful guest experience at the moment. It is suggested that technology can’t substitute for good service or the value of knowing a guest’s name (Wilson, 2006). A study among general manages (GMs) in the U.S. found out that only 11% of respondents considered the pace of technology change extremely important (H&MM, 2006b). Furthermore, about 60% of respondents are responsible for technology purchase and only 7% of them say that technology is the product category their spend most amount of their budget. 70% of the responding GMs spend less than $500,000 annually on all product categories.

It is argued that even though a hotel could offer all the technology in the world, it would not overcome a bad experience a guest gets at the hotel if their needs are not met (Wilson, 2006).
Technology related to guest experience is mainly discussed as products in guest rooms (e.g. LCD TV, high-speed internet connection) or information technology systems (e.g. CRM system or reservation system) used in a hotel or brand level. Even though technology, as a guest room product, does not contribute to the bottom-line of the hotel, it contributes to the overall look and feel of the experience the guest pays for (Wilson, 2006). Especially the new brands in the upscale segment, such as NYLO Hotels and Hyatt Place, are characterized by offering state-of-the-art technology in the guest rooms (Ernst & Young, 2006). Information systems are used to help hotels to personalize the guest experience. For example Ritz-Carlton uses a CRM system for transparent customization of the guest experience. The system enables the brand to collect information on customer preferences in each visit and customize the next visit based on that information e.g. providing hypo allergic pillows or certain type of room (Gilmore & Pine, 1997, p.99-100).

From technology perspective, Hilton does a very good job in engaging the guest information... At the point of reservation they are asking questions trying to find the reason for travelling, and there is a whole engagement built in our customer relationship management system. The information enables us to create personalized welcome letters with targeted information. For example if they are coming with two kids, we can include all the information related sightseeing etc. (Steve Veinot, Hilton Vancouver Airport, 2006)
5.2 Theme strategy

The brand guidelines related to the franchising agreements discussed in Chapter 3 cover many of the experience creating components. There are, however, different kinds of strategies used in the industry to apply the experience, and its theme and motifs across the different properties. These strategies differ based on the level of standardization at different properties of the same brand and extend of communication of the experience theme to the guests.

Gilmore and Pine (2002, p.92-93) argue that use of theme turns a service into an experience. Theme is the underlying concept behind how a particular place is staged. It is not a marketing slogan or a corporate mission statement (Gilmore & Pine, 1998, p.102-103). According to them this applies in the hotel industry as well. Theme allows hotels to harmonize the set of impressions that engage guests. Hotels can formally state the impressions they want to be remembered by. A benefit of communicating impressions is that it not only helps employees but also designers to conduct their work. Theme is linked to a motif. Motif is the outward appearance of the theme e.g. the physical set, worker’s clothing and behaviour, and props. (Gilmore and Pine, 2002, p.92-93)

Hotels creating experiences need to make two decisions when they create a theme strategy. These are (Gilmore and Pine, 2002, p.94):

- Is the theme articulated publicly or not
- Is the theme applied uniformly across all locations.

These two decision create four alternative theme strategies, self-explanatory, all­compassing, undercover, and undisclosed motifs which are presented in Figure 5.1.
The first strategy is the all-compelling motifs where a theme is explicitly stated. The theme is applied as a common motif throughout all locations of the hotel brand. This means that no matter which location the guest visits the motif remains the same. Example of this strategy is the Ritz-Carlton theme ‘We are ladies and gentlemen serving ladies and gentlemen’. All the elements that create experience are infused with a common core concept. The second strategy is self-explanatory motifs. In this strategy the theme is explicitly stated as well but it is applied differently in each location. For example Disney does not have same motif in its hotels even though the overall Disney theme of parents and children sharing happiness and knowledge is very explicit. Third is the undercover motifs. Here the theme is not explicitly stated but it is applied across locations through a common motif. Example of this strategy is Sonesta Hotels. Their theme about adding value to the lives of people is not explicit but all the locations try to enhance the lives of the guests through e.g. art. The last strategy, the undisclosed motifs, is the most complex one. The theme is not explicitly stated and there is no common motif across the
locations of the brand. In this case the brand applies subtle themes individually. For example Joie de Vivre Hospitality founded by Chip Conley develops each hotel based on a different magazine. Hotel Rex is based on the New Yorker and the Phoenix in San Francisco is based on Rolling Stone. They do not use the design elements of the magazine but rather the attributes related to the magazine and its reader base. (Gilmore and Pine, 2002, p.93-96)

These differences in standardization of the motif and communication of the themes were found in the interviewed brands as well. In general it was suggested that it is critical for the hotels to be able to customize the motifs based on the local characteristics and to avoid the ‘cookie cutter’ style. This implies that the most popular strategies among the interviewees were the self-explanatory and undisclosed motifs.

Based on the interviews there are at least two other observations related theme strategies. The theme strategy differed from one brand to another. For example among the interviewed brands Residency-Inn by Marriot seemed to have less freedom at the property level regarding the experience and motifs. Their decision-making was limited to pricing. The motifs and operations were based on the brand guidelines. Hilton on the other hand seemed to have more relaxed guidelines since the GM was quite freely able to renovate the hotel restaurant with in-house designer of the company owning the property. They were able to define the theme and motifs of the restaurant by themselves. The only requirements Hilton brand set were that the restaurant in this kind of property had to have certain square footage, number of seats, and type of breakfast.

Freedom related to implementing all the motifs of the brand was also found to be dependent on the ownership structure. Based on the interviews, the more fragmented the ownership in the brand the more difficult it is for brands to implement unified motifs. An example of this is the strata structure where individual owners actually own rooms of the hotel. The difficulties to implement unified motifs to these properties rise from the need to get approval
for decisions from this wide owner base. The burden of getting new brand initiatives approved is left on the shoulders of the GM of the property. Fragmented ownership can also be linked with risk averse behaviour. For example the Four Point brand under Starwood has mainly owners that own a single property and have invested their life savings in that property. They are not that prepared to ride the ups and down of the industry. In bad times they panic and want to cut back on the standards. It should be noted, however, that properties that are brand owned and operated do not necessarily have less freedom for local decision making than the ones owned by third parties. For example Hyatt owned and operated Hyatt Regency Vancouver was able to conduct their renovation fairly independently. The hotel was able to create the concept for renovation with a local interior design company and apply local characteristics to the concept.

