THE POLITICAL ECONOMY OF HOTEL-MOTEL DEVELOPMENT: A CASE STUDY OF THE INDUSTRY IN NEW ENGLAND

by

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Submitted to the Department of Urban Studies and Planning
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ABSTRACT

This thesis presents an industrial case study of the hotel-motel industry in New England. The study attempts to examine a series of empirical and theoretical questions pertaining to the industry in the region and the U. S. Investigation focuses on three inter-related issue areas concerning capital investment in the region: the influence of risk and seasonality; the effect of economic conditions (i.e., the business cycle); and the capital/labor substitution phenomena. The case study includes an extensive historical analysis of the origin on the hotel-motel industry, and presents a discussion of recent trends of industrial performance and structure.

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CHAPTER I: INTRODUCTION

Hotels and motels constitute a growing industry whose primary functions are to provide lodging, food service, and meeting facilities for the business and recreational needs of the country. The industry occupies a key position in the large "travel" segment of the economy, and is part of the expanding service sector. Receipts for the first time are expected to exceed $20 billion in 1979.

Despite its obvious importance, relatively little effort has been directed towards developing a full understanding of this industry. Commenting on its own investigation of the travel industry in 1973, the National Tourism Resources Review Commission noted that it felt "like an explorer who has stumbled upon a new continent."[1] This is, in part, due to the fact that both industry and, to a certain extent, organized labor have chosen to keep a low profile and eschew federal and state "interference."

The industry's situation of relative anonymity changed over the past two years when it became increasingly involved in national and local public policy debates. Proposals to institute gas rationing, boost the minimum wage, and eliminate the "three-martini-lunch" business deduction have all elicited strong, vocal protests, and predictions of dire consequences by industry spokespersons.

Controversy has also surrounded the allocation of - at the time of this writing - some 200 million dollars in the Department of Housing and

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[1] National Tourism Resources Review Commission, Destination U. S. A., Vol. 1, Summary Report, (Washington: Government Printing Office, June 1973), p. 1.

Urban Development's "Urban Development Action Grant" (UDAG) Program to hotel and hotel-related projects. The purpose of these grants is to obstensibly foster the "revitalization" of central cities. Critics charge that most hotel jobs are low paying, "dead-end," and seasonal; while complaining that the grants constitute an unnecessary capital subsidy to projects which would have been built anyway.

The H. U. D. Secretary has rejected these criticisms and stated that: "Hotels are the best employers of low and moderate income and unskilled people that I can think of. It is possible to start as a dishwasher and end up as a chef."[2] H. U. D. estimates that 12,152 hotel jobs will be either saved or created as the result of its fiscal 1978 UDAG program.[3] Moreover, the Department claims that these projects are all "leveraged" - which is to say, that public UDAG funds stimulated private investment which would not have occurred otherwise.

In the New England region, the lodging industry has recently stepped up its efforts to increase government travel promotion budgets. As a result, the New England Regional Commission has sponsored a $250,000 media campaign with "I'll take New England Any Day" as its slogan. (Ironically, the double entendre of this statement has escaped the slogan makers.) Industry

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[2]Quoted in, "Let 'em Wash Dishes," Disclosure (Chicago: National Training and Information Center, April 1978), p. 3.

[3]Susan Jacobs, "The Urban Impacts of HUD's Urban Development Action Grant Program," forthcoming in Norman J. Glickman (ed.), The Urban Impacts of Federal Policies (Baltimore: John Hopkins University Press, 1979), table 3.

trade associations are also attempting to encourage individual state legislatures to increase public financial assistance to their industry. In Vermont, for example, the industry has claimed that tourism is countercyclical in recessionary periods.[4] In Massachusetts, the hotel-motel association is backing a bill to provide state financing for convention facilities as one means to increase industry revenues (although the rationale being used is that it will boost tax revenues).

Individual hotel projects have sparked conflict within metropolitan areas. In Boston, the conundrum surrounding a proposed 395-room hotel slated for the Waterfront area has resulted in the dismissal of the city's redevelopment director, an investigation by an independent city watchdog agency, and strong neighborhood opposition. "We are being invaded!," a neighborhood spokesperson insists, "Tourism is taking over here - it's perpetual Mardi Gras. The hotel is the end of the line. I told that Mayor White: 'You'll have to decide: will this be a business district or a neighborhood?'"[5]

Neighborhood activists in numerous cities link the current boom in hotel development with what they perceive as the general trend towards "gentrification" of the city and displacement of the poor. "They're already moving me out of my home," reports a Baltimore tenant. "Say they offer me a hotel job and business goes bad. Then I'm out of a home and

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[4] "Survey '79," New England Business (Vol. 1, no. 1, January 16, 1979), p. 33.

[5] Janey Scott, "Long Wharf Politics," The Real Paper (Vol. 8, no. 24, June 16, 1979), p. 6.

a job, worse off than before."[6]

Objective of the Study

This case study does not propose to directly address all of the issues that have been raised thus far. Its objective is not to provide a comprehensive study of employment in the industry or to fully discuss the fiscal impacts of hotel-motel development. These are important issues which merit careful consideration. They are timely questions as well, both because the industry is about to enter the "boom" phase of its "boom - bust" cycle, and because there are presently more and more calls for public capital subsidies for this new construction.

The objective of this case study is to examine private investment in the hotel-motel industry in the New England region. The study does not purport to be a definitive analysis of the industry in the region. Rather, its purpose is to examine the structural dynamics behind the placement of private investment in the industry, using New England as a case example.

Methodology of the Study

The analysis is based on a mixture of new and existing data sources. A great deal of information has been extracted from the U.S. Bureau of the Census' Census of Selected Service Industries and National Travel Survey. Regrettably, the last available complete year for these Census data is 1972. Since data for 1977 is expected to be published by late 1979/early 1980, no attempt has been made to

[6] Disclosure, op. cit., p. 3.

estimate updated figures based on the earlier survey, although some advance statistics have been used.

The primary source of new information comes from structured interviews with enterprise owners and managers, government officials, trade unionists, and institutional lenders. These interviews were conducted during the winter and early spring of 1979 in three New England states. A total of twenty one such interviews were completed.

This study also makes new use of an existing data source. The analysis of labor will depend partially upon output from the Social Security Administration's one-percent sample Longitudinal Employee-Employer (LEED) file covering the period 1967 - 1975.[7]

Organization of the Study

This case study is divided into four additional chapters. Chapter II examines the historical origins of the modern hotel-motel industry. The chapter emphasizes the economic functions that the industry fulfills in servicing the business and recreational sectors. The business sector utilizes hotels and motels to further the exchange of produced commodities and support the administrative function of the modern corporation; and to make the actual production process more efficient through the transferance of information essential to production planning and the advancement of production techniques.

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[7]For a discussion of this source, see Barry Bluestone, Alan Matthews and Lynn Ware, Worker Mobility in the New England Region (Cambridge: Joint Center for Urban Studies of MIT-Harvard, New England Economy Project, Working Paper No. 3, December 8, 1978).

Chapter III presents a discussion of production and risk in the industry. The chapter begins by examining the different types of operations within the industry, i.e. hotels and motels. The balance of the chapter consists of an analysis of the risk structure of the industry -- both for different types of operations and different geographical regions. The chapter concludes with a brief presentation of various risk reduction strategies.

Investment in the lodging industry, as with other enterprise groups, is predicated on profitability. But profitability, and even the basis for profitability, is not always apparent in the hotel-motel industry. Chapter IV examines the institutional aspects of investment in the lodging industry. This includes an analysis of investment over the past twenty years.

The final section, Chapter V, describes how the investment decision is played out geographically; and what some of the implications are for the New England region's workforce.

Chapter II: Historical Origins.

This chapter traces the history of the modern hotel-motel industry from its origins in the early nineteenth century. Hotels emerged as a new form (distinguishable from the earlier tavern) designed to service the exchange needs of urban mercantilists. Hotels were considered risky ventures from the outset, and their development was often linked to urban land speculation.

Hotels, and later motels, have served important economic functions -- furthering the exchange, production, material distribution, and administrative goals of commerce. It was only later in the development of the industry that hotels and motels became important services to the leisure activities of the populace.

EARLY COMMERCIAL HOTEL: THE EXCHANGE AND LODGING FUNCTION

The modern commercial hotel emerged during the first decades of the 19th century as a direct outgrowth of the pecuniary interests of the urban mercantilist class. The hotel provided the actual physical conditions necessary for the successful completion of mercantile exchange activity. So closely linked were the commercial and lodging uses that, between 1800 and 1860, the words "hotel" and "exchange" were practically synonomous. The early hotel offered a physical arena for buyers and sellers, guardians of commodities unable to go to market on their own account.

The Exchange Coffee House

The first grand hotel was Boston's Exchange Coffee House, which opened in 1808. It was, at the time of its construction, "the largest building in America" and Boston's first skyscraper -- rising to the then-unheard-of-height of seven stories. The Exchange housed over 200 apartments containing nearly 300 rooms. It boasted a huge Exchange Room with multiple galleries, and a then-famous central staircase leading up to a naval observatory within a gigantic, tin-plated dome. There were, in addition, numerous ballrooms, dining halls, and "society rooms."[1]

The Exchange Coffee House was built in response to a number of economic and political developments within mercantile Boston. These included: a great increase in the number of commercial agents travelling to Boston, and

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[1] Doris E. King, "Early Hotel Entrepreneurs and Promoters, 1793-1860," Exploration In Entreprenuerial History (Cambridge: Harvard Research Center in Entreprenuerial History, VIII, Feb., 1956), p. 152.

inadequate lodging and exchange facilities within the city for them; a deficiency in physical support for local merchants; the growth of a large pool of investment capital; the emergence of a burgeoning downtown real estate market; and, the presence of leading mercantilists who recognized the potential benefits that a hotel-exchange might bring to the city.

Both foreign and domestic commerce flourished in Boston during the first decades of the 19th century. Foreign trade multiplied as the result of American neutrality during the Napoleonic Wars, and was left largely unaffected by Jefferson's restrictive Embargo in 1807 (which Boston merchants chose to ignore). This expansion of trade brought with it a tremendous increase in the number of importer's agents and European merchants into the port city.

Boston also experienced an influx of travelling retailers eager to purchase various provisions. By the early 1820's it could still be said that: "In the United States there are no commercial travellers; consequently, the shop or storekeepers are obliged to repair to larger towns... . There is, therefore, always a great concentration of persons at the principal seaports, to purchase groceries, woolens, cotton goods, etc."[2]

This veritable invasion of commercial agents soon overburdened the city's transient lodging houses, inns, and exchanges. A new Merchants

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[2]Cited in Allan R. Pred, Urban Growth and the Circulation of Information: The United States System of Cities, 1790-1840 (Cambridge: Harvard University Press, 1973), p. 150

Exchange was erected on State Street, but most merchants continued to work at their places of residence (also primarily on State Street). However, as these original merchant's homes were converted into banks, insurance offices, accounting houses, and other commercial services, many mercantilists moved into new residences outside the limits of the original colonial town. This decentralization of mercantile residence/place of work proved costly, however, since "speculative marketing and complicated credit requirements of the carrying trade required a location adjacent to the sources of market information."[3]

Consequently, Boston merchants sought to return to the downtown area where information was easily disseminated and transactions more easily handled. Central location leant itself to increased efficiency at a given cost, and - as a result - additional mercantile profits. This locational advantage became increasingly apparent as trade expanded and hinterland purchasers and commercial representatives flocked in increasing numbers to established mercantile centers. However, the physical means of support for this burgeoning activity in the downtown area was clearly deficient.

A new group of entrepreneurs, real estate speculators, emerged to both accelerate and capitalize on the concentration of commercial activities in the downtown core. Real estate speculators sought, either through buying and selling or rental, to capture a portion of the increased mercantile profit in the central commercial district.

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[3] David Ward, "The Industrial Revolution And The Emergence of Boston's Central Business District," Economic Geography (Vol. 42, No.2, April, 1966), p. 157.

This speculative activity was itself fueled by mercantilists in search of investment opportunities. It is estimated that, during the first half of the nineteenth century, mercantile interests were absorbing fully 42 cents out of each dollar of final sales.[4] New legal and financial formations (i.e., the joint stock company) greatly increased the liquidity and mobility of this capital and facilitated investment activity in new areas of business.

When Andrew Dexter, Jr., Boston lawyer and real estate speculator, set out to "found" the nation's first grand hotel in 1806, the commercial need and financial structure necessary to support such a venture were already in place. What Dexter soon discovered, however, was that hotel undertakings entail considerable front-end risk and require adequate working capital during the rent-up stage.

Dexter purchased the block of land formed by Congress, Devonshire, Water and State streets in the heart of the downtown. He gave purchase-money mortgages to the sellers and commenced construction utilizing his own private capital. The hotel portion of the building opened in May, 1808, but by the following January Dexter had run out of operating cash. Dexter mortgaged all of his holdings to the Berkshire Bank of Lenox, Massachusetts. This capital infusion kept him in business until June, when the bank took possession of the half-finished structure and Dexter retired to Nova Scotia.[5]

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[4]Theodore Marburg, "Income Originating in Trade," in Trends in the American Economy in the Nineteenth Century (Princeton: 1960), p. 21.

[5]King, Op. cit., p. 152.

Immediately after Dexter's ruin, Boston's leading citizens moved in to rescue the Exchange. A new "Exchange Company" was formed, with prominent Boston lawyer Harrison Gray Otis as President[6], and the city's leading merchants, bankers, and insurance company officials as associates. The State Legislature was induced to pass an act incorporating the associates, and $250,000 was raised through the sale of public stock. The Exchange Company purchased the hotel from the Berkshire Bank and completed the Exchange portion of the building.[7]

Until its destruction by fire in 1818, the Exchange was "the boast of Boston" and "the very centre of business activity in the Massachusetts capital."[8] The owners were praised in the Boston press as "respectable gentlemen" whose "liberality" in improving the building had kept them from making any dividend "of consequence."[9]

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[6] Ibid., Otis was "A Harvard graduate, a leading Federalist politican, destined to win fame as mayor, congressman, and U. S. District Attorney, but his fortune came from real estate investments."

[7] Ibid.

[8] Robert B. Ludy, Historic Hotels of the World (Philadelphia: David McKay Co., 1927), p. 132.

[9] New England Palladium, Nov. 6, 1818; Columbia Centinel, Dec. 26, 1818, cited in Op. cit., King, p. 152.

Significance of the Exchange Coffee House

The significance of the Exchange is, according to one writer, "that it is probably the first House in which a whole city manifested great civic pride, and for which a city admitted its urgent need."[10] While the exchange hotel itself did not appear to earn a competitive rate of return on investment (it initially went bankrupt), it served the collective needs of the mercantile community.

Through the provision of central location and essential amenities for exchange activities, the Exchange Coffee House helped to speed up the actual physical movement of merchant's commodities. Goods unloaded at the docks remained warehoused pending the completion of the sales process. Full profit was only realized when these goods completed their route of circulation to intermediary retailers and final consumers, and money capital was returned to merchants and the initial producers of commodities.

The development of the hotel as market place facilitator (or service industry) can be viewed as part of the general attempt to minimize the amount of capital required for successful mercantile ventures.[11] Hotel-exchanges were instrumental in reducing the amount of time during which commodities remained in circulation and the capital associated with them remained tied up. This had the effect of maximizing the rate of profit.

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[10] King, op. cit., p. 153.

[11] Alfred Watkins, "Mercantile Cities and the Phase Of Primitive Capitalist Accumulation in the United States," unpublished Ph. D. dissertation (Austin: University of Texas, no date).

The construction of hotels - as well as transportation and communication infrastructure - reduced the turnover time of merchants capital through increasing efficiency in the exchange and movement of goods. The process of buying in order to sell dearer was thus quickened, and the rate of profit increased.

It is little wonder, therefore, that after the "success" of the Exchange "dozens of cities, large and small, were to have merchant's groups build such houses 'for the honor of the town.'"[12] The profit margin on many of these exchange-hotels must have been slight, for in the Panic of 1819 a good many of them went out of business. New hotel construction did not begin again until the Depression had lifted in 1825.

The Exchange Coffee House, and many of the other early hotels, served as a site of collective consumption for urban mercantilists. The hotels were used to complete transactions (some houses issued their own script), lodge travelling merchants, provide food and entertainment, and act as a source of information. Although the hotels were instrumental in raising the general rate of profit, it is unclear that the houses themselves served as great sources of capitalistic accumulation. The earliest attempt to resolve this contradiction was to place hotel ownership with those leading mercantists secure enough in their wealth to accept a marginally lower rate of return.

The second attempt was aimed at increasing profitability through the introduction of professional management. Previously, the innkeeper had

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[12] King, Op. cit., p. 153.

been a sole proprietor living on the premises. With the Exchange Coffee House, management was separated from ownership and given responsibility over staffing and procurement of material goods.

Inter Urban Competition and Luxury Consumption

Competition, especially among port cities, for increased domestic and foreign trade became acute after the economic recovery of 1825. "A complex of city imperialisms arose," notes Arthur Schlesinger, Sr., "each scheming for domination, each battling with its rivals for advantage."[13]

One important manifestion of this inter-urban competition was new hotel construction. Mercantile elites competed among each other to produce the largest and most luxurious hotels. Generally, a group of "civic minded" merchants would take the lead and form a hotel company. The official spokesperson of such a goup was likely to be "a lawyer-politican, with a past record of real-estate speculation."[14]

Chief among the hotels of this period were Baltimore's City Hotel and Boston's Tremont House. The City Hotel, which opened in 1826, was planned,

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[13]Arthur Schelesinger, Sr., "The City in American Life," in P. Kramer and F. L. Holborn, eds., The City in American Life (New York: Putnam's, 1970) p. 28.