5.3 Added value from guest experiences

A memorable guest experience adds value to the different stakeholders (other than guests) in the hotel industry through at least six key ways. In addition to differentiation, successfully designed guest experience gives hotels an opportunity to build loyalty, increase revenues, remove amenities creep, and create additional revenues from fees and memorabilia.

Memorable experiences create greater customer loyalty (Schmitt, 2003, p.19-20; Pullman & Gross, 2004, p.551-552, Long, 2004, p.60-67). The loyalty is created through both the functional design and emotional connection with guests (Pullman & Gross, 2004, p.552-553). Experiences with an emotional engagement make the offering less indispensable to an individual customer (Moore, 2003, p.74). More experiential facilities and other channels delivering the experience are found to increase the customer impressions, and create more positive attitudes and greater purchase intentions (Schmitt, 2003, p.19-20). For example the Heavenly Bed experience launched by Westin increased the overall hotel satisfaction by 12% (Schmitt, 2003, p.74).
Successful customer experience also increases hotel revenues. Experiences allow companies to charge premium prices for greater perceived customer value (Moore, 2003, p.74). They can increase the time guests spend in the hotel and increase repeat visits (Gilmore & Pine, 2002, p.96). Furthermore, a memorable experience can increase customer retention which has significant impact on the lifetime value of the customer. Additionally, costs of customer acquisition (i.e. sales) are reduced due to increased customer retention (Moore, 2003, p.74).

Hotels not doing so well in customer service are the ones that typically are not running at high occupancy. They are not able to charge as high a premium for their services because they are not providing that experience and so they end up suffering. (Victor Burt, Starwood Hotels and Resorts Worldwide Inc., 2006)

Well, anytime you spend a lot of money, the expectations are very high to get your ROI as quickly as possible... we renovated half of the building and now we are going to renovate the other half... We just completed our projections for next year and the expectations are high to get more business and to get higher rates. With our group business we are booking five years out and we are seeing the average rate increasing 10-15% already...To have the rate go up 10% across the business is not a crazy expectation at all, its very do-able. (Manuel Sousa, Hyatt Regency Vancouver, 2006)

Another added value to the firm from experiences that engage customers, is breaking the cycle of trying to offer better features every year (Clark et al., 2006, p.48). In the hotel industry this is know as the amenities creep. Experiences refocus both guests and hotels from incremental add-ons or improvements that can’t be used to increase room rates.

Hotels can also gain additional value from experience through fees they charge guests (Gilmore & Pine, 2002, p.89). Examples of different types of fees are entry fee, per-play fee, per-time fee, initiation fee, membership fee, and access fee. For example Bellagio in Las Vegas has an entry fee to its fine-art gallery. Another example is hotel spas that create a place within a place to which hotels charge admissions/service charges. (Gilmore & Pine, 2002, p.89-91)

Finally, experiences create opportunities to get additional revenues from sales of memorabilia and other products related to the hotel stay. An example of this is the retail success
of luxury bedding line and Heavenly Beds by Westin. By beginning of 2006, seven moths after its launch, sales of Westin’s signature luxury bedding line at a national retailer, Nordstrom, exceeded $5 million. A retail program at W hotels sells, in addition to furnishings, items such as unique jewellery and handbags, and limited edition CDs and apparel. The sales of its signature beds and pillows are 1,000 and 20,000 units a year respectively (Rauen, 2006, p.52-56).

5.4 Creators of guest experience

It is important to define the participants in the guest experience creation since it enables recognition of potential customers and competitors for an experience design offering. Defining participants can be approached from at least two different perspectives - guests and the hotel.

For guests, staying in a hotel is usually part of a wider experience of travelling. Thus, players that create the experience are basically all the participants in the travel or tourism value chain presented in Chapter 2. These include for example travel agencies, website developers of travelling websites, hostesses in the airplane, the taxi driver to the hotel, and waiters in the local restaurant.

For the purpose of this project, participants in the experience creation will be defined from the hotel business perspective. When hotels are considered as open systems then it can be argued that all the functions presented in Chapter 3.1 contribute to the hotel guest experience. These functions can be outsourced or conducted in-house depending on the ownership and management structures of a given entity. Based on the secondary research and interview there are at least seven key participants in the creation of a guest experience:

- Owners
- Hotel brands
- Hotel management
- Guests
- Hotel employees
 Owners are one of the key participants in creation of a guest experience. As discussed in Chapter 3 they are the ones making the initial investment and providing additional capital for renovations as required. Thus, they have a final say in new construction and renovation projects but they also have to follow brand guidelines if they are in a franchising agreement. It should be noted that they could change the brand if the required guest experience is not inline with their vision or rest of their portfolio. Owners and asset managers, hired by the owners, have strong decision-making power regarding the guest experience.

A huge part in guest experience creation is the ownership of the property... We manage a lot of the hotels but we don’t actually own lot of properties so we have to go to a owner to build a hotel and we go to them in order to recapitalize and renovate the property...Sometimes it is the owner, in many cases the asset manager or somebody they have hired to look after the building on their behalf. (Victor Burt, Starwood Hotels and Resorts Worldwide Inc., 2006)

Hotel brands define the brand guidelines that are used to create and deliver the guest experience in all the properties under the specific brand. The guidelines vary in their level of detail and extensiveness depending on the brand. They also vary in their theme strategy.

Brands possess expertise and decision making power related to the guest experience. For example the most significant guest experience innovation, the Heavenly Bed, in recent years came from a brand. It was an initiative of the brand’s CEO and the experience was successfully implemented in all properties under the Westin brand (Schmitt, 2003, p.72-74). At a corporate level, expertise that can contribute to the creation of guest experience include corporate level management, business development, in-house design and architectural expertise, and marketing and sales (Dube et al., 1999, p.18). This expertise can potentially be supplementary to the experience design offering described in Chapter 4.
As an example, in new constructions brands provide architects and developers prototypical plans. Architects rely on these plans in their work but they can also be customized for the owner. Customization is done based on factors such as size of hotel local market, local building costs, and site requirements (Gibeault, 2006, p.58). Brands often improve their prototypes from year to year and require ‘new generations’ of hotels follow the updated ones. This leads to a situation where required standards are different based on the construction year of the hotel. (Gibeault, 2006, p.58-59)

Based on the interviews, at least at the individual properly level, the brand defines certain elements in the creation of guest experience but there is still room for independent decision making in a property level. In addition to guidelines, brands offer specialized expertise in e.g. marketing and design if needed in development of the experience. It is suggested that brands can do only so much and the rest has to be customized based on local characteristics.

With all of our Hyatt hotels, the grand bed is the most comfortable for the majority of our hotels. We have also decided as a company that every time we renovate we will put in LCD TVs... So those are examples of Hyatt level decisions. And then you need to renovate incorporating all that, but looking at the hotel’s point of view. If it is in Vancouver, the renovation or new look and feel of the hotel has to say West Coast. The look here will not necessary work in New York and vice versa. (Manuel Sousa, Hyatt Regency, 2006)

Marriot requires that certain elements need to be renovated every 6 years. Last year we were at that level. We had the brand and its guidelines and then we had the owners that were taking care of their investment, the physical building... Marriot is very strong in brand standards. When you walk in Residence-Inn here or in Salt Lake City they all look, not totally same, but you can really tell that you are in Residence-Inn without seeing the sign. (Susan Labentsoff, Residence Inn by Marriot, 2006)

From rooms perspective we had to renew the beds. Hilton has some furniture packages but they are not terrible specific on it. Like I said we have to have flat TV as a minimum standard. They have new stainless steel program. Thus, they have power over pieces of the room. They base that on the information they get from guest surveys. (Steve Veinot, Hilton Vancouver Airport, 2006)
Hotel management is also considered to be a significant contributor to the guest experience. The management includes the general manager, GM, and the management team in the areas such as sales, marketing, and HR. Hotel management makes sure that the experience promised by the brand is implemented at a hotel level (Dube, et al., 1999, p.18). Even though there are lots of fundamental strategic level decisions (e.g. hotel size, ownership arrangement, management arrangement) made before opening a hotel, GMs still have a power to continuously develop and change the guest experience at the operational level (Brown & Dev, 1999, p.24).

Based on the interviews, GM’s task in developing and changing guest experiences was on the one hand in pursuing owners to implement innovations or renewals done by brands. On the other hand they were negotiating on behalf of the owner. Moreover, general managers were found to have an active role in renovation projects of hotels. They seem to be the connecting force among the diverse group of stakeholders in guest experience creation.

For rooms we are currently addressing lighting issues and we just redid the beds. Luckily, I do not have to anything with that since we have a designer in our management group who looks after that. My role is to define what we need and how we spend capital money and seek approval for that. The designer takes and runs with it, then she buys everything and I have to manage the project. (Steve Veinot, Hilton Vancouver Airport, 2006)

The Hilton Service and Royalty Tracking surveys reflect very well the issues we have in the hotel and it is a great tool to communicate with management group in terms of required investments. (Steve Veinot, Hilton Vancouver Airport, 2006)

As noted in Chapter 4, in service businesses customers are active participants in the experience. In the hotel industry, this means that guests themselves and other guests staying in the hotel at the same time are critical contributors to the experience they will get. Moreover, guests’ feedback and opinions are taken as input to creation of the experience. This input is taken into account mainly in hotel operations and at the brand level. According to interviewees, hotels use extensive guest surveys and multiple feedback channels to capture guest satisfaction with the experience on a daily, monthly, and yearly level. Some Starwood brands have also a guest
advisory board that gives feedback right from the opening of the hotel and throughout its operations.

Hotel employees are considered the most important group in creation of the guest experience through the service they provide. It should be noted that this is mainly related to service and interaction with guests. However, they also give input to the renovation and design of the property. It was discussed in the interviews that the experience of the employees is critical to the success of the guest experience. Design solutions need to take this group into account not just in terms of actions that are visible to the guests but actions in “back-office” as well. According to interviewees the most critical functions contributing to the guest experience are the front desk and maintenance. It was also suggested that employee feedback is taken into account in renovation projects.

Providing the product and service. Everybody else is renovating, having rewards programs... at the end of the day everybody is providing a place to stay, meet and eat... but it is the people that makes the experience different. You can’t copy that. (Susan Labentsoff, Residence Inn by Marriot, 2006)

Architects also play important part in creation of guest experience. They are the ones designing the experience venue usually relying on prototypical plans provided by brands if the hotel is already under certain flag (Gibeault, 2006, p.58-59). Their expertise is in creating e.g. certain number of rooms for that specific space. They create the frame that the interior designers will have to fill. Generally the objective of the architects is related to maximizing the revenue generating space (guest rooms), and keep the vertical core, horizontal circulation and support area as minimal as possible (Ruter & Penner, 2001, p.77). They are also enhancing the visibility and appearance of the structure. Architects work closely with the contractors. Contactors usually supply permanently installed items in the building (e.g. counters, front desks, heating and cooling units) while owner provides everything that can be taken with them if moved (e.g. furniture,
telephones, computers, small appliances). The hotel operator provides carpets and wall covering, washers, dryers, kitchen appliances, and signage (Gibeault, 2006, p. 57-59).