[14]King, Op. cit., p. 156.

owned, and financed by the Brown family of Baltimore.[15] The hotel was managed by the same man who had run the Exchange Coffee House. The City Hotel was so important to the commercial and social life of the city that in 1860, when the hotel became involved in litigation, a Baltimore judge ruled that the house must be kept open because as a "first-class hotel" it had become a "public institution and a public necessity."[16]

Boston's Tremont House opened in 1829 and had an almost immediate effect throughout the country. As one commentator noted:

> Every city in the nation... wanted a hotel as grand as the Tremont, or better, and got it as speedily as possible, whether there was business enough to justify it or not. Generally, there was not, but American enterprise had accepted the theory that good hotels make for much travel, and that no city amounts to anything unless it has one or more which the community can lavish prodigal admiration and which gives outsiders a favorable impression of the city's greatness, enterprise, and hospitality.17

The Tremont House stood as the standard of luxury for the nation's hotels. It was built (at a cost of $200,000) and owned by a company headed by William Harvard Eliot and several other leading merchants. The Tremont featured

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[15] Alexander Brown and Sons was the only American-based firm among the leading Anglo-American merchant bankers. The Browns were also the principal organizers and backers of the Baltimore and Ohio Railroad. See Alfred Chandler, The Visible Hand, p. 28.

[16] King, Op. cit., p. 154.

[17] Jefferson Williamson, The American Hotel, An Anecodatal History (New York: Alfred A. Knopf, Inc., 1920), p. 28.

170 private rooms, doors with locks, indoor plumbing, and every room supplied with free soap.[18] The Tremont catered "only to the upper stratum of European visitors and those Americans who were getting on in the world;" and made itself exclusive "by fixing a flat two-dollar-a-day rate"[19] (approximately three days wages of a non-agricultural worker). "The hotel lobby, like the outer rooms of a royal place," comments one writer, "became a gathering place, a vantage point for a glimpse of the great, the rich, and the powerful."[20]

The Tremont House featured a new, more advanced, division of labor within the firm. The Tremont introduced the first bellboys (called "rotunda men") as a luxury service. The hotel also witnessed the standardization of food service. Previously, food was placed on a large table at once and guests ate their fill. In the Tremont, a "French system" was installed whereby guests were divided into small groups for service and each given whatever he ordered. In addition, the Tremont House introduced a sort of military drill for the waiters. This procedure was especially pronounced at banquets, when waiters would march in simultaneously with each course.

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[18] Lundberg, Donald E. The Hotel and Restaurant Business. 2nd Edition. Boston: Cahners Books International, 1976.

[19] Ibid.

[20] Ibid.

Merchants' groups in other port cities tried to match the luxury of the Tremont House. Philadelphia's United States Hotel was erected (1828) directly opposite the Second Bank of the United States. New York saw the construction of Holt's Hotel (1833) and John Jacob Astor's emmense Astor House (1834). The Astor House was constructed at a cost of $400,000[21], contained over 340 guestrooms, and employed 103 male and 65 female workers[22] (an employee/room ratio roughly equivalent to today's luxury hotels).

Competition also developed among business elites within certain cities. In New Orleans, rivalry between the Yankee and Creole merchant's communities turned into a contest as to which could build the biggest hotel. The St. Charles was built by the Yankees for the staggering sum of $800,000.[23] French businessmen initially planned a $1,500,000 hotel, but this was scaled down considerably as the result of the financial crisis of 1837.[24]

New Towns and Railroads

Hotel construction was not limited to the major port cities. Promoting a good hotel was often considered necessary to attract people to new towns.

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[21]Brian McGinty, The Palace Inns (Harrisburg: Stackpole Books, 1978), p. 18.

[22]Williamson, Op. cit., p. 197.

[23]The hotel served as a home for the State's Stock Exchange and Chamber of Commerce; and served as resort for the wealthiest planters.

[24]McGinty, Op. cit., p. 19. Their St. Louis Hotel was considered a "poor immitation" and cost a "mere" $500,000. The lobby of the hotel was used for public slave auctions.

In reality, of course, a certain amount of economic activity was the essential ingredient for new-town formation. Hotels served as the center of exchange activity, housed nascent public administration functions, and provided a certain amount of flexibility in a tight housing market. The hotel itself may have been a necessary, but certainly not a sufficient condition for new-town formation.[25]

Railroads, on the other hand, were very important for towns, and hotels emerged to service them. Once commercial relations were established in the seaport cities, an extensive commerical infrastructure was created to service the transport and purchase aspects of mercantile activity. Both mercantile and state surplus capital were directed into the construction of roads, canals, steamships, and railroads. Factors, acting as the agents of urban merchants appeared in the major western market centers to purchase crops and other goods and arrange for their shipment.[26]

The great absolute increase in both the number of commercial transactions and travelling business agents led to the construction of new hotel-exchanges - usually at the site of a railroad terminal. Worcester,

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[25]"At Port Sheldon, Michigan, a hotel, The Ottawa House, was built at a cost of $200,000 in the heart of a black pine forest. This was in 1837. By 1842, five years later, the city had failed to materialize, and the hotel was dismantled, and the four pillars which graced its front were dragged away by ox team to become part of a mansion in Grand Rapids," Lundberg, _Op_. _cit_., p. 20.

[26]Watkins, _Op_. _cit_., pp. 36-37.

for example, saw the construction of the Worcester Exchange Hotel, and Springfield got its Massasoit House (1843). Both were the outgrowth of the Boston and Worcester and, later, the Western Railroad. In Boston, the terminus city, the South Cove Company built a complex which included a wharf, luxury hotel, railroad terminal, wharehouses, and six miles of new streets.[27]

The railroad companies themselves did not become involved in hotel development until after the 1850's. Soon thereafter "nearly all railroads had extensive holdings, either directly or by means of subsidiary companies." companies."[28]

Producer-Oriented Hotels

Beginning in approximately 1830, manufacturer's agents began to appear as hotel guests along side the merchant's wholesale commission agents. The hotel quickly came to service the producer of goods as usefully as it had aided the mercantist. The development of new urban markets enabled the manufacturer to expand into new and more distant regions. In the hotel, the producer or agent or commissioned middleman -- took orders and

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[27]Walter Muir Whitehead, Boston: A Topographical History (Cambridge: Bel Knap Press, 1959). By 1838, the Boston and Worcester railroad was carrying 100 passengers a day to and from Worcester.

[28]Williamson, Op. cit., p. 121.

arranged for the exchange of goods and money. Hotels became instrumentalities for the organization of new markets, and thus assisted in opening new possiblities for heightened production and accumulation.

Hotels were useful in enabling the manufacturer to appropriate a larger portion of the surplus extracted in the manufacturing process itself. The construction of hotels in important market areas provided physical support for the manufacturer's own sales agent or wholesaler.

Hotels built in factory centers helped to create the essential commercial infrastructure that allowed the manufacturer to manipulate the distribution of surplus value more effectively at the point of production itself. Sales terms were arranged which were more advantangeous to the producer, and on his own "turf" as well. The general effect of this new exchange activity in market/consumption centers and in production centers was to shift the distribution of the surplus away from the mercantilist and towards the producer.[29] In each instance the hotel - if properly located - was able to share, albeit to some lesser extent, in this increase in producer's profitability.

New England, as the birthplace of American manufacturing, also initiated the first producer-oriented hotels. In Lowell, Massachusetts, a "first-class" hotel, the Merrimack House, was built during the same year (1832)

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[29]As Watkins (p. 14) notes, "The success of merchant's capital is ... based on the establishment of conditions which ensure its ultimate subjection to industrial interests." The construction of a transportation and commercial infrastructure succeeded in speeding the movement of goods and information, but - by extending and deepening the market - increased the opportunity for more direct access by manufacturers.

as were the mills.[30] In Manchester, New Hampshire, the Amoskeag Manufacturing Company built a hotel on company owned land in 1840 and leased it to an operator on a long-term basis.[31]

These factory-hotels serviced the management as well as the exchange function of the early manufacturing company. Cotton textile production in Lowell and Manchester was owned and administered by entrepreneurs in Boston. In the pre-telegraphic era, management information exchange required frequent inter-urban travel[32] and hotel use.

The Commercial Hotel and the Distribution of Manufactured Consumer Goods

As the railroad expanded across the country following the Civil War a new distribution system for consumer goods arose. Retailers no longer made biannual trips to eastern markets to purchase dry-goods. Instead, full-line, full-service, wholesalers went "by the cars" to towns and villages on the railroads, and by horse and buggy to the most distant country stores.

The travelling merchant no longer sold on commission, but rather purchased the goods from the manufacturer and sold to the small retailers.

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[30] Henry A. Miles, The Growth of Lowell, 1846, in Charles N. Glabb, ed., The American City (Homewood, Ill.: Dorsey Press, 1963), p. 130.

[31] Luddy, Op. cit., p. 213.

[32] Pred, Op. cit., p. 214.

The commission merchant became a full-time specialized jobber. This system worked to the benefit of the retailer who found it less necessary to go to market. It also reduced his storage needs and enabled him to adopt a more flexible buying policy. As Chandler notes, these new arrangements pleased the manufacturer as well:

> They now obtained cash for their products instead of waiting for payment for six months to a year until the product was finally sold. Payments in cash substantially reduced the manufacturer's requirements for working capital and therefore his dependence on the merchants who supplied it.33

This new distribution system had an important impact on the future of the hotel industry. Previously, demand for lodging facilities had varied widely depending on factors such as the weather or the buying season. The tremendous expansion in the number of commercial travellers ("drummers") with their sample-grips and trunks enabled the hoteliers to achieve a higher level of certainty, and a reduced level of variability, in the demand for their services. As one commentator of the time noted:

> Travel and the custom on which the hotels depended, had before that been on a retail scale. They were supported by a transient and fluctuating traffic. They now at last obtained a permanent and paying clientage which rose or fell in volume only with the general prosperity and activity of the country's business.34

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[33] Alfred D. Chandler, Jr., The Visible Hand: The Managerial Revolution in American Business (Cambridge: Belknap Press, 1977), p. 216.

[34] Trade and Travel: Commercial, Financial, Transportation and Hotel Interests of the United States (New York: Commercial Travelers Club, 1895), p. 155.

By 1883, the number of drummers were estimated by the Hotel Gazette to be more than two hundred thousand.[35] Their expenses, for railroad fares and hotel bills, were believed to be about one million dollars a day.[36] The travelling salesman provided a large proportion of the transient trade for urban commercial hotels and practically all of the patronage in small cities and towns.[37] This new source of demand set off a boom in new hotel construction across the United States.

The Commercial Hotel at the Turn of the Century

The development of modern mass retailing - through the mail-order house, the department store, and chain store - began to make inroads in the consumer goods distribution system in the 1880's. The travelling salesman diminished in importance and many of the hotels in smaller towns suffered accordingly. The advent of the automobile had a further discouraging effect on hotel operations in villages and small towns. A salesman travelling from a central point could service a wider area with an automobile and return to his "base" at night.

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[35]Williamson, Op. cit., p. 124.

[36]Trade and Travel, Op. cit., p.

[37]Norman S. Hayner, Hotel Life (Chapell Hill: University of North Carolina, 1936), p. 94.

By the turn of the twentieth century, the development of new, larger, transient hotels was confined mainly to urban areas. Hotels still served primarily as a site for the consumption of services associated with exchange activity. The type of exchange activity serviced by the hotel depended upon the industrial base of the urban area. Some hotels serviced the exchange needs of factories (with material sellers and finished product buyers as clients) while others catered to mass merchandising centers.

The Modern Commercial Hotel: Administrative Function

Much of today's capital stock in hotels was put in place during the period of "Coolidge prosperity," in the late 1920's. Many of the larger, urban, hotels were built in response to a perceived demand from a relatively new type of business -- the central-office headed corporation.

As Alfred Chandler notes, during the 1920's the central-office controlled business entity became a central feature of American history.[38]

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[38] Alfred Chandler, *op. cit.*, p. 234.

These corporations linked together geographically-dispersed establishments both within and across different industries. In some industries, such as insurance, the central office coordinated the activities of its numerous branches in sales, operations and investments. Insurance head offices became large, centralized bureaucratic enterprises - but limited their activity to a single industry. For other corporations, diversification across industries became an explicit strategy for growth during the 1920's. Head-offices administered vast, far-flung industrial empires. Interest was great, and mergers frequent, in steel, food, petroleum, non-ferrous metals, machinery and liquor.

The emergence of the central-office headed corporation geographically separated the administrative function from the production process itself, and had an important impact on business travel. A new breed of corporate managers shuttled back and forth between branch plants, regional offices and the central office, carrying out the administrative duties of the corporations. Plant managers made periodic trips to head offices to be instructed on production scheduling matters. Tens of thousands of sales-men made similar pilgrimages to corporate and regional headquarters for group sales meetings. Finally, the yearly company convention served not only as forum for information exchange, but also as a means by which the entire corporate organism became conscious of itself as an organization. In the words of Sinclair Lewis' conventioneer Babbitt, they would "zoom for Zenith." With a sense of corporate identity and loyalty thus instilled, the "company man" could go back to his local operation, cognizant of the fact that he was part of a larger corporate "team."

The growth of the modern corporation has, therefore, been marked by an increased horizontal (departmentalized) and increased spatial (head office/branch office) division of labor within its management function. The initial physical manifestation of this corporate transformation and growth was the major expansion of downtown office space in the nation's larger cities during the 1920's. Corporate headquarters generally have a greater square foot/worker ratio than other types of office operations. Between 1920 and 1930 downtown office space in the ten largest cities increased by 3,000 percent, precipitating a real estate boom in each central business district.[39] A secondary response linked particularly to the increased spatial division of labor within the corporation, was the construction of thousands of hotel rooms and associated facilities, for the travelling businessman.

In national centers this trend towards hotel building was most pronounced. In Chicago, for example, where there had been 11,000 hotel rooms in 1920, new construction doubled that amount by June, 1921. The supply of rooms at that point far surpassed demand, and consequently many hotels ceased to show a profit. Yet, new hotel construction in Chicago continued - buoyed in part by the new,capital-rich, corporations (especially insurance companies) looking for investment outlets, and partially because of a speculative market for hotel bond issues. When the Stevens Hotel - with 3,000 rooms - opened in 1927, practically the

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[39] R. D. McKenzie, The Metropolitan Community (New York: McGraw Hill, 1930).

entire Chicago hotel industry suffered a sharp decline in occupancy and profits. Still, new hotel construction in Chicago continued.[40]

Regional centers, such as Boston, also witnessed rapid hotel expansion. Boston experienced a 52 percent increase in its supply of hotel rooms during the 1920's. During the 1927-1929 period alone, some 3,100 hotel rooms were added to the stock. This amounts to fully 25 percent of all hotel room construction in the city from 1895 to present.[41] Many of this building occurred adjacent to the new insurance district on lower Boylston Street.

The fate of many of these hotels serves as a prime example of the dependence of real estate on location. When they were built in the 1920's, most urban hotels were either transporation terminal or commercial destination oriented. Construction occurred either adjacent to major transportation facilities (primarily railroad stations) or adjoining important commercial districts. The steep decline in railroad patronage coupled with inter-and intra-metropolitan shifts in corporate office and manufacturing location have had direct-and often devestating-effects on hotel operations. Consequently, the portion of lodging industry receipts captured by primarily urban hotels (as opposed to suburban and highway motels and newer motor hotels) declined from 95.9 percent in 1939 to 47.0 percent in 1977.

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[40] American Hotel Association, The Future Outlook of the Hotel Industry (New York: 1946).

[41] Jason Kelly, Sarah Wermiel, Hotel and Convention Center Demand and Supply in Boston (Boston: Boston Redevelopment Authority Research Department, March 1979).

The Emergence of the Resort Hotel in New England

New England developed as a favorite vacation spot for the nation's economic and political elite. By the mid-19th century, Newport, Rhode Island was second only to Cape May and Long Branch, New Jersey as a leading beach resort. The popularity of New England resorts in the second half of the century increased to match the growth of the new middle class and expanding haute bourgeoisie.

As the noted English historian E. J. Hobsbawn has written: "Industrial capitalism produced two novel forms of pleasure travel: tourism and summer holidays for the bourgeoisie and mechanized day trips for the masses..."[46] In New England, the wealthiest class had always spent summers in Europe. By the 1870's, they were building summer mansions along the coast. Day trips for urban workers came much later.

In New England, the resort industry began in the 1860's when farmers began taking in summer tourists. Soon "sporting camps" were established, which were later changed into lodges for vacationers.

The resort boom began in earnest in the 1880's. New rail lines were opened to both the mountain areas and the New England shore. A sort of "pleasure periphery" developed outside of the urbanized areas of the region.

Cape Cod and the South Shore section of Massachusetts experienced especially rapid growth. As the Boston Chamber of Commerce boasted:

> The accommodations provided by the railroad for week-end visitors are particularly extensive, and for the benefit of the

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[46] E. J. Hobsbawn, The Age of Capital (New York: New American Library, 1979), p. 224.