There are at least three types of contract design companies in the hotel industry (West and Huges, 1991, p. 370-373). These are specialized fee-based contractors, interior designers, and decorators. The fee-based contractors offer specialized services like purchasing service or forecast research. The interior designers have some of the skills of architects and are knowledgeable about building regulations but do not necessarily have specialized services available. The decorators mainly work with the surface aesthetics. They do not manage or implement the design of the establishment (West and Huges, 1991, p.370-373). In addition to contract designers, who are more focused on the interior design work, there are at least one to three design consultancies with roots in industrial design offering experience design services to the hotel industry (H&MM, 2005b). However, these players are not considered as established participants in the guest experience creation due to the limited number of projects done for the industry. As an example of the work done by these consultancies, IDEO worked with Marriot to refine one of their brands. IDEO’s methodology includes a team of anthropologists and architects that observe guests throughout the hotel experience to define the key moments in the experience. The results from the project were a brand brief that defined a renewed identity and a plan for creating more meaningful customer relationships (Marriott, 2006; Business Week, 2005).

Hotel companies use contract designers even though they have a design team in-house (West and Huges, 1991, p.370-373). For example even though Hilton International has in-house design teams it uses contract designers for individual hotel projects. Similarly Novotel Hotels uses external help in new builds and some refurbishments. However, it can be a challenge for design contractors to get involved in the early stages of the design process and be able to sell ‘complete packages’ including market research services. The hotel companies are looking for the
cheapest option available and thus, the design contractors are brought to the process in later stages. (West and Hughes, 1991, p.370-373)

The designer we use is a local designer just couple blocks away from the hotel. But like in everything else, you can’t have just one person to give the ideas and suggestions. The more people you get together in the room providing suggestions and ideas and recommendations the better the real world product will be at the end... our corporate office folks obviously do this all the time and you need to take their expertise into consideration as well. (Manuel Sousa, Hyatt Regency, 2006)

To summarize, the groups participating in the actual design and development of the guest experience are owners (and their asset managers), brands (marketing & sales, business development, design & architecture), contract designers (specialized design services, interior designers, decorators), architects, hotel management and employees, and finally guests themselves. The owners and brands are the two key players that have decision-making power in the experience creation and currently purchase hotel design services. Except for the few design consultancies moving into the market, there is not one group among the established participants that would fulfil the role of experience design discussed in Chapter 4. Experience design’s role is to create the experience that delivers the preferred customer behaviour. To do this the experience designers should (Moore, 2003, p.73):

- Drive the brand manifestation from presence to transformation, across all channels
- Bridge the gap between strategic intent and actual delivery with a functional and rewarding customer experience
- Deliver an experience based on customer needs that differentiates the business
- Drive toward channel exploitation for maximum brand opportunity.

Thus, while industry does not yet have established participants that fulfil this role, the offering of contract designers is closest. Consequently, they can be defined as key competitors and as supplementary or even complementary services for experience design depending on the service range offered by the specific contractor.
6 MARKET POTENTIAL

The potential market for experience design can be defined by the new hotel construction pipeline, renovation activity, and size of the hotel design services market.

6.1 Lodging supply and construction pipeline

Growth of lodging supply has been limited or even reduced during past years. New lodging supply growth is expected to be less than 1% in the U.S. in 2005 (Ernst & Young, 2006).

The main reasons behind this are that hotels are exiting the lodging market or converting rooms into residential units. Current property and room breakdown in the U.S. is presented in Table 6.1.

Table 6.1 U.S. Property and Room Breakdown 2004 and 2005.

<table>
<thead>
<tr>
<th>Breakdown</th>
<th>Properties* 2004</th>
<th>Rooms* 2004</th>
<th>Properties* 2005</th>
<th>Rooms** 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Airport</td>
<td>1,914</td>
<td>273,839</td>
<td>1,933</td>
<td>274,769</td>
</tr>
<tr>
<td>Suburban</td>
<td>15,792</td>
<td>1,563,986</td>
<td>15,792</td>
<td>1,563,986</td>
</tr>
<tr>
<td>Urban</td>
<td>4,648</td>
<td>706,235</td>
<td>15,853</td>
<td>1,570,134</td>
</tr>
<tr>
<td>Highway</td>
<td>6,666</td>
<td>446,121</td>
<td>6,761</td>
<td>452,017</td>
</tr>
<tr>
<td>Resort</td>
<td>4,055</td>
<td>595,272</td>
<td>3,835</td>
<td>573,092</td>
</tr>
<tr>
<td>Small Metro/Town</td>
<td>14,523</td>
<td>826,455</td>
<td>14,613</td>
<td>832,187</td>
</tr>
<tr>
<td>Size</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under 75 rooms</td>
<td>27,464</td>
<td>1,163,668</td>
<td>27,416</td>
<td>1,160,329</td>
</tr>
<tr>
<td>75-149 rooms</td>
<td>14,326</td>
<td>1,524,099</td>
<td>14,432</td>
<td>1,532,477</td>
</tr>
<tr>
<td>150-299 rooms</td>
<td>4,235</td>
<td>847,089</td>
<td>4,182</td>
<td>836,554</td>
</tr>
<tr>
<td>300-500 rooms</td>
<td>1,070</td>
<td>398,491</td>
<td>1,062</td>
<td>396,544</td>
</tr>
<tr>
<td>Over 500 rooms</td>
<td>503</td>
<td>478,561</td>
<td>498</td>
<td>476,562</td>
</tr>
<tr>
<td>Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under $30</td>
<td>924</td>
<td>55,692</td>
<td>857</td>
<td>52,830</td>
</tr>
<tr>
<td>$30-$44.99</td>
<td>7,995</td>
<td>509,785</td>
<td>7,518</td>
<td>405,028</td>
</tr>
<tr>
<td>$45-$59.99</td>
<td>16,054</td>
<td>1,044,610</td>
<td>10,850</td>
<td>669,174</td>
</tr>
<tr>
<td>$60-$85</td>
<td>14,280</td>
<td>1,367,826</td>
<td>16,562</td>
<td>1,329,544</td>
</tr>
<tr>
<td>Over $85</td>
<td>8,345</td>
<td>1,433,995</td>
<td>11,803</td>
<td>1,945,890</td>
</tr>
</tbody>
</table>

Data Source: AH&LA (2006). Note * Based on a total of 47,598 properties and 4,411,908 guestrooms. ** Based on a total of 47,590 properties and 4,402,466 guestrooms.
In the U.S., supply increase has also been below the demand increase for several years. The year-over-year demand growth had increased 36 consecutive months in June 2006 when it finally began to slow down (Lomanno, 2006). As the industry is entering into a mature phase of the growth cycle it is witnessing the beginning stages of strong supply growth. The supply has increased on a monthly basis and its growth will speed up since currently there are more than 160,000 new hotel rooms under construction (Lomanno, 2006). The supply growth is expected to continue and reach its highest levels in a decade in the next several years (Lomanno, 2006; Gunter, 2006). The supply growth is forecasted to stay below demand growth in 2006 and 2007 (Smith Travel Research, 2006).

Figure 6.1 describes demand and supply mechanism of the industry and the current phase of the cycle, movement towards peak, which is marked with an arrow. It is estimated that currently the overall supply growth is below normal level of the cycle (Ernst & Young, 2006).

**Figure 6.1 Demand and Supply Mechanism in Different Phases of Industry Cycle.**

**Movement towards peak**
- Demand response
  - Normal rate of increase

**Supply**
- Construction begins as ADR approaches feasibility level

**Movement from peak**
- Demand response
  - Normal decline

**Supply**
- Construction slowly halts

**Severe demand-based recession**
- Demand response
  - Rapid decline

**Supply**
- Construction stops abruptly

*Based on Corgel, 2005, p.14.*
The 10 and 25 year averages for new hotel room construction starts are 108,652 and 82,625 respectively (Smith Travel Research, 2006). It is forecasted that construction of new hotel rooms will increase by 45% over 2005 to 119,000 new rooms in 2006 this is still estimated to be inline with the averages. The level of construction is the highest since 2000. The amount of new hotel room constructions was 82,625 in 2005 and 80,038 in 2004. One of the drivers behind the 2006 supply increase is the highest three-year lodging RevPAR increase in the U.S. since 1981 (Smith Travel Research, 2006). The estimated amount of new hotel rooms opening in 2006 is 88,711, and 100,000 in 2007 (Ernst & Young, 2006).

The largest percentage supply growth has estimated to be in the mid-price hotels without food and beverage and upscale hotels segments (Ernst & Young, 2006; Gunter, 2006). Lenders and investors in the industry have been showing special interest towards full-service segment due to the higher entry barriers in that segment and higher expected profit potential (PKF Consulting, 2006b). For them the most attractive property type is a full-service well-branded hotel in a decent condition in a major city or resort location (PKF Consulting, 2006b).

Table 6.2 presents the current development pipeline at the U.S. based on the phase of the development process (Smith Travel Research, 2006). The pre-planning phase refers to a phase where the architect for the project is not yet defined. The construction pipeline includes 3,436 hotels and it’s still growing in 2006 but not as fast as in 2005. This is due to shortage of quality building sites, increasing interest rates, and escalating construction costs and price of land (Gunter, 2006).
Table 6.2  Total U.S. Active Development Pipeline of Rooms.

<table>
<thead>
<tr>
<th>Phase</th>
<th>Sep 2006</th>
<th>Sep 2005</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Construction</td>
<td>163,434</td>
<td>95,967</td>
<td>70.3%</td>
</tr>
<tr>
<td>Final Planning</td>
<td>58,010</td>
<td>18,226</td>
<td>218.3%</td>
</tr>
<tr>
<td>Planning</td>
<td>312,832</td>
<td>168,687</td>
<td>85.5%</td>
</tr>
<tr>
<td>Active Pipeline</td>
<td>534,276</td>
<td>282,880</td>
<td>88.3%</td>
</tr>
<tr>
<td>Pre-Planning</td>
<td>79,104</td>
<td>56,489</td>
<td>40.0%</td>
</tr>
<tr>
<td>Total</td>
<td>613,380</td>
<td>339,369</td>
<td>80.7%</td>
</tr>
</tbody>
</table>

*Data Source: Smith Travel Research (2006).*

### 6.2 Renovations

The other potential target market for experience design is the renovation projects. An annual survey of 1,500 general managers in the U.S. in 2006, found that for 27% of the respondents it had been less than a year since the hotel was last renovated (H&MM, 2005a, 2006a). In 2005 the percentage was 24.6%. There has been a decrease from 28% in 2005 to 15.7% in 2006 in renovations taking place at the moment and within next 6 months. However, there is a positive increase in renovation plans occurring within the next year. The renovations and renovation plans are summarised in Table 6.3. (H&MM, 2005a, 2006a)

Table 6.3  Renovations and Renovations Plans in U.S. Hotels.

<table>
<thead>
<tr>
<th>Renovation done</th>
<th>2005</th>
<th>2006</th>
<th>Renovation plans</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than a year</td>
<td>24.6%</td>
<td>27%</td>
<td>Now to 6 months</td>
<td>28%</td>
<td>15.7%</td>
</tr>
<tr>
<td>1 to 3 years</td>
<td>31.6%</td>
<td>30.4%</td>
<td>6 to 12 months</td>
<td>19.3%</td>
<td>24.6%</td>
</tr>
<tr>
<td>4 to 5 years</td>
<td>23.3%</td>
<td>21.6%</td>
<td>13 to 18 months</td>
<td>11%</td>
<td>14.2%</td>
</tr>
<tr>
<td>6 to 10 years</td>
<td>17.9%</td>
<td>17.7%</td>
<td>19 to 24 months</td>
<td>7%</td>
<td>8.4%</td>
</tr>
<tr>
<td>10 years +</td>
<td>2.74%</td>
<td>3.3%</td>
<td>2 to 3 years</td>
<td>17.3%</td>
<td>18.8%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>4 or more years</td>
<td>17.3%</td>
<td>18.4%</td>
</tr>
</tbody>
</table>

*Data Source: H&MM, (2005a, 2006a).*

### 6.3 Hotel design services

Hotel construction and renovation statistics tell about the activity in the industry related to designing guest experiences. However, to be able to estimate the market potential for experience design services, the hotel design segment needs to be studied in more detail. As
defined in Chapter 5, the interior design services in the hotel industry are most similar to the experience design services.