Many of the new hotels construction in the 1920's in national centers were developed by national hotel corporations. Two of the most prosperous of these were the Stalter Corporation and the Bowman-Biltmore Corporation. Statler owed its origins to its early success in building "temporary hotels" at the sites of International Expositions, such as Chicago and Buffalo, at the turn of the century. The Bowman-Biltmore chain was created out of the hotel boom induced by World War I. As Williams notes:

> the outbreak of the World War ushered in an era of extraordinary travel to New York and other financial centers, and the Biltmore rode high on the tide of prosperity. The company began to acquire other hotels, and the Bowman Biltmore chain ....sprang into existence.42

Other hotels were built in smaller cities in the 1920's. Often times these hotels were "community-financed" through a series of prearranged deals with local property owners and contractors, usually with the local Chamber of Commerce acting as a catalyst. In Gardner, Massachusetts, for example, the local Chamber of Commerce raised (through stocks and bonds) $300,000 for the erection of a hotel. The Chamber was also instrumental in raising funds for hotel projects in Providence, New Bedford, and Lowell.[43]

> The idea for the community-financed hotel usually originated from two sources. First, some small-town hotel projects were motivated by a sincere desire for civic improvement on the part of all concerned...Local industries had the feeling that visitors to their plants were discouraged by the inability to find modern hotel facilities in the town.
>
> On the other hand, however, many small-town hotels were

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[42]Williams, op. cit., p. 164.

[43]No title, Commerical Organization Department (Washington: Chamber of Commerce of the U. S., 1933), p. 16.

> promoted through artificial stimulation of "civic pride" by selfish interests, seeking to make a personal profit on the construction. For example, in many instances the idea for a new hotel proved to have started with the owner of a piece of land where the hotel "ought" to be built, or the owner of an adjacent piece of property which would increase in value with the erection of the hotel.
>
> Frequently the new hotel project was initiated by an outside promoter with an eye toward profiting on the fund-raising for the project. These vested interests, often with the aid of local organizations whose support was commandeered through their fears of otherwise being labeled obstructionists, created an artificial wave of enthusiasm for the new hotel project, which outshadowed any calm appeal to business sense.44

Hotels built in this manner were usually too large for local demand, and were money losers before they were built. Those that did survive at first were soon crippled by the Depression.

During the 1930's, approximately 80 percent of the nation's hotels fell into the hands of courts, mortgagors, and receivers. Many hotels went into bankruptcy before opening their doors. It is estimated that at least $2.5 billion of original hotel investments were written off the books during this period. First mortgage bonds of the nation's leading hotels dropped to around 15 percent of parity.* Institutional lenders, even those which had been fairly conservative in their investment policy, soon found themselves emeshed in the hotel operating business. The Metropolitan Life Insurance Company, for example, became the owner of 138 hotels.[45]

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[44] American Hotel Association, op. cit.

* The Sheraton Corporation started as an investment company in the 1930's buying stocks and bonds at below value. Some of its early acquisitions happened to be hotels.

[45] Ibid., p.

> wealthier class of summer residents, made up principally of Boston businessmen and their families, exclusive trains of parlor cars, patronized only by regular subscribers, are run throughout the season.[47]

By 1891, the White Mountains of New Hampshire had some 60 resort hotels with more than 11,000 guest rooms.[48] Spending the summer in the cool mountain air was considered a pleasant way to escape the heat of the city, as well as the "social thing to do."

The Berkshire region of Western Massachusetts and the Green Mountains of Vermont also developed as resort areas; as did the Maine coast and the southern Connecticut shoreline. The sixteen mile seaside strip of New Hampshire emerged as a popular summer spot for the middle-class in the late 1880's.

For the urban working class, summer recreation equalled a Sunday day trip. In Boston, this generally amounted to a steamer trip or a railway excursion to nearby Nantasket or Revere Beach. It was estimated in 1910 that approximately one million such day trips per year were made out of Boston to points between Plymouth and Gloucester.[49]

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[47] Boston Chamber of Commerce, New England (Boston: 1911), p. 286.

[48] Lundberg, Op. cit., p. 130.

[49] Boston Chamber of Commerce, Op. cit., p. 287.

In the early twentieth century, as production continued to increase, workers were granted vacation time (usually without pay*). The growth in automobile ownership allowed vacationers to spend weekends and even weeks in such far-flung locations as the Berkshires, White Mountains, and Cape Cod. Tourist courts, the precursor of today's motels sprung up to service these vacationers. These establishments were typically 15-units and run by "mom and pop" operators on a seasonal basis. Fifteen units was considered the limit for these enterprises, because sizes much higher would require paid help.

Winter ski vacationing began early in the 1930's in locations such as Warner, New Hampshire and Woodstock, Vermont. Skiing, however, did not become "big business" until the 1960's. Vermont has effectively reduced the seasonality of demand in its recreational industry through actively promoting its ski industry.

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*A 1920 survey of 624 firms showed that 85 percent provided paid vacation to office employees, while only 18 percent gave paid vacations to factory workers. Workers were exhorted by manufactures to "let your vacation be an investment in efficiency." See Robert Goldman and John Wilson, "The Rationalization of Leisure," Politics and Society (No. 2, 1977), pp. 157-187.

Chapter III: Production and Risk

This chapter discussed both the nature of production and basis for profitability within the firm, and the risk structure of the industry as a whole. The chapter begins by discussing the type of industrial operations: hotels, motels, and motor hotels. These categories are defined descriptively by the orientation to the automobile, but are analytically distinguishable by their degree of labor intensity.

The profit center in all operations is shown to be the rooms department, and the key to expansion is high occupancy. Profitability is characterized by high earnings leverage. A small change in occupancy causes proportionately larger changes in income because of the fixed cost structure.

The risk structure of the industry is examined in terms of systematic risk stemming mostly from business cycle fluctuations, and unsystematic risk which is the celebrated "other" factors category. A risk profile of various regions and types of operations is developed. Finally, strategies aimed at reducing risk are discussed.

In 1972, the hotel-motel industry in New England consisted of some 3700 establishments ranging in size from 1500 rooms to less than ten units. Many firms were seasonal in operation, and approximately 28 percent had no payroll whatsoever. Gross revenue per establishment varied from less than $1,000 to almost $35 million per year. Ownership and control rested with both "mom and pop" type operations and multi-billion dollar conglomerates. To summarize, the industry is quite diverse with respect to ownership, management, and extent of operations. Common themes and discernable industrial structure are, however, readily observable.

In our analysis, the structure of the industry can be arrayed hierarchically within three dimensions ordered according to the amount on predictability of revenues, and total employment per establishment:

ONWERSHIP/MANAGEMENT	MARKET	LOCATION
1. Corporate owned, leased, or managed.	1. Convention/ group business	1. City-Airport
2. Franchised	2. Business traveller.	2. Suburban
3. Single owner/ operator (ma & pop)	3. Tourist	3. Sea and Ski
		4. Highway

This descriptive hierarchy should be properly considered as an outcome of certain economic and political forces. It will be the purpose of this thesis to explicate the structure and dynamic of these forces.

The objectives of this chapter will be twofold. First, we will present an overview of hotel-motel operations. This will consist of a discussion of the types of establishments, and a depiction of how money is made in the industry. The second objective of the chapter will be to examine the components of the investment decision from the standpoint of risk structure and risk-reduction strategies.

Types of Operations

This case study will examine three establishment types within the lodging industry: hotel, motels (including tourist courts), and motor hotels. Hotels, motels and motor hotels are establishments primary engaged in supplying transient lodging, food, recreational facilities, and meeting space to the general public. These three groupings constitute standard Industrial Classification 701 as determined by the Office of Management and Budget. Excluded from consideration in this study are private membership hotels, residential hotels, rooming houses, and camps and trailering parks (S. I. C. 702, S. I. C. 703, S. I. C. 704).

Hotels, motels and motor hotels represent three qualitatively different types of operation. Table 1 presents a comparison of hotels, motels, and motor hotels on the national level for the year 1972. Table 2 displays

Table 1

Comparison of Hotels, Motels, and Motor Hotels

1972

Basis of Comparison	Hotel	Motel	Motor Hotel
	Type of Establishment[1]		
Size			
Percentage of establishments with:			
100 and over units	16.6	8.1	35.3
50-99 units	16.6	11.5	20.4
25-49 units	35.5	26.3	22.2
5-24 units	31.3	54.1	22.1
	100.0	100.0	100.0
Average Number of Units	70.3	37.3	87.8
Receipts			
Average receipts/room	$6,282	$3,727	$5,987
Average receipts/establishment (000)	$ 441.4	$ 139.0	$ 526.0
Age			
Percentage of establishments[2] commencing operations:			
Before 1942	50.8	10.1	8.0
1942-1954	13.8	28.1	8.1
1955-1963	14.8	36.5	29.3
1964-1972	20.7	25.4	54.6
	100.0	100.0	100.0
Facilities			
Percentage of establishments[2] with:			
Free off-street parking	74.1	97.9	98.9
Restaurant	62.5	28.8	80.1
Public Meeting Room	50.3	19.0	70.5
Labor			
Average rooms/worker	2.11[2]	3.79	2.26
Average receipts/worker	$13,672	$14,116	$13,558
Average payroll/receipts	34.21	24.20	27.79

[1]Establishments with payroll only.

[2]Hotels with 25 guestrooms or more.

Source: Census of Selected Service Industries, 1972.

Table 2

Distribution of Establishments, Rooms, Receipts and Employment - by Establishment Type and Size
1972

Establishment Types	Size (# rooms)	Establishments	Percent of Total Rooms	Receipts	Employment
All	300 and over	1.5	16.1	31.4	28.7
	100-299	10.4	31.6	36.8	37.6
	50-99	13.4	18.7	14.7	16.1
	25-49	28.5	19.7	10.7	11.3
	Less than 25	46.2	14.1	6.3	6.3
	Total	100.0	100.2*	99.9	100.0
Hotels	300 and over	1.1	12.5	26.5	23.4
	100-299	3.3	10.6	12.8	14.0
	50-99	4.4	6.0	4.3	5.4
	25-49	9.3	6.1	2.7	3.6
	Less than 25	8.2	2.6	1.9	1.9
	Sub Total	26.3	37.8	48.2	48.3
Motels	300 and over	0.2	2.1	2.5	2.5
	100-299	5.3	15.2	16.4	15.7
	50-99	7.8	10.7	8.6	8.9
	25-49	17.8	12.7	7.3	7.1
	Less than 25	36.7	11.1	4.3	4.3
	Sub Total	67.8	51.8	39.1	38.5
Motor Hotels	300 and over	0.2	1.5	2.4	2.2
	100-299	1.8	5.9	7.5	7.9
	50-99	1.2	1.7	1.8	1.9
	25-49	1.3	0.9	0.6	0.7
	Less than 25	1.3	0.4	0.1	0.1
	Sub Total	100.0	10.4	12.4	12.8
	Grand Total	100.0	100.0	99.7*	99.6*

*Differs from 100.0 due to rounding. Establishments with payroll only

Source: Census of Selected Service Industries, 1972.

the distribution of all establishments, rooms, receipts, and employment by establishment type and size for the same year.

As Table 1 illustrates, hotels are generally older, have the highest average receipts per room, and are the most labor intensive. Over half of all hotels were constructed prior to 1942. The average room collected $6,282 in 1972, of which 34.2 percent went to payroll.

Motels, on average, are smaller, newer, are less labor intensive, and have a much lower receipts per room. Most motels were built during the 1955-1963 period, over half of all establishments contained fewer than 25 guestrooms, and only 24.2 percent of the average $3,727 per room revenue went towards payroll costs. There was an average of 3.79 rooms per motel worker. This is because hotels provided more services (i.e. bellmen, elevator operators), and because hotels generally included more facilities. Twice as many hotels had restaurants (62.5% of hotels versus 28.8% of motels); and, hotels were much more likely to have public meeting rooms (50.3% of hotels versus 19.0% of motels). As its name implies, the motel is much more oriented towards the motoring public, and is more likely to provide off-street parking.

Motor hotels are a hybrid of motels and hotels. These establishments are, on average, newer than hotels (although many are converted hotels), and are slightly larger. Motor hotels almost always provide "free" parking, and usually have restaurant and meeting room facilities as well. Yet despite these additional facilities, motor hotels are somewhat less labor intensive than hotels (2.26 rooms per employee and 27.8 percent of receipts to payroll). This is because motor hotels generally offer fewer "extras" such as room and bell service, porters, elevator operators, and switchboard personnel;

or, because these services have been automated. This latter reason is probably a reflection of the relative newness of many of the motor hotels (in 1972 over half of these establishments had been built during the previous eight years).

"Motor inns" and "motor lodges" are variously categorized as motels or motor hotels depending upon whether they are multi-storied or offer hotel-type facilities. However, since the Census Bureau relies heavily on self-designation, the nominal categorizations "hotel," "motel," and "motor hotel" should not be overemphasized, especially other than in the aggregate level.

In the aggregate, however, hotels, motels, and motor hotels are most cearly distinguishable by their degree of labor intensity. Table 3 depicts the payroll/receipts ratios* of the three types of operations across five different size categories. As the data shows, hotels consistently have the highest payroll/receipts ratio. Motels are between 74.1% and 79.8% as labor intensive as hotels; while motor hotels range between 81.0% and 88.0% of the hotel ratio.

The long term trend in the industry has been towards the less labor intensive motel-type operation. Between 1939 and 1977, motels and motor hotels increased their share of the lodging market from 4.1% to 53.0%. As Table 5 illustrates, hotels and motels (and motor hotels) are competing modes of operation within the industry. The growth of one segment is

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* Payroll/receipts is a better indicator than rooms/employee in that it shows less distortion because of the influence of part time employees. In addition, the total payroll and total receipt figures are collected on a yearly basis, while the total employment figure represents only those employees working the week of March 12th and is therefore susceptible to the distortions of seasonality.

Table 3

Labor Intensity of Hotels, Motels, Motor Hotels, 1972:
By Establishment Class

Payroll/Receipt Ratio

Size (# rooms)	Hotels	Motels	Motor Hotels
300 +	35.3	26.2	28.6
100-299	33.7	26.2	28.2
50-99	32.6	26.0	27.2
25-49	28.5	21.4	23.5
Less than 25	22.5	16.7	19.8

Source: Census of Selected Service Industries, 1972.

Table 3a

Relative Labor Intensity: Hotels, Motels, Motor Hotels, 1972:
By Establishment Size Class

Percent of Hotel Payroll/Receipt Ratio

Size Class (# rooms)	Hotels	Motels	Motor Hotels
300 +	100.0	74.2	81.0
100-299	100.0	77.7	83.7
50-99	100.0	79.8	83.4
25-49	100.0	75.1	82.4
Less than 25	100.0	74.2	88.0

Source: Census of Selected Service Industries, 1972.

Table 4

Industry Receipts by Type of Establishment

1939-1977 ($1972)

Year	Hotel Amount ($Mil's)	Hotel Percent	Motel, Motor Hotel Amount ($Mil's)	Motel, Motor Hotel Percent
1939	$2,956.2	95.9%	$ 125.7	4.1%
1948	4,892.8	91.9	435.8	8.1
1954	4,203.7	84.0	869.0	16.0
1958	4,352.0	76.7	1,324.6	23.3
1963	4,192.1	64.4	2,317.2	35.6
1967	4,851.8	58.5	3,438.6	42.5
1972	4,794.3	47.5	5,293.5	52.5
1977	5,804.6	47.0	6,519.6	53.0

Source: Census of Selected Service Industries, 1939-1972, Bureau of Domestic Commerce, 1977.

Table 5

Percent Change in Receipts, by

Type of Establishment, 1948-1977

Period	Hotel	Motel, Motor Hotel
1948-54	-14.1%	+99.4
1954-58	+3.5	+52.4
1958-63	-3.7	+74.9
1963-67	+15.7	+48.4
1967-72	-1.2	+53.9
1972-77	+21.1	+23.2

correlation coefficient= (-.93)

source: See Table 4

strongly negatively correlated (-.93) with that of the other. Between 1939 and 1972 the development trend clearly favored motel-type operations. However, this tendency has moderated during recent years. In 1977, hotels achieved their highest level of receipts, and for the first time since 1939, the growth rate (1972-1977) in hotel receipts nearly matched that of motels.

The relative importance of hotels, motels and motor hotels during 1972 is displayed in Table 2 . Despite the trend towards smaller motels, the "grand hotel" remains a dominating force in the industry. During 1972, hotels of over 300 rooms constituted only 1.1% of all establishments; however, they accounted for 12.5% of all rooms, 26.5% of all receipts, and 23.4% of total employment. By way of contrast, motels of less than 25 rooms are the largest single grouping (36.7% of all establishments), but constituted only 11.1% of total rooms, 4.3% of receipts, and 4.3% of employment. Motor hotels are most important (in terms of revenues, employment, and receipts) in the 100-299 room size range.

Among all establishments, 68.2% of all industry revenue is concentrated among those enterprises containing over 100 guestrooms, though large operations account for only 11.9% of all establishments and 47.7% of all rooms. These large revenue generators have been the primary target for chain expansion - through both new construction and the reorganization of existing operations. This phenomenon will be treated in greater detail in Chapter 4 .

Operations and Profitability

Hotel-motel entrepreneurs and investors are in the business to make a profit. The meaning of "profitability" may vary depending upon the interests of one of several classes of actors. Some investors are interested in long term appreciation and tax benefits, while others are concerned exclusively with generating a positive cash flow. Regardless of individual interest, however, the enterprise must be capable of producing a cash flow large enough to cover undistributed operating expenses, taxes, and any fixed capital changes. Residual cash can then be distributed to the owners or reinvested in the enterprise.

Table 6 illustrates the results of operations for 1977 for 800 hotels and motels sampled by the industry accounting firm Harris, Kerr, Forster and Company. As can be readily observed, the key profit center is the rooms department. The rooms department contributed 82.6% of all operating income, and had a "profit rate" (operating income/department revenues) of 72.4%. In contrast, the food and beverage department contributed 13.8% of total operating income (on 35.9% of total revenue) and had a department "profit rate" of 19.7%.

The food and beverage departments is much more labor intensive than rooms department. In 1977, 41.0% of all departmental revenue in food and beverage went to payroll and related costs.* In comparison, only 19.1% of all rooms department revenue went to labor.

Holding the mix of hotels and motels with and without resturants constant, Harris, Kerr, Forster and Company reports that restaurant

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*These include vacation, employees meals, payroll taxes, and employee benefits.

patronage in the industry has pursued a downward trend since 1957. According to the accounting firm, "the total number of guest food covers served during 1977 equalled but 78 percent of the base year's [1957] total."[1] Thus, the long term trend, both among and within different types of operations, has been away from the more labor intensive forms of production.

It is not surprising, therefore, to find that firms wishing to develop their markets and accumulate capital* are more likely to expand their rooms department than their restaurant operation. Once the decision is made to respond to the possibilities for heightened profitability inherent in accumualtion and market power, key issues regarding timing and attracting resources must be resolved.

The key to expansion is usually a high level of occupancy (capacity utilization). Higher levels of occupancy mean greater activity in the main profit center (rooms), and affords the possibility to raise room rates. Continued high occupancy and room rates suggest that the expansion of productive capacity and broadening of the base for heightened accumulation and profitability may be in order.

Industry accounting data and information from field interviews indicate that expansion should be preceeded by a demonstration of strong performance (steady occupancy at maximum room rates), with the per cent occupancy in the mid-eighties. Theoretically, this is the optional moment for expansion, assuming continued lodging industry growth in the area. The immediate

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[1] Trade in the Hotel-Motel Business, 1978 Edition (New York: Harris, Kerr, Forster and Company, 1978).

*Not all enterprises are concerned with accumulation. Many independents are in business to supplement their income and provide for their own subsistence.

Table 6

Results of Operations, 1977

	Percent of Total Revenue	
Departmental Revenues and Expenses		
Rooms Department		
Revenue	57.0	
Expenses	15.7	
Operating Income		41.3
Food and Beverage Department		
Revenue	35.9	
Expenses	29.0	
Operating Income		6.9
Telephone Department		
Revenue	2.6	
Expenses	3.7	
Operating Income		(1.1)*
Other (Operating Dept. Rentals, and Other Income)		
Revenue	4.5	
Expenses	1.6	
Operating Income		2.9
Total Operated Department's Income		50.0
Undistributed Operating Expenses		24.5
Income Before Fixed Charges		25.5
Property Taxes & Insurance		4.3
Income Before Other Fixed Charges[1]		21.2

*Loss

[1] Income before deducting Depreciation, Rent, Interest, Amortization, and Income Taxes.

Source: Trends in the Hotel-Motel Business, 1978 Edition (New York: Harris, Kerr, Forster, and Co., 1978).

effect of expansion may be to lower occupancy to near the break-even point. However, as occupancy rises profits will increase percentage wise much faster than change in the volume of operation. This is because fixed capital charges are static and operating costs are only mildly variable therefore a boost in sales will result in a relatively small additional cost and a proportionately large additional profit. This is known as "earnings leverage."

For example, a firm moving from 65% to 75% occupancy will generate 15.4% more sales revenue -- but net income before taxes will increase by 389%.[2] Moreover, as the firm increases its occupancy rate, its profit margin will increase as well. In 1977, the break-even point for establishments sampled by the accounting firm Laventhol and Horwath was 62.4%. Data show that as occupancy rises so does the profit margin:[3]

Occupancy	Profit Margin (Net Income Before Taxes/ Total Revenue)
62.4%	0.0%
65.0%	1.8%
75.0%	7.6%
85.0%	12.0%
95.0%	15.5%

Just as earnings leverage produces a widening profit margin on the upside, so too can it result in some fairly dramatic losses when business is on the

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[2] Laventhol and Horwarth, U. S. Lodging Industry, 1978 Edition (Philadelphia, 1978).

[3] Ibid.

decline and occupancy rates are falling:[4]

Occupancy	Profit Margin
62.4%	0.0%
55.0%	-6.1%
50.0%	-11.3%
45.0%	-17.5%
40.0%	-25.4%

Restaurant and bar earnings suffer severely during business declines. This is because payroll is the largest dining room cost, and a minimum crew must be maintained regardless of business volume. As one interviewee indicated, "Sometimes there are more staff than customers present." During the depression, the owner of a New York hotel is said to have remarked: "If I could go into the dining room and pay every prospective diner a dollar not to eat here I could save money."[5] The same principle of earnings leverage also applies to the operation of the bar and entertainment room.

Risk

Those firms which resort to rental or debt financing (as most do) in order to expand productive capacity are boosting potential profitability, but are also increasing their downside risk. In 1977, interest and rental expenses accounted for 12.6% of total sales among those firms sampled by Laventhol and Horwath. This additional burden of fixed capital charges

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[4] Ibid.

[5] American Hotel Association, The Future Outlook of the Hotel Industry (New York: 1946).

has the effect of raising the break-even occupancy point and making the enterprise more vulnerable to variations in demand and occupancy. This variability in demand is usually associated with economic forces affecting real income, business activity, or travel. In addition, changes in climatic conditions can have a devastating effect on recreationally-oriented lodging operations.

Earnings leverage and high fixed costs are the important supply-related factors influencing risk. In order to better understand demand-side risk it is necessary to examine the two major components of demand -- recreation and business -- and see how they relate to cyclicality in the economy.

Revenues in the lodging industry are fairly evenly divided between those derived from recreational travel and business travel, with business holding a slight (though declining) edge. According to the American Hotel and Motel Association, in 1975 business (including convention) guests accounted for 54 per cent of all industry revenues, though they consumed only 35 per cent of total room nights.[6] Table 7 lists the ten leading industrial purchasers of hotel-motel services. Clearly, salespersons and others involved in exchange activity are the major commercial consumers, though individuals connected with administrative functions (i.e., bank examiners, members of professional organizations) and production (i.e., construction workers, actors) are also highly represented.

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[6]Cited in U. S. Industrial Outlook, 1978 (Washington: GPO, 1978), p. 456.

Table 7

Ten Major Industrial Purchasers of Overnight Accomodations

Rank	Industry	Typical Representatives
1.	Wholesale trade	Salesmen for industrial products
2.	Finance and insurance	Agents, brokers; bank examiners
3.	Miscellaneous professional services	Lawyers; accountants; engineers
4.	New construction	Contractors; buyers, workers
5.	Retail trade	Buyers; salesmen
6.	Health-care services	Doctors; patients; salesmen of medical equipment and pharmaceuticals
7.	Food processors	Buyers; salesmen to the trade
8.	Motion picture production, amusement, recreation services, and commercial sports	Production companies; artists and entertainers; professional teams
9.	Nonprofit organizations	Members of business and professional associations
10.	Miscellaneous business services	Agents and employees of advertising companies; credit and computer services; news syndicates

Source: U. S. Department of Commerce, "Input-Output Structure of the U. S. Economy: 1967," cited in Clarence Peters, "Pre-Opening Market Analysis for Hotels," Cornell Hotel and Restaurant Administration Quarterly (May, 1978), p. 17.

Both recreational and business segments of demand are highly sensitive to shifts in the state of the economy. Figure shows the close correlation between percentage changes in occupancy rates ($occupancy_t$ - $occupancy_{t-1}$/ $occupancy_t$) for the industry as a whole and changes in GNP (correlation coefficient = .81). Figure shows the change in income derived from the lodging industry as compared to the overall growth in national income for the 1958-1977 period. Data show that the change in income associated with the lodging industry moved procyclically throughout the timespan with the exception of the 1971 and 1975 periods.

The counter-cyclical decline in lodging industrial income (as measured by both revenues and value added) in 1971 probably was the result of the continuing fall in real income being experienced by families*, and a failure to recover the consumer confidence evidenced in the late 1960's. The pick-up in business-related demand failed to adequately off-set the fall-off in recreational demand and the industry suffered a decline.

Industrial performance during 1975, when compared to 1971, suggests an important market shift. Durng the late period, lodging industrial income increased (though not to its 1973 level) despite the continuation of both the business recession and a decline in real family income. Moreover, evidence indicates that this revenue growth was sustained by the recreational segment, which increased its market share dramatically from 28% to 46%.[7] This shift reflected not only a sharp fall-off in business and convention demand, but also a change in consumer psychology. Consumers adopted a more "inflationary" (buy now) attitude toward the purchase of recreational services. Personal

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[7] *Ibid.*

Figure 1

Percent Change From Previous Year:

GNP and Hotel-Motel Occupancy Rate

1963-1977

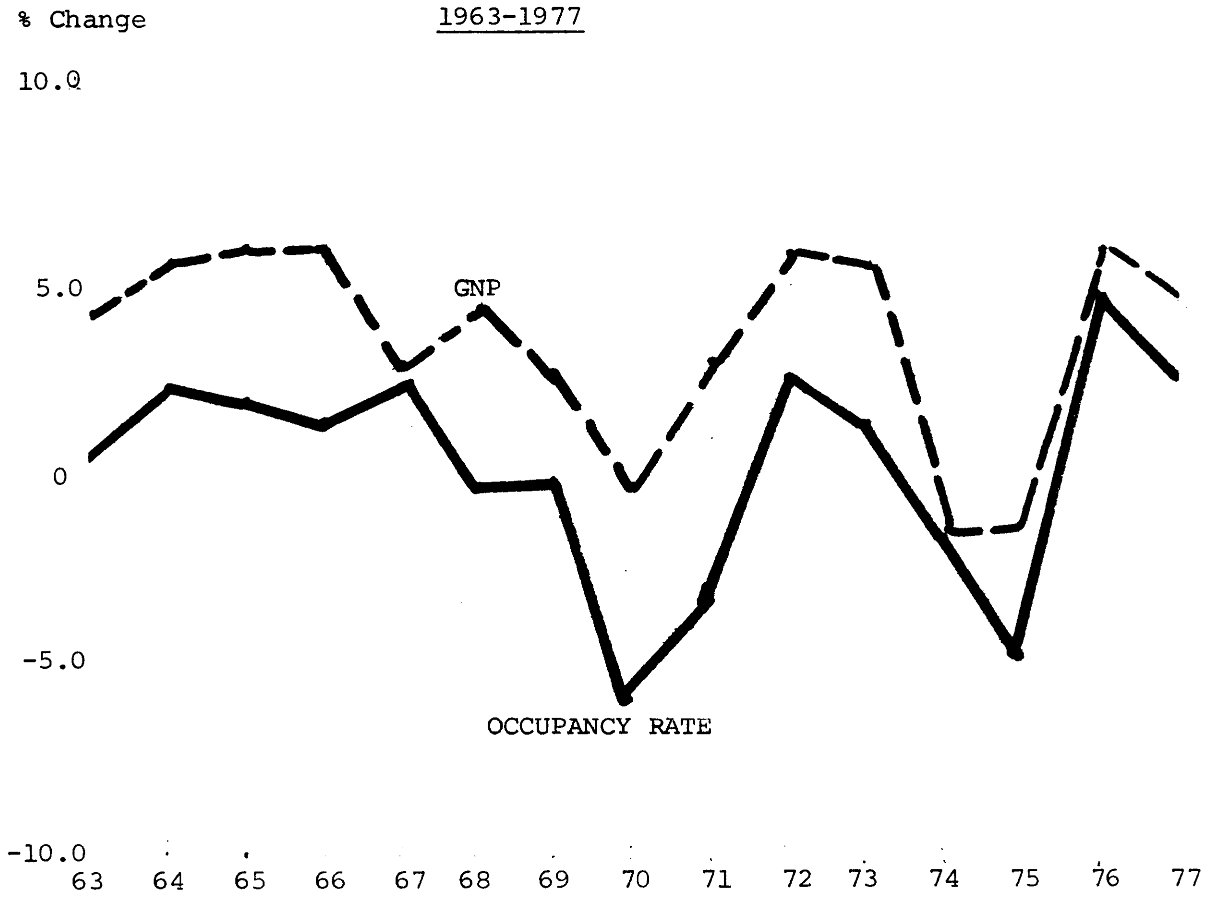
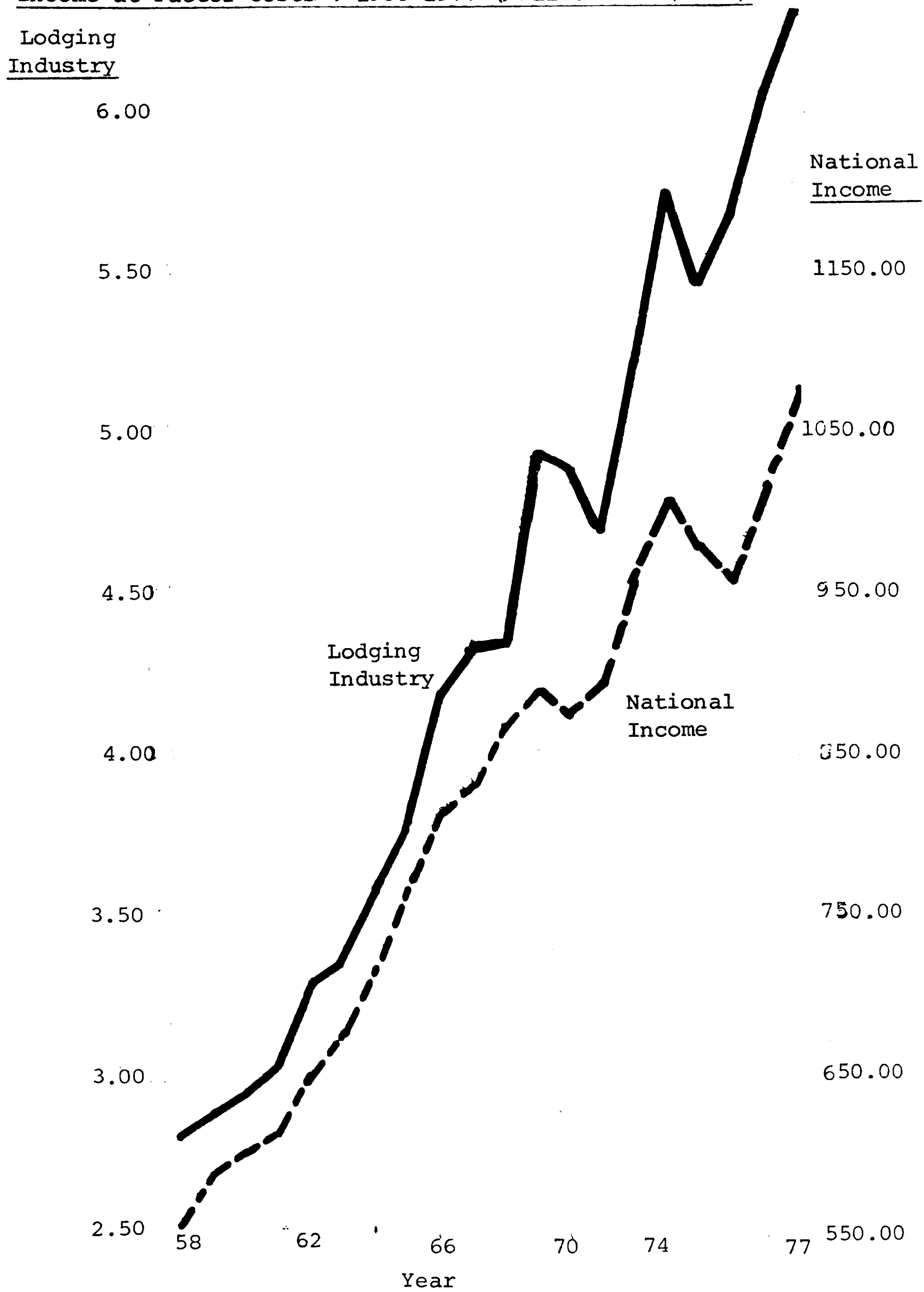


Figure 2

Trend in Lodging Industry Relative to National

Income at Factor Costs : 1958-1977 (billions of $1972)



consumption expenditures increased by 1.89% during 1975 even though real family income fell by 2.8%.[8] Vacation spending, postponed during the 1974 recession and energy "crisis," became a priority item for consumers in 1975 and the lodging industry -- particularly its recreational segment -- benefitted accordingly. Total industry revenue increased by 1.72%. The movement of industry revenue in both 1971 and 1975 would seem to suggest that the recreational segment is relatively less sensitive to cyclicality than the commercial segment. While the level of disposable personal income (which increased on a per capita basis by 1.0% in 1975) is a key determinant of recreational lodging demand, other factors (i.e., transporation development, travel pattern changes, length of average work week, weather) also play a strong role.

"Systematic" and "Unsystematic" Risk

Writing in the Cornell Hotel and Restaurant Administration Quarterly, Arbel and Grier present an analysis of the hotel motel industry which yields some useful insights regarding risk structure. Following Sharpe's[9] methodology, Arbel and Grier differentiate between two components of total risk: "systematic risk" and "unsystematic risk." Systematic risk they define as:

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[8] Economic Report of the President, 1978 (Washington: GPO, 1978), Tables B-2, B-22, B-25.

[9] William F. Sharpe, "A Simplified Model for Portfolio Analysis," Management Science (January, 1963), pp. 227-293.