A study on hospitality design services revealed that 75 of the largest hospitality design companies globally get almost half of their project fees from hotel projects. The total amount of fees from hotel projects was approximately $187 million between July 2005 and June 2006. This is expected to increase in the next year to over $223 millions. The project fees do not include revenues from projects given to the subcontractors. Among the hotel projects, over 70% came from the luxury hotel segment. Two other segments, boutique and mid/economy segments, shared rest of the fees. The percentages of project fees and dollar amounts are presented in Table 6.4. (Davidsen, 2006, p.38)

<table>
<thead>
<tr>
<th>Hotel projects from all hospitality projects</th>
<th>2006</th>
<th>2007 forecast</th>
<th>2006</th>
<th>2007 forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxury</td>
<td>35.4%</td>
<td>27%</td>
<td>$134,514,506</td>
<td>$168,335,543</td>
</tr>
<tr>
<td>Boutique</td>
<td>6.2%</td>
<td>30.4%</td>
<td>$23,559,038</td>
<td>$28,055,924</td>
</tr>
<tr>
<td>Mid/Economy</td>
<td>7.6%</td>
<td>21.6%</td>
<td>$28,878,821</td>
<td>$27,179,176</td>
</tr>
<tr>
<td>Total</td>
<td>49.2%</td>
<td>17.7%</td>
<td>$186,952,365</td>
<td>$223,570,643</td>
</tr>
</tbody>
</table>

*Data Source: Davidsen (2006).*

Hotel design services industry is characterized by a few major players and a large number of smaller companies. Only 9 companies generate over $10 million of project fees annually and only three of them achieve over $20 million. About half of the largest 75 companies have less than $2 million project fees annually. (Davidsen, 2006, p.26-34)

The annual listing of top hotel design firms by H&MM (2004, 2005b, 2006b) gives a more positive estimation on the market size. In their listing, the top 20 companies generate over $411 millions in lodging fees in a 12-month period ending June 30, 2006. Fees increased over 64% from 2005 while the number of project grew only by 19%. The top 20 companies faced a
significant increase in number of projects in 2005 compare to 2004. The total fees and number of projects of the top 20 companies are presented in Table 6.5.

Table 6.5  Lodging Project Fees and Number of Projects of Top 20 Companies.

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>% change</th>
<th>2005</th>
<th>% change</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees in millions</td>
<td>$184.3</td>
<td>35.9%</td>
<td>$250.4</td>
<td>64.5%</td>
<td>$411.8</td>
</tr>
<tr>
<td># of projects</td>
<td>338</td>
<td>72.2%</td>
<td>582</td>
<td>18.9%</td>
<td>692</td>
</tr>
</tbody>
</table>


In H&MM’s survey the top 20 companies are mainly concentrated in upper-upscale and upscale segments if resorts are excluded – 18 of them named upper-upscale as one of their top segments while upscale was mentioned by 15 companies (Table 6.6). Compared to 2005 there has been increase in concentration to upper-upscale segment. None of the leading companies is concentrating on the economy segment. (H&MM, 2005b, 2006b)

Table 6.6  Segments Served by Top 20 Companies.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Companies 2005</th>
<th>Companies 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upper-upscale</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>Upscale</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>Mid-scale w/ F&amp;B</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Mid-scale w/o F&amp;B</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Economy</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

7 CONCLUSION

The U.S. hotel industry is highly aware of the importance of engaging and memorable guest experience as one of the few means left for them to compete and differentiate in increasingly commoditized market. Even though the industry has experienced positive growth in all key performance measures in past few years it has become increasingly difficult for hotels to avoid amenities creep and price based competition.

The industry is facing two key challenges regarding creation of guest experiences. First, to be successful the guest experience needs to be coherent. All the components in the experience need to be inline and communicate the same theme. This can be challenging for the hotel industry since there is a large number of participants in the experience creation and all of them have influence over different set of components. Moreover, the industry is still highly fixed in the service mindset and has not moved fully to the experience mindset. It is focusing on improving the functioning of the hotel as a product and efficiency in processing of guests as input and output in a service process. In an experience mindset, guests and their individual experiences are the focal point in experience creation.

Experience design offers solutions to these challenges. It creates an experience solution from the guest’s perspective and takes all the experience components into account. Experience design solutions are built to engage guests in all experience levels and realms. Its objective is to get guests to spend more time and money in the experience throughout the entire lifecycle of the customer relationship. Experience design recognizes the guest as an active participant in the experience, and their preferences and behaviour are captured through the observational research methodology it uses. Moreover, the discipline understands the opportunities technology offers in
the creation of the experience. Experience design offers hotels and brands an opportunity to
differentiate and create emotional connection with the guests.

Figure 7.1 presents the complexity of guest experience creation in the hotel industry at
the moment. It shows the main components of the guest experience and which players participate
to the creation on specific components and have influence over their creation. Guest experience
creation with experience design offering is presented in Figure 7.2.

Figure 7.1  Guest Experience Creation in the Hotel Industry without Experience Design.

Hotel Guest Experience

Physical property | Room design and amenities | Brand and theme | Marketing comm | Sales channels | Service

Owner | Architect | Contract designer | Guest | Brand | Hotel mgmt | Hotel staff

Developed by author.
Based on the secondary research and interviews, the main components of the hotel guest experience are physical property, room design and amenities, franchisee brand and experience theme, sales channels, marketing communications, and finally the service at the hotel. What is critical for a successful guest experience is that all the components are inline with the selected theme of the experience. They all communicate the same message, and create same look and feel of the experience to the guest. The experience promise and actual experience needs to be the same. For example, the marketing message that communicates the promise of the experience needs to be consistent with the experience gained when booking a room on the internet or by phone. Moreover, the coherency needs to continue when the guest arrives at the hotel and is greeted by the hotel staff and when they open guest room door. If one of these components fails to be inline with others, the guest will not trust the genuineness of the experience.
As can be seen in Figure 7.1 the main participants in the guest experience are the owner, brands, architects, contract designers, hotel staff, hotel management, and guests. Other less influential participants such as service providers, suppliers, channel partners, and construction contractors are not listed in the figure. All participants contribute to the creation of guest experience differently and they have influence over different sets of components. The only participant that has influence in all of the components can be argued to be the franchising brand. However, it should be remembered that it is the owner of the physical property who selects the possible franchising brand. The different participants are driven by different goals, perceptions, and measures for successful guest experience. It seems that guests, the key participant whose individual experience hotel business is trying to build, do not currently have influence over most of the components.