In their empirical study, Arbel and Grier estimated the amount of systematic risk for different regions and categories of operation. The authors also assigned proportionate weights to systematic and unsystematic risk for each subset. They did this by studying hotel-motel operations for the years 1955-1976, and using variance in occupancy rates as the measure of total risk.

Arbel and Grier acknowledge that rate of occupancy is not a substitute for earnings, and that two establishments with the same occupancy rate can have quite different financial results (depending on differences in fixed capital costs, variable cost structure, etc.). However, they assert that occupancy rates tend to move with earnings. To evaluate this assertion, the correlation between the percentage change in occupancy rates and the percentage change in the proportion of total revenue going to fixed capital charges and profit was calculated to be .92*. This partially substantiates the use of occupancy rate variability as a valid measure of risk, though change in return on investment remains the ideal -- albeit unavailable -- indicator.

Arbel and Grier calculated the variance in occupancy rates for 50 hotel-motel subsets based on cross-sectional averages for each of the 21 years in the study period. The average annual national occupancy rate for

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*This is based on data for the years 1963-1977 contained in Trends in the Hotel-Motel Business, 1978 Edition (New York: Harris, Kerr, Forster and Company, 1978). The measure "proportion of total revenue going to fixed costs" begs the basic question "proportion of what?." But with actual revenue figures lacking, this measure is meaningful at the aggregate level.

the industry as a whole was based on a sample of 1,000 establishments, representing all relevant subsets. The relationship between the occupancy level of industry as a whole and the relevant subset was then determined by regressing one against the other over the historical period.*

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* Source: Arbel and Grier, *op. cit.*

*The equation is:

(1) $OR_{jt} = \alpha_j + \beta_j OR_{mt} + \mu_{jt}$

where

OR_{jt} = occupancy rate for hotel subset j in period t

OR_{mt} = occupancy rate for the hotel industry as a whole during period t

μ_{mt} = residual occupancy rate for hotel subset j during period t

α_j = intercept of the best linear fit between hotel subset j's observed occupancy rate and the hotel industry's observed occupancy rate

β_j = slope of the best linear fit between hotel subset j's observed occupancy rate and the hotel industry's observed occupancy rate

To examine the risk of occupancy rate for hotel subset j, the variance of both sides is taken, yielding:

(2) $\text{Var}(OR_j) = \beta_j^2 \text{Var}(OR_m) + \text{Var}(\mu_j)$

where

$\text{Var}(OR_j)$ = measure of total risk

$\beta_j^2 \text{Var}(OR_m)$ = measure of systematic risk

$\text{Var}(\mu_j)$ = measure of unsystematic risk

Durbin-Watson test revealed significant serial correlation, implying that better estimates can be derived by adjusting for the serial correlation cause by a common trend in the data. As a result Equation (1) was estimated with first differences rather than absolute values.

regions ranges between a variance of 4.55 and 13.23. However, the total variance (risk) for a portfolio which includes all transient hotels in all regions is only 3.99. The total "market risk," theoretically achievable through diversification for multi-property operators, is less than the risk associated with any given region.

Table 8b shows the apportionment of total variance attributable to systematic risk (i.e. the national trend) and unsystematic risk (i.e. "other factors"). The results indicate that the relative mix of systematic-unsystematic risk is distributed unevenly among regions and different categories of operation. These findings again serve to support the contention that diversification tends to reduce the portion of unsystematic risk. For example, a fully diversified portfolio of transient hotels might be able to reduce its portion of unsystematic risk to eight per cent.

Table 8c illustrates the relative volatility of the systematic portion of risk faced by different regions and categories of operation. Beta values of less than one indicate that the subset will vary less than the industry overall, while betas greater than one indicate greater volatility. Since we know that the per centage change in the national occupancy rate is highly correlated with changes in GNP (see Figure), we can infer that the major factor influencing the portion of systematic risk is the business cycle. The data in Tables a, b, c would seem to confirm this notion and, in addition, provide a rough indication of the sensitivity of different types of operations in different regions to national business trends (degree of procyclicality).

Table 8a

Total Risk in Terms of Variance in Occupancy Rates

	All Hotels-Motels	Transient Hotels	Motels With Restaurants	Motels Without Restaurants
All Regions	3.50	3.99	5.84	5.34
New England & Middle Atlantic	5.47	7.16	9.31	13.10
North Central	2.76	5.39	3.75	9.37
South Atlantic	8.64	13.23	15.25	20.02
South Central	3.85	5.12	7.89	5.18
Mountain & Pacific	4.52	4.55	10.83	7.74

Source: Avner Arbel and Paul Grier, "The Risk Structure of the Hotel Industry," Cornell Hotel and Restaurant Administration Quarterly (November, 1978), p. 16.

Table 8 b

Systematic and Unsystematic Risk as a Per Centage of Total Risk

	All Hotels		Transient Hotels		Motels With Restaurants		Motels Without Restaurants	
	SR	UR	SR	UR	SR	UR	SR	UR
All Regions	79	21	92	8	53	47	35	65
New England & Middle Atlantic	78	22	67	33	63	37	18	82
North Central	62	38	71	29	25	75*	16	84
South Atlantic	58	42	31	69	43	57	53	47
South Central	30	70	30	70	17	83*	17	83
Mountain & Pacific	78	22	56	44	78	22	0	100*

*Not significantly different from 0 at 5% confidence level.

Source: See Table 8 a.

Table 8 c

Index of Systematic Risk (β) and t Statistics

	Transient Hotels		Motels w/Restaurants		Motels w/o Restaurants	
	β	(t)	β	(t)	β	(t)
All Regions	1.03	(14.39)	0.91	(4.25)	0.70	(2.91)
New England & Middle Atlantic	1.18	(6.04)	1.14	(4.31)	0.71	(2.54)
North Central	1.06	(6.68)	0.46	(1.91)*	0.57	(2.42)
South Atlantic	1.09	(2.85)	1.20	(2.85)	1.53	(3.49)
South Central	0.66	(2.75)	0.55	(1.52)*	0.44	(2.47)
Mountain & Pacific	0.86	(4.76)	1.37	(6.31)	-0.04	(-0.09)*

* Not significantly different from o at 5% confidence level.

Source: See Table 8 a.

As the author notes:

> since the variance of the national occupancy rate is given, the systematic risk will vary among individual hotels or regional groups only through differences in the betas of the hotels. Beta...is an index of the relative volatility of the hotel. A hotel that is less volatile than the hotel industry as a whole will have a beta that is less than one; one more volatile than the industry overall will have a beta greater than one. The beta for the hotel industry as a whole is, of course, equal to one. [12]

The residuals of the regression equation (variance not explainable in terms of the independent variable, which is the trend in occupancy rates for the hotel industry as a whole) constitute the unsystematic risk. Thus, the r^2 for any given subgroup would indicate the per centage of total risk which is systematic (explainable by the independent variable), and the difference between r^2 and unity would equal the per centage of unsystematic risk. To be sure, this is very much a "first-cut" type of analysis. However, the data does allow us to make some important observations concerning inter-regional and cross-category differences in the variability of occupancy rates, and the influence of diversificaton.

The results of Arbel and Grier's analysis on a regional basis is presented in Table 8a . The data show that there are substantial differences in total risk among different regions and types of operations. The data also show that, with few exceptions, total risk can be reduced within regions by diversifying across categories, and within categories by diversifying across regions. Thus, for example, total risk for transient hotel within

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[12] Arbel and Grier, _op_. _cit_., p. 17.

As might be expected, transient hotels as a group display the highest portion of systematic risk (92 per cent) on both intra-regional and inter-regional levels. This indicates that almost all of the variance experienced by this industry grouping can be attributed to changes in occupancy levels experienced by the industry as a whole (and, by inference, changes in the national economy). This makes sense, since one would expect transient hotels, which are usually oriented towards business demand, to exhibit the greatest amount of responsiveness to national economic trends.

The beta value for transient hotels (1.03) indicates that the degree of procyclicality for this group nearly matches that of the industry as a whole. Positive betas for all subsets mean that the systematic risk for all relevent subgroups is procyclical. Variation around a value of one tells whether the systematic risk exhibited by the industry group is more or less procyclical than the industry as a whole.

For example, findings show that motels without restaurants have a much lower beta (.70), indicating less systematic risk for this type of operation. However, as Arbel and Grier point out:

> Although a hotel or regional group with a beta of less than one has less systematic risk than the industry as a whole, it does not necessarily have less _total_ risk because, if its unsystematic risk is high, its total risk may be above that of the hotel industry as a whole.[13]

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[13] _Ibid._

> the part of total variability of returns caused by factors that simultaneously affect the returns of the hotel industry as a whole. These factors are typically related to changes in general economic conditions, the social environment, and the relative competitiveness of the industry. All hotels will be affected to a certain extent by systematic risk.[10]

"Unsystematic risk" the authors categorize as:

> the portion of total risk that is unique to a particular hotel or hotel category. It is affected by such individualistic factors as management performance, local competition, and shifts in consumer preferences. It can also be affected by a particular hotel's financial structure and operating leverage, as well as its sensi-itivity to inflation. Sometimes unsystematic risk is common to a particular subindustry and not to others.[11]

Systematic risk can never be eliminated totally, but can be reduced somewhat through diversification across regions and different types of operations. Unsystematic risk, on the other hand, can be neutralized to varying degrees by assembling an asset mix consisting of many different types of operations in different regions. Theoretically, this type of risk can be reduced to zero if the holder can assemble the "market portfolio" (e.g. total unsystematic risk [random error] averages to zero).

Only multi-property owners can reduce systematic risk through diversification, or move towards eliminating unsystematic risk. Single-property owners and operators can only act to reduce the unsystematic risk of their own operations -- they have very little control over systematic risk. This implies a certain economy of scale for the large national chain operations.

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[10]Avner Arbel and Paul Grier, "The Risk Structure of the Hotel Industry," Cornell Hotel and Restaurant Administration Quarterly (November, 1978), p. 16.

[11]Ibid., p. 17.

Thus, even though the beta for motels without restaurants is low, the fact that unsystematic risk is high (65%) means that the total risk for this category (5.34) remains higher than that of all hotels-motels (3.50). This also makes good sense, since this type of operation caters mainly to recreational travellers, and: (1) disposable personal income and personal consumption expenditures, two primary determinants of recreational demand, vary less on a year to year basis than total GPN (thus yielding a lower beta); and (2) occupancy levels for this type of establishment would tend to be influenced more by local and firm-specific factors, such as the interplay between regional weather patterns and seasonality (thus yielding a higher proportion of unsystematic risk).

Looking at the distribution of systematic and unsystematic risk on an inter-regional basis, it is noteworthy that among all regional groups, the New England and Middle Atlantic region: (1) has the highest total unsystematic risk for motels without restaurants; and (2) has the highest total systematic risk for transient hotels. The former observation reflects, no doubt, the fact that the region displays the highest level of seasonality. Motels without restaurants in this region have a relatively low portion of variance in occupancy explainable in terms of the national ("systematic") occupancy rate (18%), and a relatively high total variance (13.10). Consequently, the amount of unsystematic risk exhibited by these establishments (10.74) is the highest of any regional group.

Conversely, transient hotels in this region have a relatively high portion of variance in occupancy attributable to the national trend (67%), and a fairly high amount of total variance (7.16). As a result, the total amount of systematic risk for this regional group (4.80) is higher than that of any other region surveyed. Contributing to this state of affairs is the fact that transient hotels in the New England and Middle Atlantic region exhibit the highest degree of procyclicality (beta value of 1.18) of any regions.

Among all establishment types in the New England and Middle Atlantic region, only motels with restaurants exhibit moderate levels of total risk, unsystematic risk, and systematic risk; and, only this group displays a degree of procyclicality approximating the industry as a whole. This is because these establishments often tend to be multi-market (mixing business and recreational demand), and are located near suburban industrial parks (which, otsensibly, provide a more stable business demand), or are sited at major highway interchanges (with heavier and more regular vacation travel demand).

Risk Reduction Strategies

"He characterized himself as a man who 'does not like surprises -- not bad ones....'"

Description of Howard B. Johnson, New York Times
August 6, 1979.

Steady growth during the 1958-1969 period, made possible in part by "high volume and cheap labor," had the effect of diverting much of the lodging industry from the task of developing strategies to lessen the

risk inherent in high earnings leverage and cyclical sensitivity. However, variability in demand experienced in the first half of the 1970's -- and during the 1973-1975 recession in particular -- has forced the industry to become increasingly concerned about adopting measures aimed at sheltering business income from economic instability and higher levels of risk. These strategies may be grouped into four categories:

(1) Diversification. This stragegy, mentioned in the previous section, is available only to multi-establishment operators. In 1972, multi-establishment companies accounted for 2.4% of all firms, 7.5% of all establishments, and 43.5% of all receipts.[14] The larger multi-establishment firms have all achieved regional diversification, but their location decisions are also tempered by considerations of market growth. New England is considered a "low growth" region: between 1958 and 1972, regional receipts increased by only 52.7%, compared to a national average of 74.1%. In 1972, New England had 6.5 per cent of all establishments with payroll but only 4.3 per cent of all chain properties. By 1977, New England's share of total chain properties had declined to 3.6 per cent.[15]

Some multi-establishment companies also diversify across

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[14] Census of Selected Service Industries 1972, General Report On Industrial Organization, Table 7.

[15] Chain Lodging Analysis, various years, American Hotel & Motel Association (New York) In addition, the risk profile for New England is such that its marginal contribution to the reduction of total risk is less than that of other regions.

different types of operations*, intra-regional locations (i.e. suburban, center city, and highway), and rate groups (i.e., budget, luxury). This last strategy has been curtailed during recent years as franchise holders maintained that this constituted unfair competition from their own parent chain corporation.

(2) Creaming. This strategy is aimed at capturing the more "stable" portion of the recreational and business market. In this manner, firms seek to minimize their exposure to unsystematic risk.

A good example of this strategy in operation is the convention hotel. A hotel with a strong convention demand can enter a new year with as many as 40% of its total room-nights pre-booked. This depends, of course, on the existence of a convention facility within close proximity. In addition, it is important that the convention facility be capable of attracting a sufficient number of national as opposed to regional conventions (it is estimated that nights spent by out-of-towners is about double for national conventions).

Even with a strong convention demand, these hotels are not immune to fluctuations in occupancy. The convention-related market itself tends to move with the overall trend in occupancy and the business cycle. Analysis was done on the trends in rooms assigned for major Boston conventions by the Greater Boston Convention and Tourist Bureau for the years 1966-1976.

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*For example, Laurence Geller, senior vice president for development at Holiday Inns, characterizes his company as "not restricted to a single kind of property...We have many different product lines, and we are seeking opportunities in all those lines." Holiday Inns has an interest in "resorts, center city hotels, airports, suburban inns -- whatever the type of property..." "Eric Bernard leads Holiday Inns into the 80's," Lodging Hospitality (May 1979), pp. 6-10.

Indexed to 1967 (1967=100), these room assignments show a correlation (58.5) with the number of hotel guests on the national level. Thus, convention hotels are -- to a certain degree -- trading off unsystematic risk for systematic risk.

Catering to "group business" is another strategy aimed at stabilizing demand: Many hotels have what are called "Distinguished Corporate Service" programs offering lower rates and more amenities to large corporate clients. Some hotels have special "V. I. P." floors accessible only to major corporate users.

With respect to recreational demand, luxury resort hotels which cater to the upper classes are considered to be more stable revenue generators. However, because of high fixed and semivariable costs, and the popularity of overseas and Carribean jet travel, there is a real necessity for these hotels to operate on a four-season basis. This has tended to put New England resort hotels in an increasingly disadventageous position. The Mount Washington Hotel, one of the region's premier resort hotels, was pushed into bankruptcy during the 1973-1975 economic slowdown. Today, the hotel is only able to sustain itself through conventions and group tours, which account for fully two-thirds of annual guest volume.[16]

Casino gambling offers a high volume non-weather-related source of demand for local hotels and national chains. Legalization of gambling in Atlantic City has set off a boom in hotel construction in that city.

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[16] Jourdan Houston, "A Dowager Hotel Struggles Back from Bankruptcy," New York Times (July 22, 1979), p. F3.

Recent moves (backed by the industry association) to extend casino gambling to Barnstable and Berkshire counties have been thwarted in Massachusetts Legislatures, but continued pro-gambling pressure is expected.

(3) Redefine Market Niche. As travel patterns changed in the 1970's, major hotel corporations moved towards destination-oriented locations for their new operations. Transient highway sites are now considered too risky because of uncertainties surrounding gasoline supplies. As the president of Holiday Inns, Michael D. Rose, explains:

> We intend to continue our pattern of expansion, but we're being more careful about selecting locations that will be served by mass transit.17

Holiday Inns, which has traditionally emphasized its roadside operations, has recently made heavier investments in urban areas. The energy situation is, and will continue to be, a major consideration for this firm (which plans a 35,000 room expansion over the next five years).

The tilt toward urban location is evident in figures supplied by the American Hotel and Motel Association which show that over 90 per cent of all money spent for new construction and modernization during 1977 occurred in metropolitan areas. Airport locations are also identified as important growth markets.[18]

While urban and airport markets have become important because of changes in national travel patterns, other market niches have opened up as the result of intra-industry competition. The best example of this is the "budget motel" market.

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[17] Barbara Lovenheim, "Holiday Inns Is Booming," New York Times (August 5, 1979), p. F1.

[18] American Hotel & Motel Asso., Construction & Modernization Forecast (October 26, 1977). Based on construction reports by chains.

Major national chains, intent on "creaming" what they considered to be the more stable portion of the market (primarily businessmen travelling on a fat expense account), added services and "frills," and upped room rates to their maximum levels. This opened up the potential market for establishments catering to the travelling public and businessmen operating on fixed budgets. In the words of Fred Roedel, president of the budget-chain Chalet Susse International:

> I did the analysis. It became sort of a case. I found a couple of important things. First, the (low-priced motel) industry is made up of mom and pops. There is a great lack of professionalism. Very few know what it costs them to clean a room. Second, the market for inexpensive but clean and attractive rooms is huge. The big chains have priced themselves into the stratosphere and the mom and pops don't have a quality image. There was a gap and it was a very big one.[19]

The first budget chain was Motel 6 which opened its first property in 1963. During the early 1970's, these operations demonstrated superior average return on investment and reduced risk. This latter characteristic was noted by Arbel and Grier who hypothesized that "when the occupancy rate for the hotel industry as a whole declines (e.g. during a recession), people tend to switch from high-priced lodging accomodations to less expensive facilities. This phenomenon significantly reduced the systematic risk of the low-rate group of motels."[20]

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[19] John Klug, Chalet Susse International (Boston: Harvard Business School Intercollegrate Case Clearing House, No. 9-673-090, rev. March 1974), p. 1.

[20] Arbel and Grier, *op. cit.*, p. 19.

Major chain operations attempted to diversify into the budget field. Holiday Inns opened Holiday Inn, Jrs., and Howard Johnson tried to start a budget chain called three Penny Inns. These efforts failed because (a) the major chains were unable to keep construction costs at a sufficiently low level (the rule of thumb in the industry states that rates must at a minimum be $1.25 to $1.50 for each $1,000 in construction costs); (b) overhead costs were too high for the major corporations; and (c) franchisees complained that parent sponsored budgets would "cut our throats." For these primarily institutional reasons, the major corporations have backed away from pursuing the budget market and have left this segment to new entrants.

An intermediate and more sophisticated strategy for redefining one's market niche is to go "multi-market." For example, this would mean marketing group meetings in the winter to offset the seasonal effects of tourism, or offering special weekend packages for vacationers to balance out peak business demand during the week. Going "multi-market" helps to increase property utilization during slack periods and thereby reduce the downside risk inherent in any single market segment.

(4) Product Differentiation. Many hotels-motels have sought to differentiate what is essentially a homogenous product: "a room for the night." The extent to which the product can be differentiated and identified with the particular hotel-motel or chain tends to instill "consumer loyalty." This loyalty is often essential in generating repeat occupancy (both recreational and business). Repeat customers provide a certain level of stability in demand, and thus help to reduce the risk of the venture.

There are numerous strategies devoted to developing product differentiation in the lodging industry. The personalized service provided by the typical "mom and pop" operation was often a sufficient salespoint to ensure repeat business. However, as the industry grew and became "big business" other measures were used. These were not without their costs.

(a) Advertising - created an "image." In 1974, corporations in the lodging industry spent 1.7% of all receipts on advertising (compared to 1.2% for all services and 0.8% for all industries).[21]

Advertising has become increasingly important as the industry orients itself to pleasure travellers and fights for a larger share of consumer's discretionary income. "We're competing with Bonwit Teller now for the consumer's dollar," remarked one chain executive.

(b) Convenience. In large measure, the chains were able to establish themselves by offering a "free" reservation system and consumer credit. Individual enterprises belonging to the chain as franchisees must pay for this computerized reservation service. The nature of this payment varies according to the chain. For some chains, the fee is on a per reservation basis, while for others it is part of the royalty fee. Royalities usually vary between 3% - 5% of total revenue plus an initiation fee of between $3,000 and $20,000. Several chains have separate initiation, royalty, and reservation fees.

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[21] Internal Revenue Service, Statistics of Income, 1974, Corporations Income Tax (Washington: Government Printing Office, 1978).

Credit cards are also not without cost. In 1977, credit card commissions accounted for 1.1% of total sales.[22]

(c) Location. A key location can give "prestige value" to any operation. However, a prime location, especially in a metropolitan area, can be very expensive to acquire or lease. Since the cost of land has to be factored into the rate schedule, management must be conscious of its competitive position within the local market. If the hotel enjoys a monopoly in the locality, the prime location may not be necessary (though a future competitor may seize the site). If, on the other hand, the local market is at least nominally competitive, an expensive location and higher rate structure may work against the operator.

(d) Services. In past years, much emphasis has been placed on offering the guest a "total package" of service, including, for example, the use of a rent-a-car. Hotels owned by airlines were part of a larger "travel package."

Chapter IV: Institutional Aspects of Investment

Overview

The traditional textbook exposition of the theory of investment posits the rational entrepreneur seeking to maximize the present value of expected future profits derived from any given investment. Expected returns are seen to be based on current profit levels, capacity utilization, and prospects for long term growth.[1] The investment decision is then made subject to the constraints of perceived risk and capital market conditions (e.g. could the investment be profitably postponed?).

Empirical studies of firm behavior have often tended to question the veracity of the neoclassical formulation.[2] Establishments are observed to be facing imperfect competition, acting under poor information, and facing the usual oligopolistic quandry (how will my competitors react?). Moreover, individual firms may pursue objectives other than profit maximization -- such as stabilization of prices and margins, achieving target market shares, and disuading competition.

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[1]Edwin Kuh, "Theory and Investments in the Study of Investment Behavior," American Economic Review (Vol. L111, May, 1963), pp. 260-268.

[2]Robert Lanzilloti, "Pricing Objectives in Large Companies," American Economic Review (Vol. XLV111, Dec. 1958), pp. 921-940, concludes that: "No single theory of the firm - and certainly no single motivational hypothesis such as profit maximazation - is likely to impose an unambiguous course of action for the firm for any given situation."

This picture is made all the more complex in the lodging industry because of the multiplicity of institutional actors involved. The investment decision, per se, rarely resides with any single actor. This is partially because so little of new investment -- be it expansion, rehabilitation, or new construction -- is financed out of retained earnings. Investment usually involves recourse to debt financing. Among corporations, the lodging industry has a much higher proportion of its total assets accountable for by long-term debt (50.3%) than do other service sector industries (26.9%), manufacturing industries (17.3%), or all industries (13.4%).[3] At a minimum, therefore, the investment decision usually involves an owner and a lender.

The situation becomes more complicated because of the nature of the industry and the assets involved. Hotels and motels constitute both an operating business and a real estate investment. As part of the attempt to boost profitability, the management function was seperated from ownership (see Chapter Three). Since cash flow (and debt coverage) depends on the competence of the operator, management becomes an important, and sometimes determining, factor in the investment decision.

Looking again at the corporate balance sheet, we note that land makes up 10.1 percent of total assets of the lodging industry -- compared to 4.5 percent for the other service sector industries, and 1.6 percent for all corporations.[4] This opens the possibility for real estate appreciation and speculation for owners of well sited properties. On occassion, this rationale

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[3]Internal Revenue Service, Statistics of Income, 1974, Corporation Income Tax Return (Washington: Government Printing Office, 1978).

[4]Ibid.

may outweigh operating incomes as an ownership and investment consideration.

Of equal, or greater, importance for equity investors is the fact that hotels and motels serve as prime vehicles for depreciation, and, as a consequence, offer significant tax shelter benefits for wealthy investors. Hotel-motel structures -- which ordinarily account for two-thirds of total property cost[5] -- have shorter depreciable lives than office buildings or retail stores. Furniture and equipment -- representing approximately 18% of cost -- have an even faster depreciation schedule than structures.

Depreciation expenses for new structures and equipment can result in a pre-tax loss even though the cash flow may be positive. This provides an interest-free method of obtaining working-capital for the enterprise. More importantly, accelerated depreciation postpones the recognition of taxable income, can be divided among a number of taxpayers or taxable years, and can be used to convert ordinary income to capital gains income in later years.[6]

Equity investors may, therefore, be drawn to a hotel-motel project for a number of reasons. Financing arrangements are often quite intricate, as different classes of actors may have distinct requirements. For example, a large downturn commercial hotel project will usually involve -- at the very least -- a group consisting of equity investors, a hotel operating company, a developer, and one or more mortgage lenders.

The objectives of these actors may vary widely. The equity investors

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[5]Clifford T. Fay, Richard C. Rhoades, Robert L. Rosenblatt, Managerial Accounting For The Hospitality Industries, 2nd edition (Dubuque: Wm. C. Brown Co., 1976) p. 517.

[6]Ibid.

may be split into two groups. One group (perhaps consisting of foreign investors) may be primarily concerned with long-term real estate appreciation at the site and a steady cash-flow. Another group (perhaps a syndicate consisting of wealthy doctors and lawyers) may be motivated by the tax shelter benefits to be derived from rapid depreciation of new structures and equipment. The operating company may be interested in the potential for rate escalation and volume growth (since they often work on the basis of a fee equal to a fixed percentage of income). The mortgage holder may judge the worthiness of the investment on the basis of the debt coverage ratio, the amount of loanable funds available, and the yield spread on alternative investments. The developer will probably be concerned with a quick turnover of his invested capital through a speedy construction process, ready access to construction finance, and an assured final take-out by a permanent mortgage or, preferably for a face amount in excess of total costs.

Under conditions such as these, it is not difficult to imagine situations whereby groups of actors, all pursuing rational "profit maximization" ends, produce outcomes which grossly distort and render meaningless any notion of supply/demand equilibrium. A management company may attempt to overstate market demand, a developer may inflate the value of the finished product, and the equity partners may seek also to push up depreciable costs while minimizing their share of risk capital. A mortgagor flush with investment funds, and looking desperately for outlets, may uncritically accept these assessments.

The result of this situation might be overcapacity, with fixed costs possibly in excess of income. For example, in Atlanta some $250 million worth of real estate, including a 500-room hotel, fell back into the hands

of lenders in early 1978. The Omni complex, representing $100 million of investment, could not service the interest on its debt even when fully leased.[7] Lenders convinced that "Atlanta is booming" poured hundreds of millions of available dollars into real estate deals without careful analysis.

Many hotel-motel projects do not depend on the participation of large institutional lenders or real estate syndicates. Smaller motels may be financed entirely through personal savings, borrowings from friends, a purchase money mortgage from the previous owner, or possibly a second mortgage on the family house. The investment decision may be based solely on a desire for income security during old age. Many motels and smaller hotels are strictly "ma and pa" type of operations whose aim is to generate sufficient cash flow to support -- at least in part -- a family, couple, or individual.

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[7]"Atlanta's Worst Flop in Real Estate Yet," Business Week (No. 2523, February 27, 1978), p. 33.

Institutional Forms of Ownership and Control: The Chains

The three forms of legal organization in the lodging industry are proprietorships, partnerships, and corporations. Underlying these legal forms is a basic division between chain and independent control.

According to the American Hotel and Motel Association (AHMA), in 1977 chains accounted for 29.2 percent of all U. S. properties and 63.1 percent of all available rooms.[8] The AHMA reports that the twenty five largest chains (7.6 percent of all chains) control 78 percent of the rooms in the total chain market, and just under 50 percent of all hotel-motel rooms available in the U. S. The top seven chains* alone control 71 percent of all chain rooms and 45 percent of the U. S. total.

Although no precise breakdown of chain/non-chain affiliation according to legal form of organization is available, it appears reasonable to assume that chains are most heavily represented among corporations (which include all the "parent" chains) and partnerships (a popular form of syndicating ownership for franchisees). Proprietorships are predominatly small independents, though they have been seeking chain affiliation in increasing numbers over the past decade.

The amount of control that a national chain exercises over an individual establishment varies widely. One sample indicates that approximately 15 percent of all chain properties are company owned, eight percent are company managed, six percent are leased, and 71 percent are

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[8]American Hotel and Motel Association, 1977 Chain Lodging Analysis.

*Holiday Inns (258,711), Best Western (92,770), Ramada Inns (87,883), Sheraton (74,707), Budget Motels (69,394), Hilton (64,414), and Howard Johnson (58,977).

franchised.[9]

The relationship between franchisee or member in a referral organization and the national chain is determined contractually. The payment to the chain is generally based on an initial fee, royalties, an advertising fee, a reservation fee, and often times "other" payments. The chart below compares the requirements necessary to join the nation's four leading chain and referral groups.[10]

Chain	Initial Fee	Royalty	Advertising Fee	Reservation Fee	Other Fees
Holiday Inns	$20,000 + $150/rm. over 100 rms.	4% gross room revenue	1.8% gross room revenue	None	Holidex (computer terminal) fee: $3/rm/month
Best Western	$2,040 + $18 each room over 20	None	7¢/rm/day	7.2¢/ rm/day	monthly; annual dues
Ramada Inns	$100/rm; $15,000 minimum	3% gross room sales	$4.41/rm/ month	$450 terminal rental +19% gross rm. sales	1¢/rm/day training fee
Sheraton Corp. (ITT)	$15,000	4% gross room revenue	None	1.6% gross room rentals	None

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[9] This is based on a sample consisting of 33 large firms controlling 4,549 properties representing 827.926 rooms. Jean-Robert H. Cauvin, "Executive-Compensation Practices in the North American Lodging Industry," Cornell H. R. A. Quarterly (May 1979), pp. 53-60. The American Hotel and Motel Association reports (1977) 10,912 chain properties in the U. S. and 1,276,922 chain rooms. The Industry and Trade Administration of the Dept. of Commerce reported 5,808 chain properties in 1977, of which 22.6 percent were chain owned, but this does not appear to include "membership groups such as Best Western.

[10] "Chain and Franchise Directory," Lodging Hospitality (Aug. 1978), pp. 63-65.

Great emphasis has been placed in recent years on management contracts as the most desirable method for chain expansion. The terms of the management contract usually specify both a basic fee (based on a percentage of gross revenue) and an "incentive fee" (generally a percentage of gross operating income based on a sliding scale). Management contracts allow the chain to exercise direct control over daily operations (as opposed to the franchisee's relative autonomy). In addition, management contracts allow chain managers to determine discretionary purchasing of supplies and services (some of which the chains themselves sell).[11]

Perhaps most importantly, from the perspective of the chain, management contracts offer a relatively risk-free avenue to expansion. These arrangements usually require neither an equity commitment or assumption of debt on the part of the chain. These matters remain the province of the hotel-motel investors. However, because of the keen competition among chains for these lucrative contracts, many are now willing to provide some money in the form of land financing or working capital. The expansion of management contracts has also necessitated a concomitant growth in mid-level management staff capable of taking on operating responsibilites.

Chain ownership of new operations is usually reserved for the most profitable establishments, particularly casinos. Leases have fallen into

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[11] The Industry and Trade Administration reports total sales of products and services from franchisors to franchisees in 1977 of $24.6 billion (on 5,808 reporting establishments).

disfavor as a form of chain control, because they require a long-term commitment to pay a fixed monthly rental. Management contracts enable the chain to take a assured percentage of gross revenues (and thereby cover all overhead costs), and share in the profitability of the enterprise. This provides income insurance during cyclical downturns and boosts corporate profits during upswings.

Many chains have minimum requirements for the size of an affiliated property -- either as a franchise, leased, or managed operation. Hilton, Sheraton, and Howard Johnson (which is not in management) all require a minimum of 100 rooms for new franchises.[12] The major chains will not take on any property for management if it cannot guarantee a minimum of $100,000/year in fees. Many will not look at a management contract on a property of less than 300 rooms. This has opened up the market for independent management companies. As Lodging Hospitality reports:

> Well-established management firms...can often undercut the chains' management contract fees because of low overhead. An independent firm allows the owner to continue his present franchise affiliation while most chains require new management-contracted properties to join their system.[13]

The minimum size at which absentee management can profitability be instituted, from the perspective of the hotel owner, depends on whether

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[12] "Chain and Franchise Directory," Lodging Hospitality (Aug. 1978), pp. 63-65.

[13] Robert Kiener, "The Management Contract," Lodging Hospitality (April 1975), p. 45.

profits can be sufficiently increased to absorb a charge equal to three to five percent of gross revenue. According to hotel finance expert Stephen Brener, this number has increased from 50 units twenty years ago to 150 units today.[14] One owner-operator of a 155 room hotel in our interview sample indicated that he could still not afford absentee management because, he felt, total administrative salaries would then expand beyond the carrying capacity of the business.

Influence of Lenders: Insurance Companies

Mortgage lenders play an important role in emphasizing professional management capability and reinforcing chain affiliation. Insurance companies, the most important institution in the capital market for hotels and motels*, overwhelmingly prefer franchise agreements. In a sample consisting of 34 of the nation's 51 largest insurance companies, Lodging Hospitality found that all but two companies required chain affiliation.

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[14] Stephen W. Brener, "Considering Absentee Management?," Lodging Hospitality (May 1976), pp. 16-17.

*Donald R. Knab, senior vice-president for real estate at Prudential Insurance Company, the nation's largest institutional investor in real estate, states that Prudential is "the country's largest owner of motels." The New Money Target: Profitable Real Estate," Business Week (August 1, 1977), p. 57. Equitable Life Assurance Society is said to have over one billion in hotels and motels, or about 10% of its total real estate portfolio (Business Week, July 17, 1978, p. 71). Metropolitan Life Insurance Company and Aetna Life and Casualty each have hotel-motel investments in the hundreds of millions, while John Hancock's investment is estimated at $325 million, with $100 million in additional commitments (Lodging Hospitality, December, 1978). Most of the more regional insurance companies, such as Connecticut General and Massachusetts Mutual also have sizeable hotel-motel investments.