The complexity of the participants and their influence over the experience creates a threat of incoherency in the created experience that can lead to confusion and dissatisfaction among guests. Thus, there is an opportunity for the experience design offering that takes all these components into account from the guests’ perspective. The experience design solution is built on the guests’ needs and behaviour.

The offering, potential customer segments, key competitors, and the positioning of the experience design offering will be discussed further in the following chapters.

7.1 Experience design offering

Based on the secondary search and interviews there is a need for experience design offering that creates the experience from the guests’ perspective integrating all the components of the experience to the solution.
It seems that the current solutions that contribute to building guest experiences do not fully take into account four key characteristics of an experience. In addition to components, guest experience design should take into account the layers of the experimental world, experience realms, and lifecycle of the experience engagement. Moreover, integration of technology into experience creation could be improved.

As mentioned, experience creation should take into account all the different components that create the guest experience and develop a coherent solution based on them. The current players usually concentrate only on limited number of components. Second, the creation should also consider the different layers of the experiential world of the guest. Thus, the experience should be created not just based on the product (hotel) and service but also on the product category, usage and consumption situation, and socio-cultural context. Moreover, to create a successful guest experience the four different realms, the entertainment, education, aesthetic, and escapist realm, should be included in the solution. It is suggested that experience that combines all these four realms creates the most engaging experience for the guest. For hotels this means offering guests an opportunity to take part in all types of realms if they want to. For example hotels are usually more familiar with offering aesthetic and entertainment types of experiences than educational and escapist ones. Finally, the process of engagement with the experience should be given attention to. Experience for the guest is not just one stay in particular hotel, but it is a process developing throughout the customer relationship. Experience design recognizes this perspective. Its goal is to make the guest stay longer, come more often, and be more engaged with the experience, not just to get the best price for one stay.

Experience design also integrates technology into the experience. Clearly the opportunities related to technology are not fully recognized in the industry. Technology that can be used in the experience varies widely from CRM and centralized reservation systems to conference facilitation technologies and high-tech products in the guest rooms. Technology can
help hotels to for example create the different realms (e.g. entertainment systems in guest rooms),
customize guest's stay (e.g. CRM system that stores individual preferences), and give power to
the guest in the experience (e.g. selecting on-demand movies). A challenge related to technology
as room amenities component is that the technology lifecycle is much faster than the investment
or renovation cycles of the industry.

To summarize, the benefits of experience design are related to creating emotional
connection with guests through all the experience components, building relationships with guest
in an individual level, and looking experience solution from the guests’ point of view. The
experience design offering adds value to the hotel business through differentiation, increased
guest loyalty and satisfaction, increased revenues, avoidance of amenities creep, and additional
revenues from memorabilia.

7.1.1 Three types of solutions

Experience design offering to the hotel industry could have at least three different forms.
These are experience design solutions for individual properties in new builds and renovation
projects, brand level experience development, and strategic level consultation projects. The first
offering is creation of the guest experiences on a property level for new constructions or
renovations. This would mean designing the experience from the perspective of target customers
at the particular hotel property. It would include combining the experience components and the
tailoring the solution to fit with local characteristics and the wishes of the particular owner and
brand. Second, there is an opportunity to offer brand level guest experience development projects.
This offering would include development of new guest experience concept or revitalizing old
ones. The solution could provide a complete experience design process or parts of it. Thus, it
could include for example market research, concept development, building and testing prototype
rooms or environments, and developing experience guidelines for implementation. One extension
to the offering could be including a product design or 'memorabilia design' to the solution that
utilized the emerging interest of brands to sell their signature products to guest to extend the
experience to their homes. Finally, strategic level consultations could include projects related to
innovation and design strategy, future trends in the industry, usage of technology in experiences,
and product portfolio and pipeline. The consultations would use the innovation and design tools
of the experience design discipline that the target customer segment might not have in-house.

The market for all the offering types is expected to be favourable and growing for next
years due to the growth in new builds pipeline, solid renovation activity, and increase in hotel
design services demand.

7.2 Potential customer segments

Potential customers for experience design services include hotel brands and hotel owners.
These are the two key players that have decision-making power in the experience creation and
currently purchase hotel design services.

7.2.1 Brands

Brands are a significant player in defining and developing experiences. Lately most
innovative and industry changing innovations related to guest experiences have come from the
brands. Even though they have in-house functions related to the experience design offering,
arbor and design and strategic level business development, they purchase design services.
The offering for the brands would be the creation of a new experience concepts and strategic level
consulting. The business model for this segment would be project based and possible royalties in
concept development projects based on the number of properties or rooms the new concept is
implemented in.
There are at least six characteristics that should be taken into account when defining the most appealing group of brands to target the services. As the experience design offers tools for differentiation most appealing customers would be the ones already facing the commoditization threat and amenities creep. Most likely these brands would have a large portfolio of hotels targeting to both leisure and business travellers. They would be situated in a crowded market place like near airports or city areas. They would also have lost the battle of being among the first ones introducing improved bed experience and thus facing difficulties to turn the investment into their bottom-line.

Another characteristic is the owner base of the brand. The most attractive situation is one where the brand owns a large percentage of its properties. This would enable the brand to test concepts with its own properties and prove benefits to rest of the owners. A very disperse owner base might be more risk averse for new concepts and resist their implementation.