Management contracts were required by nine of the lenders.[15]

Because of the emphasis on management (fueled in part by a fear of direct management in the eventuality of foreclosure) institutional lenders usually refuse to finance those projects too small to support professional absentee management.* Insurance companies avoid projects of less than 100-200 rooms -- the average minimum is 121 -- and most prefer larger hotels. One interviewee (an insurance company real estate executive) considered the most desirable type of investment to be "a middle sized hotel, say 250-350 rooms, not very expensive, $25,000 to $30,000 per room, with extensive facilities..."

Insurance companies prefer larger projects for other reasons as well. Perhaps most importantly, large hotels-motels are more easily able to support income participation clauses, or "kickers," as a condition of the mortgage contract. As is the case with management contracts, income participation clauses require a percentage of revenue (one percent of gross room sales is typical) in addition to the contract interest rate. Institutional lenders like kickers because they provide a hedge against inflation, and add approximately a quarter point to yield.

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[15] Stephen W. Brener, "Where and How Financing Will Come in 1979," Lodging Hospitality (December 1978), pp. 22-25.

*Bruce W. Fraser, Director of real estate investment for Massachusetts Mutual, has stated that: "We like to balance our portfolio with commercial investments and hotel investments. Hotels are riskier, but we can charge higher interest rates. We look for hotels or motels with major chain affiliation, a franchise or management contract. It would take a most unusual circumstance for a small, independent operator to get money. It has been done, but on a very selective basis." Lodging and Food-Service News, December 11, 1976.

Income participation clauses are required on about 50 percent of new deals according to one industry source. They vary in complexity, and may involve moving percentages of "participation" dictated by threshhold levels of income after operating expense and debt service have been paid. The ultimate kicker would be for the lender to require an equity position ("free equity") and share in proceeds of refinancing, real estate appreciation, profits, and the benefits of depreciation.

Owners generally try to resist the imposition of income participation clauses, or attempt to restrict their requirements. However, since insurance companies control perhaps as much as 70% of the mortgage market for large (over 100 rooms) properties,[16] they are often "the only game in town." Commercial banks limit their involvement to interim construction loans (and require commitments for permanent take-out). Savings banks are approachable on the local level, but usually have smaller allocations for commerical mortgages generally and hotels-motels specifically. Savings banks are much more sensitive to fluctuations in consumer savings (disintermediation especially) and therefore tend to shy away from these "higher risk" mortgages.

Pension funds offer an attractive alternative source of capital for hotel-motel development because of their recent tendency towards diverisification (prescribed by the Employees Retirement Income Security Act). Some pension funds have made direct investments in hotels and motels in New England. However, many of the funds most active in real estate are

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[16] see "Chains see Modest Growth in Capacity During 1979," Lodging Hospitality (December 1978), p. 30.

investing through "commingled funds" managed by large banks, and, again, insurance companies. Prudential's PRISA and Equitable Account 8 are two of the largest of these funds.

Corporate Strategies: Out of Ownership

Hotel-motel corporations have recourse to borrowing not only through the mortgage market, but also through the market for publicly-offered bonds and debentures.* There is also the quasi-borrowing option of a sale-leaseback transaction.** Real-estate investment trusts (REIT's) provided a significant amount of both short and long-term money in the early 1970's before the real estate market collapsed in 1974-1975. For example, Hotel Investors (a REIT) did the construction financing on the Boston (airport) Hilton in 1971 and held the long-term mortgage (with a kicker).

Major chains are capable of capitalizing on franchise and management fees to take larger equity positions on their own properties, but they

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*This bond market is, once more, dominated by insurance company purchases. Life insurance companies are the largest institutional holder of corporate bonds.

**This range of borrowing options "is available mainly to larger hotel-motel chains...For smaller chains and independent establishments, bond and debenture financing, or sales-lease back transactions, if any, are much less prevalent." Royal Ship and Robert Morre Fisher, "The Postwar Boom In Hotels and Motels," Staff Economic Studies No. 9 [1965] Board of Governors of The Federal Reserve System.

have, for the most part*, shied away from this strategy. The reason for this is that as publicly held corporations**, they are much more concerned about the value of their stock than their relative ownership position. By de-emphasizing ownership (or large equity and debt layouts) the corporation is able to claim its profits on a smaller asset base. By eliminating investment in structures the company reduces its book depreciation costs. Reduction in long-term debt means less interest payments. The net result is both higher (reported) earnings per share, and greater returns on assets. This makes the company's stock appear to be more attractive and is an influence in upgrading its price/earnings (P/E) ratio. A brief review of recent events concerning Sheraton and Hilton provides a good example of this strategy in operation.

Sheraton was a Boston-based company started in 1937. By 1968, the company owned, leased, or had under management agreements 92 hotels, and operated through its franchisees 104 motor inns. In February, 1968, Sheraton was acquired by ITT*** in exchange for 3.6 million shares of

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*Howard Johnson is an exception.

**Of the twelve largest hotel chains (those with sales of over $100 million) five are publicly held independents and seven are publicly held subsidiaries.

***According to Anthony Sampson (The Sovereign State of ITT (New York: Stein and Day, 1973), p. 96): "hotels were a growth industry that could link up with other ITT industries, and 'international development,' they [ITT] predicted, 'should produce extraordinary results.' Hotels were less vulnerable than telephone companies to nationalization, and ITT could push up room changes further, and makes further economies. Most important of all, Sheraton employed very conservative accounting, using its profits to build up assets, rather than to show high earnings. ITT, by changing the accounting, could show a spectacular improvement."

of common and 300 thousand shares of preferred stock with a combined market value of $200 million.

The conglomerate established a five-year plan with the objective of challenging Hilton and Intercontinental Hotels* on the world market. The strategy called for the expenditure of $700 million for new construction in 38 countries, including the U. S.

This strategy was brought into question in 1970 when the lustre began to fade from ITT's stock price and high P/E ratio. This was largely the result of (1) anti-trust suits; (2) cut-backs in military contracts, and; (3) the economic slow-down in 1970. As John Blair notes:

> Ironically, the very practices that facilitated the growth of conglomerates on the upswing became an albatross around their necks during the downswing. As total sales and earnings fall, the payments of fixed obligations incurred through leverage--- interest on debt and dividends on preferred stock-absorb progressively larger shares of gross income, leading to even further declines in net earnings. The intensification of competitive rivalry inherent in buyers' markets requires cost-reducing improvements in facilities; if they are financed through new stock issues, the result is a "dilution" of the value of existing shares; if they are financed through credit, the result is a further increase in payments on fixed obligations.[17]

Sheraton's ambitious expansion plans were obviously exacerbating this predicament. ITT had already sold off 15 hotels in the South and Midwest

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*Hilton overseas operations were taken over by TWA; Intercontinental was absorbed by Pan American.

[17]John Blair, Economic Concentration (New York: Hartcourt Brace, 1972), p. 299.

to support its international operation. Sheraton now moved to dispose of 51 additional hotels in the U. S., including properties in Boston, Springfield, Quincy (MA), and Providence. In the words of Sheraton senior vice-president John Brogan: "At the time we were divesting in the U. S., Sheraton was active in expanding overseas, particularly Europe and the Middle East, but also Latin America and the Far East." Sheraton is now "a leader-if not the leader-in international hotels."[18]

By 1973, Sheraton-ITT had re-evaluated its expansion strategy and decided to get out of ownership altogether. "We're not interested in owning hotels," stated Sheraton president Howard P. "Bud" James. "Let someone else own them. We'll run them...If we have to own a hotel to get one, we don't want it."[19] According to vice-president Brogan, this now:

> fits into ITT's return on assets program. As an earnings-per-share company, they're very much interested in our bottom line, and we really do far better from the standpoint of profits on assets -- based on a very low asset base and very high profits from management contracts.20

Today, Sheraton's growth stems from a policy, expressed by its

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[18] Paul Robbins, "Look What Sheraton's Done Lately," The New Englander (October 1978), p. 51.

[19] Ibid.

[20] Ibid.

president, of "growth with other people's money."[21] Capital assets, which peaked at $700 in 1973, are now less than $400 and still going down. According to ITT's 1977 Annual Report: "It is estimated that by 1982 Sheraton's name will be on a network of five billion dollars in properties with an investment of approximately $250 million."

This additional capital will not be borrowed. Since 1974, ITT has been on a "zero incremented debt program." This way management fees and franchise royalties, which come off the top of operating revenues with little risk to Sheraton-ITT, will go right to the bottom line of the corporate balance sheet. In addition, steady revenue growth (expected to increase from $1.5 billion in 1978 to $2.4 billion in 1982), makes the subsidiary a significant cash generator for ITT's extensive worldwide operation.

Hilton shifted emphasis from ownership to management in 1975. The company sold a half-interest in six of its best hotels to Prudential Insurance for $83 million. Hilton applied $24 million of the cash proceeds to wiping out corporate debt; and free of mortgages on the six hotels, Hilton was able to reduce its long-term debt from $176 million to $118 million. In all, Hilton was able to lessen its yearly interest and depreciation charges by $3.2 million after taxes. By maintaining management contracts on the sold properties and aggressively pursuing franchising, the company was able to increase the number of hotels under

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[21] "Tinkering With Geneen's Growth Machine At ITT," Business Week (May 15, 1978), p. 60.

its control from 146 to 161 (this in a recession year) even though total corporate assets declined by over $45 million.[22]

Hilton used another $25 million of the Prudential proceeds to buy back four million shares of its own stock at very low prices. As a result, of these transactions, Hilton's net income per share increased from $2.09 to $2.87 and the value of the company's stock increased from four to 17. The Hilton family's holdings rose from 26% to 31% of outstanding shares, while its market value jumped from $16 million to $68 million. "If you are a certain kind of investor, ownership and cash flow are fine," remarked Barron Hilton. "But for us, immediate earnings per share are what we are seeking."[23]

The closing and subsequent sale of the Boston Statler-Hilton in 1976 should be understood in this context. According to one industry source, Hilton was unwilling to seek refinancing for the $20 million necessary to upgrade the property, as the company was then pursuing its debt reduction strategy. High prevailing interest rates dampened outside investor interest, and the hotel was closed down in late 1975. Five hundred workers were discharged. In early 1976, Equitable Life Insurance, the mortgage holder, brokered the sale to a local hotel management company and offered

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[22] See Hilton Hotels Annual Report, 1978 (for the year ending December 31, 1977).

[23] "Hilton Turns the Tables," Forbes (July 1, 1976), p. 40.

generous financing terms. The hotel was reopened as the Boston Park Plaza. It is still undergoing a slow remodeling.

Equity Investors

When corporate chains began moving out of ownership into management and marketing, an "equity gap" was created in the industry. Insurance companies shifted some of their immense capital resources into ownership, while maintaining their mortgage holdings as well. Many insurance companies went into "joint ventures" with other equity holders. Prudential, for example, is in a joint venture with Burlington Northern in owning many La Quinta motels.

Foreign investors have become important in some local markets -- New York in particular. Some foreign corporations have purchased American chains: Aer Lingus (which is owned by the Irish Government) purchased Dunfey Hotels in 1976 from Aetna Life and Casualty; both Nestle's and the British hotel company Truste House Forte have extensive U. S. holdings. In New England, foreign capital (primarily from Canada) has made its presence felt in Providence, Boston, and Portland. The aggregate effect of this direct investment is not considered strong in the region.

Many corporations maintain some minority ownership in their chain's larger hotels. In some cases, this is done to exhibit a greater commitment to the mortgage lender. At other times, this is for more "practical" reasons. The Securities and Exchange Commission recently accused the Hyatt Corporation at having failed to disclose conflicts of interest between

it and the Pritzker family, which controls 35 percent of the company's stock. One of the allegations charged that Hyatt had failed to disclose that:

> Three hotel ventures in New Orleans, Indianapolis and Cambridge, MA, financed almost entirely by the Prudential Insurance Company of America, were structured "from the outset to provide, among other benefits, substantial tax benefits to the Pritzker family, even though the Pritzker family supplied a small amount of the capital involved.24

Tax benefits, available through rapid depreciation, are a major inducement for equity investors. Insurance companies are relatively less interested in this potential benefit because they are taxed at less than the corporate or personal (high income) rate. Consequently, developers often times organize syndicated partnerships to attract equity money (often in excess of the developer's own initial investment), and distribute tax shelters.

For owners of smaller hotels and motels, depreciation is very helpful, but not in itself a sole criteria for investment. The sources of equity for smaller owner-operators are usually savings or personal property (i.e., their house or other business). Debt capital is generally available from local saving banks, but many small operators must make use of purchase-money mortgages or personal borrowings.

Capital Investment Behavior 1958-1977: Supply and Demand

As a bench-mark for discussion, we have constructed time series data for 1958-1977 showing the key indicators of supply and demand: occupancy,

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[24] Judith Miller, "S. E. C. Cites Hyatt on Disclosure," New York Times, December 8, 1978, p. C.3.

room rates, income available per room, and investment. Occupancy, rates, and income data have been obtained from Harris, Kerr, Forster and Company's Trends in the Hotel-Motel Business, 1978 Edition. Rates and income have been deflated to 1972 dollars.

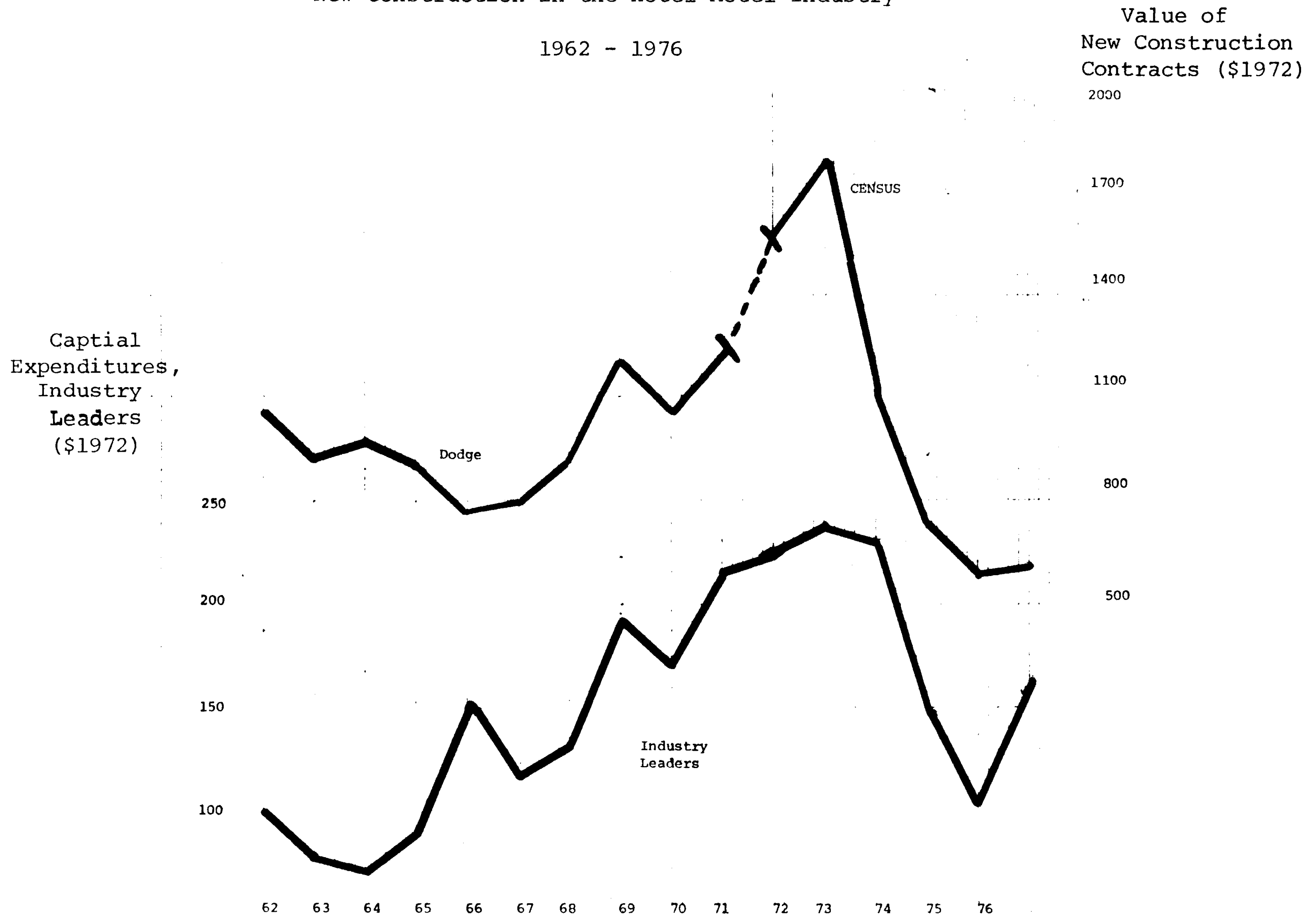
Total capital investment for hotels and motels is difficult to estimate accurately. As a measure of the relative movement of investment acitivity, we have used the figures for gross investment in new construction and renovations contracts (excluding furnishings, fixtures, equipment, land) as reported by the F. W. Dodge Corporation. Unfortunately, this data is available only for the period 1958-1971. To complete the time series, we have employed the construction reports (Current Construction) issued by the U. S. Bureau of Census, using the category "non-housekeeping residentials" as our source. Since non-housekeeping residentials includes hotels, motels, dormitories, and nursing homes, an estimated proportion applicable soley to hotel-motels was determined on the basis of total hotel-motel investment reported by F. W. Dodge in 1971 and the total non-housekeeping residential reported by the Bureau of the Census in the same year. This percentage was then applied to the Census data for the years 1972-1977.