The third characteristic is brand’s guideline policy. Brands with more centralized decision making model i.e. more strict brand guidelines would be more attractive group to sell concept development projects. These brands would have the power to create new guest experiences knowing that the owners will implement them. Another way to detect this is to find brands that have a self-explanatory or undisclosed motifs theme strategy. Target customers could have in-house design team but a more appealing case would be brands without extensive in-house expertise. This is because a strong team might limit the options to sell complete experience design solutions as the brand might be interested to bring the external design service provider in only later stages of the design process. Moreover, they might not be interested in strategic level consultations since they might already have people responsible for e.g. design strategy. Moreover, brand’s current presence or interest towards entering retail space through its own online store or partnerships might be one characteristic to look for.
Finally, brands in the resort, luxury, upper upscale, and upscale segments might not be as attractive due to the high competition presented by leading interior design companies in those segments. As mentioned the largest percentage supply growth is currently, in addition to the upscale hotel segment, in the mid-scale without food and beverage segment.

The key success factors for selling to the brands would be in creating a means to differentiate, improving guest satisfaction and loyalty, enhancing brand recognition, and increasing the franchising fee revenues from hotel operations and revenues from sales of memorabilia products. The departments to whom the offering should be targeted are mainly the strategic level business development, marketing, and in-house architecture and design.

7.2.2 Owners

The other possible target segment is the owners of the hotel properties. Owners are the ones building the properties and investing capital for renovations. They have the final say in investments and they are free to change the brand if the experience the brand offers does not support their vision or portfolio. To this segment, the offering is property level experience design solutions for both new builds and renovations. Strategic level concept development or consultations would not necessarily be appealing to the owners since the prototypical concepts come from the brands. The business model for this segment is selling experience development projects for individual properties since solutions created for one property would not be easily copied to next due to variety of brands in the owner’s portfolio.

In this customer segment there are certain characteristics that differentiate the most appealing group of customers. Most valuable would be to target owners that have a large number of hotel properties in their portfolio and these properties are in highly competitive locations that are difficult to differentiate. The brands they have in their portfolio should be less strict in their brand guidelines and have room for local decision-making. It may not be valuable to target
owners with in-house design teams. Obviously owners with portfolios at the end of investment cycle or active new constructions plans would be the most attractive in terms of getting as much business from one customer as possible.

The key success factors for selling to this segment are emphasis in increased profits, reduced operation costs (e.g. utilities, labour, room), improved capitalization rate, increase in revenue generating space through e.g. fees to separate experiences, and life span or durability of the solution. The decision makers for purchases in this segment are the top management of the owning entity and possibly the asset managers of individual properties, and lenders of capital.

The challenge related to this segment is that the projects would occur locally and would most likely require local presence during the projects. The projects would also be smaller but building on-going relationships with a set of owners might be more effective than trying to sell larger concept development projects to a handful of leading brands in the U.S. market. It might be easier to enter the market through the owner segment since the property level projects, especially renovations, may not be considered as risky and extensive as brand level ones.

7.3 Key competitors

The key competitors for the experience design offering are the contract designers (interior design companies, decorators, and specialized design services). While most of them are not direct competitors they are well-established groups with a long history for offering design services to the industry. Direct competitors i.e. other design consultancies with roots in the industrial design discipline offering experience design solutions to the hotel segment are currently rare.

Demand for hotel design services has improved significantly in past three years. The project fees and number of projects of the top hotel design companies has increased. As
mentioned the leading hotel design companies in are concentrated in resort, luxury, upper up-scale, and up-scale segments.

The differentiation among this group can be challenging in the eyes of the customer. The main differentiating factors for experience design are focusing on guests and their behaviour and needs, creating a cohesive experience taking into account all the components, and integrating technology to the solution.

7.4 Positioning statement

The experience design services should be offered to hotel brands and owners who are interested in differentiating their brand or hotels and improve the guest experience, and consequently improve the performance of the hotels. The challenges for the customers are lack of guest perspective in the current solutions and inconsistency in the experiences created by multiple participants. The experience design offering creates solutions focusing on the guest, and their needs and behaviour. Moreover, it creates a coherent and engaging guest experience by taking into account all the experience components, realms and layers, the lifecycle of the experience engagement, and technology. The experience design offering adds value to the customer through differentiation, increased guest loyalty and satisfaction, increased revenues, avoidance of amenities creep, and additional revenues from memorabilia.

7.5 Future research

There are several of possible areas for future research. The participants and their role, decision-making power and added value could be further studied. This would create better understanding of the value chain in guest experience creation in the hotel industry. Additionally, the components creating the guest experience in the hotel industry could be explored more. Especially, their importance in the eyes of guests could be studied and their effect on the
performance measures used in the hotel industry could be researched. The linkages between the
guest experience in hotel and the travelling experience could also be studied to create better
understanding of how the different participants in the travelling value chain are connected and
what could be done to improve the entire travelling experience for the customer. Finally, more
research is needed related to market and business opportunity, customer segments, and
competitive landscape of the experience design offering to further develop the business case into
a viable business plan.
APPENDIX

List of interviews

Victor Burt, Senior Director of Operations, Northwest United States and Western Canada, Starwood Hotels and Resorts Worldwide Inc., November 10, 2006,

Marion Harper Treskin, General Manager, the Westin Grand Vancouver, October 13, 2006.

Darren Judd, Manager, Residence Inn by Marriott Vancouver, September 27, 2006.

Susan Labentsoff, Director of Sales & Marketing, Residence Inn by Marriott Vancouver, September 18, 2006.

Smith Munro, General Manager, Crowne Plaza Vancouver Hotel Georgia, October 18, 2006.

Manuel Sousa, Senior Director of Sales and Marketing, Hyatt Regency Vancouver, October 31, 2006.

Steve Veinot, General Manager, Hilton Vancouver Airport, November 1, 2006.

Edith Wormsbecker, President BID RID IIDA, MCM Interiors Ltd., December 12, 2006.
REFERENCE LIST


79