To partially assess the validity of this approach, a time series on total capital investment for five of the leading firms in the hotel industry (Holiday Inns, Ramada Inns, Howard Johnson, Sonesta, and Hilton) was assembled using data reported in Valueline. This series was then matched with the Dodge-Census series (see Figure 1), and found to be comparable. The full time series for occupancy, average room rates, income

Figure 1

New Construction in the Hotel-Motel Industry

1962 - 1976



Source: See Text.

and new construction is presented in Table 1 and Figure 2.

U. S. Chronology

1. 1950's (Background)

During the 1950's hotel-motel industry capacity expanded in excess of demand. According to a Federal Reserve commissioned study,[25] the supply of available hotel-motel rooms increased by a third, while aggregate demand rose only slightly. Motels accounted for most of this increase, proliferating at an average rate of eight percent a year. Construction of hotels was limited primarily to modernization of and additions to structures erected before the early 1930's.

According to the Federal Reserve study, the expansion of new facilities was largely attributable to the Internal Revenue Code of 1954 which gave first owners of new depreciable property the option of using a declining balance method involving a rate of up to twice that of straight line. This enabled owners to convert ordinary income into capital gains at a later date.

> The boom in hotel [and motel] construction which emerged in the 1950's was more in response to anticipations of capital gain than of current yield -- prospects favored in part by changes since 1954 in Federal tax laws and regulations....[26]

Since "used" properties could be depreciated at 150 percent, this

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[25] Royal Ship and Robert Moore, *op. cit.*

[26] *Ibid.*, p. 21.

Table 1

Occupancy, Room Rates, Income, and New Construction, 1958-1977

		Deflated to $ 1972[1]		
Year	Percentage of Occupancy	Average Room Rate	Income Per Available Room[2]	New Construction (millions)
1958	66.9%	$20.32	$2,257	$ 505.5
1959	68.4%	20.36	2,364	775.3
1960	67.4%	20.23	2,149	883.5
1961	66.4%	20.07	2,143	838.1
1962	66.7%	19.86	2,050	1,051.2
1963	67.0%	19.66	2,008	925.7
1964	68.4%	19.82	2,071	975.2
1965	69.7%	19.88	2,205	906.7
1966	70.7%	19.97	2,344	774.2
1967	72.3%	20.39	2,490	791.9
1968	72.1%	20.94	2,553	913.0
1969	72.0%	21.47	2,547	1,198.5
1970	67.8%	21.71	2,221	1,044.5
1971	65.7%	21.17	1,941	1,221.6
1972	67.4%	20.74	1,967	1,583.5
1973	68.4%	20.79	1,940	1,795.9
1974	67.4%	20.56	1,845	1,116.6
1975	64.4%	20.84	1,688	723.7
1976	67.5%	21.04	1,998	589.4
1977	69.5%	21.44	2,023	600.8

[1]For room rates and income, figures adjusted using personal consumption expenditure deflator for services. For new construction, figures adjusted by non-residential structures deflator. Economic Report of the President (Washington: GPO, 1978), table B-3.

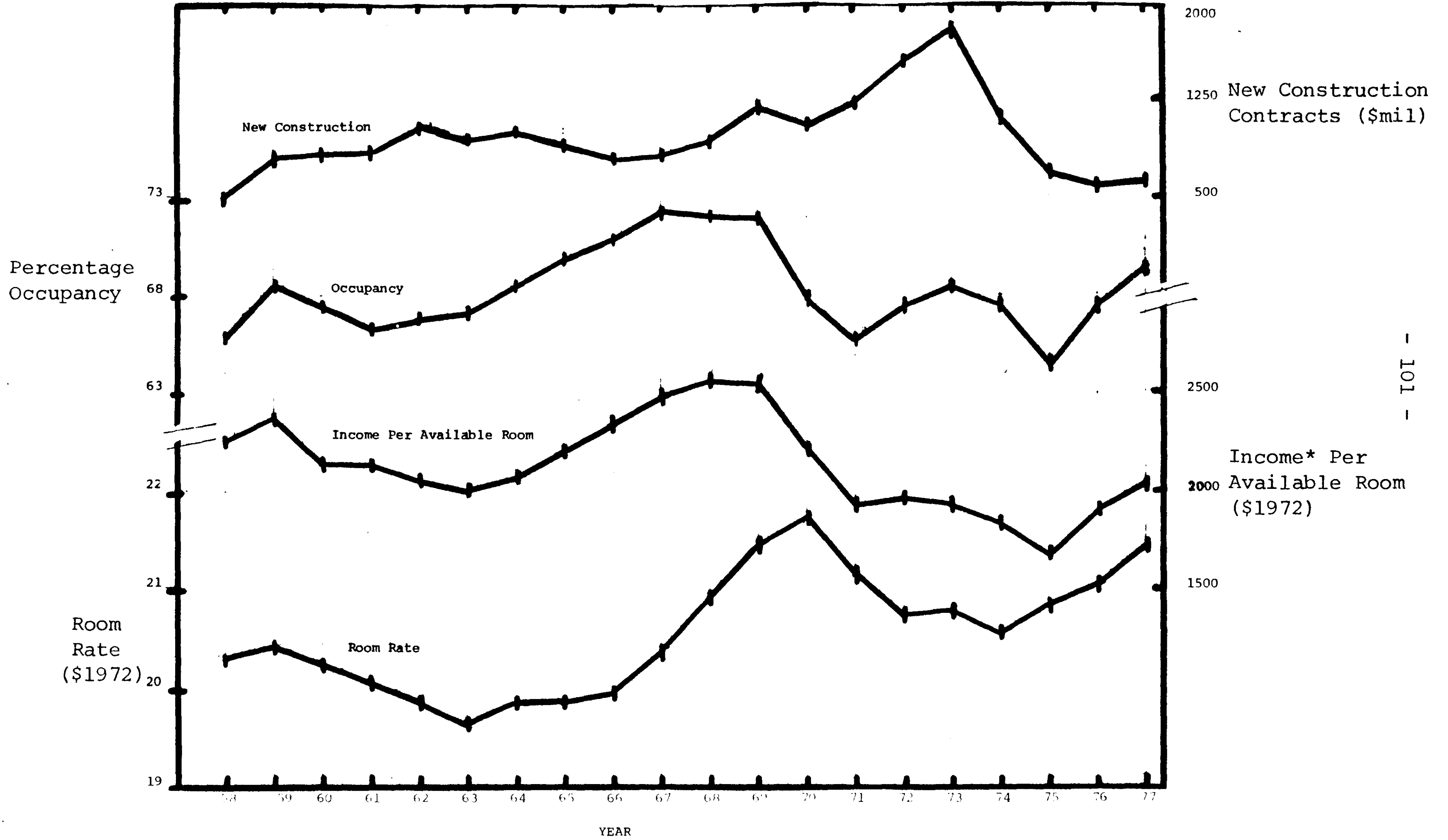
[2]Signifies income per available room after property taxes and insurance, but before depreciation, amortization, interest, other taxes, and profit.

Sources: Trends in the Hotel-Motel Business, 1978 Edition (New York: Harris, Kerr, Forster and Company, 1978). For New Construction see Table

Figure 2

Key Indicators in the Hotel-Motel Industry

1958 - 1977



*Refers to income after property taxes but before capital charges.

Source: See text.

resulted in "a somewhat higher rate of turnover of ownership of existing properties than would have taken place during the same period in the absence of such tax changes."[27] These changes in the tax code meant that many hotel companies became just as interested in real estate speculation and "leveraging" as hotel operating.* Potential tax benefits were often capitalized into the depreciable assets, resulting in higher prices. This further accelerated the real estate boom in hotels and motels.

2. 1958-1963

Capital investment in new facilities continued to rise slightly despite a fall of: 1.4% in room occupancy, 3.49% in room rates, and 15.06% in income per available room. The investment was sustained primarily by motels newly placed along Interstate highways. The number of Interstate System interchanges open or under way at the beginning of 1964 totaled 4,486, with 8,480 planned to be constructed.

Many older motels were by-passed by the new highway system. While it is not possible to accurately fix the mortality rate for these motels,

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[27] Ibid., p. 29.

*For example, A. B. Cantor, president of Carter Hotels Operating Company was quoted as describing himself thus: "I buy and sell hotels. I'm a dealer in 'em. This place I hang onto, like out of loyalty, after nineteen years, but the rest, they come and go." Quoted in "Hotel men look at their business," Catering Employee (October, 1959), p. 25. Donald E. Lundberg (The Hotel and Restaurant Business, 2nd Edition, Boston: Cahners Books International, 1976) described Sheraton's strategy in the late 1950's as: "There is a time to buy a hotel and a time to sell it, the timing dependent upon the tax base which is left for depreciation in a property, general business conditions, and whether or not the cash might not be put to better use in another property."

we note that the number of hotel-motel proprietorships (primarily small motel operations) in the U. S. declined by a startling 11 percent in the 1961-1963 period alone (see Table 2). This represents an absolute decline of 11,092 businesses.*

During the same three year period, the number of corporations grew by 24 percent (an absolute increase of 2,806), reflecting some incorporation of existing proprietorships and partnerships, but also new speculative motel developments along the Interstates.

The Interstate highway program was an important factor in destabilizing the industry. As John P. Henderson concluded in his 1965 study:

> Inadvertently, the highway program, which has been the biggest growth factor for the motel division, has also introduced a drastic change in the economic structure. Not only has the family-size establishment suffered most from relocations, but it is being inevitably ruled out of the new freeway market. In many instances, the superhighway motel is being built to state or federal specifications that traditional family proprietorships could not possibly meet. The result has been the growth of chain operations, which provide the 100-unit establishment with restaurant required by the major controlled-access highway. Thus, the pioneers, the small proprietors who started it all with a few crude "tourist cabins" or a more ambitous "motor court" with hamburger stand, have enjoyed only limited growth in the industry. The big chains such as Howard Johnson's and Holiday Inns, largely financed out of funds supplied by the insurance companies, operate the luxury establishments.[28]

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* Some of these may have incorporated or become partnerships, though the net growth in those types of organizations was only 2,079.

[28] John P. Henderson, Labor Market Institutions and Wages in the Lodging Industry (East Lansing: Michigan State University Business Studies, 1965), p. 20.

Table 2

Number of Corporations, Proprietorships, and Partnerships

for Hotels, Motels, and Tourist Courts for the

Years 1961-1975[1]

Year	Corporations[1]	Proprietorships	Partnerships	Total
1961	11,704	63,225	10,218	85,147
1962	13,007	56,280	10,349	79,636
1963	14,510	52,133	9,491	76,134
1964	15,956	50,464	9,893	75,403
1965	17,118	48,709	9,995	75,822
1966	17,180	49,965	8,713	75,858
1967	18,067	50,260	7,758	76,085
1968	16,851	51,972	8,261	77,084
1969	17,525	45,740	7,755	71,020
1970	20,049	43,217	8,233	71,499
1971	19,897	43,185	8,218	71,300
1972	19,349	48,152	7,367	74,868
1973	20,361	44,276	8,629	73,266
1974	18,236	47,792	9,083	75,111
1975	15,551	45,599	8,606	69,756

[1]The industry classification for corporations is hotels, rooming houses, camps, and other lodging places.

Source: Internal Revenue Service, Statistics of Income Business Tax Returns (Washington: GPO), 1961-1975.

While large highway motels were enjoying a boom, hotel receipts stagnated as suburbanization took command. Many central cities, in New England and elsewhere, experienced population shrinkage,* loss of retail and wholesale trade, and a decline in manufacturing employment.**

Most older hotels were built during the time when railroad terminals were the center of urban commerce -- adjacent to principal department stores, near important office complexes, and not far from factories situated near freight yards. The birth of the Interstate Highway System (1956) and the growth of airport terminals, did much to encourage the relocation of manufacturing plants, office, and retail stores to sites outside of the central business district. While this shift in transportation patterns did foster the growth of thousands of suburban motels and motor hotels, it spelled doom for many inter-city hotels. The number of hotels with 25 or more guest rooms declined by 17.5% between 1957 and 1962 alone. Moreover, despite the sharp reduction in the total stock, the average occupancy rate for transient hotels fell from 74% to 67% between 1958 and 1963.[29]

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* The eleven New England cities with populations over 100,000 lost: 7.6% of their inhabitant during 1950-1969; 5.2% between 1960 and 1970; and 5.0% during 1970-1976.

** Between 1958 and 1963, central cities lost 7.9% of their manufacturing employment and 1.8% of all retail and wholesale jobs. Suburbs registered gains of 12.2% and 22.6% respectively in manufacturing and trade employment. See Alexander Ganz, Our Large Cities: New Light on Their Recent Transformation (Cambridge: MIT Lab for Environmental Studies, 1972), figures are for 11 largest SMSA's.

[29] Trends in the Hotel-Motel Business, 1978 Edition (New York: Harris, Kerr, Forster and Co., 1978).

3. 1963-1969

New construction activity (measured in 1972 dollars) fell each year from 1964 to 1966. The number of new rooms entering the market declined from an annual rate of 105 thousand in 1963 to 78,000 in 1967.[30]

This cutback in aggregate production reflected the poor market conditions prevalent in 1963. Sheraton, for example, announced in its 1963 Annual Report that "until such time as the real estate cycle once more turns upward, Sheraton will concentrate on securing management contracts and franchising" rather than new construction of company owned hotels and motels. Sheraton had even taken the almost unheard of step of drastically reducing room rates in 1962.

Although production remained at a relatively low level until 1968, demand -- both business and recreationally oriented -- increased precipitously. As a result, between 1963 and 1967 occupancy increased by 5.2 percent, room rates climbed by 3.7 percent, and income per available room jumped by fully 24 percent. Beginning in 1968, new construction picked up to expand the base for this high level of profitability, and capture a larger share of this market growth.

The increase in product demand can be attributed to the general economic prosperity fueled by the Vietnam War. Importantly, industrial automation

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30 A Critical Analysis of the Domestic Hotel-Motel Industry (New York: Moore and Schley, Cameron and Co., 1971), p. 23. Cited in Arthur Mantel, An Economic Analysis of the Market Structure of the Hotel-Motel Industry, unpublished Ph. D dissertation (Amherst, MA: University of Massachusetts, April, 1974).

coupled with enhanced union negotiation power had yielded an expansion in worker vacation time, and a concomitant increase in recreational travel and transient lodging demand.

Before World War II paid vacations were available primarily to managers, officials, and professional workers. During the 1950's, vacation time increased, but many workers traded off for higher pay so as to more easily carry the burden of child-rearing costs and satisfy a pent up demand for consumer goods (induced by heavy advertising and the extension of suburban life styles).

In the 1960's, the number of vacation weeks grew at a spectacular rate. From 1960 to 1969, the total number of weeks that workers spent on vacations increased by almost 50 percent -- from 87 to 129 million weeks. During the same period, the average number of vacation weeks per production worker increased from 1.3 to 1.8.[31]

With lodging costs taking 10% to 11% of total pleasure travel expenditures, the hotel-motel industry experienced an increase in total receipts of 23.4% during 1963-1967. The increase was, again, predominatly in the motel/motor hotel division of the industry, but hotels were able to recoup their 1958-1963 losses in occupancy and income per available room.

Lodging industry growth did not go unnoticed by conglomerates and other corporate giants. Continuing in the tradition first established

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[31] Geoffrey H. Moore and Janice Neipert Hedges, "Trends in Labor and Leisure," Montly Labor Review, U. S. Department of Labor (Washington: GPO, February 1971), appears in Montly Labor Review Reader, BLS, Bulletin 1868, 1975.

by transportation companies (the railroads of the 19th century), airlines acquired hotel corporations so as to further horizontal integration. Pan American had started the pattern in 1947 by setting up a subsidiary International (later Intercontinential) Hotels, Inc. In 1967, Trans World Airways purchased Hilton International and other airlines quickly followed suit.* The ITT (which then owned Hertz) acquisition of Sheraton has already been mentioned.

Gulf Oil and Holiday Inns achieved economies of scale by engaging in joint advertising and setting up a common credit card. Many Gulf service stations opened adjacent to Holiday Inns.[32]

Holiday Inns, the largest of the chains, achieved both vertical and horizontal integration in the 1960's and furthered its control over both franchisees and consumers. These efforts include: (1) Innkeepers Supply Company (furniture, draperies, cleaning compounds, etc); (2) Merchants

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*Airlines with hotels in the U. S. include: Aer Lingus (Dunfey Hotels), Air France (Meridien Hotels), American (Americana Hotels); Braniff (Braniff International Hotels); Eastern (Rockresorts), Hughes Airwest (Summa Corporation), and United (Western International). Lundberg, op. cit., p. 27.

[32] Lundberg, op. cit., p. 291. Gulf Oil also moved to guarantee a portion of Holiday Inns debt, thus permitting the hotel chain to secure lower interest rates (Ibid.). Holiday Inns executives were also personally close to John Hancock Insurance Company executives. The insurance company supplied much of the loan capital (Ibid.).

Hotel Supply Company (kitchen equipment); (3) Coffee Host (coffee-making equipment); (4) Holiday Press (directories, printing services, office equipment and supplies); (5) General Data Corporation (accounting services); (6) Holiday Inn University (training); and, numerous other enterprises including real estate, construction, and nursing homes. In 1969, Holiday Inns acquired by merger TCO Industries, Inc., which owned Continental Trailways (the second largest intercity bus company) and Delta Steamship Lines, Inc.[33]

4. 1969-1977

This period was characterized by over expansion, industrial instability, and reorganization along the lines of greater chain control. Data from Figure 2 and Table 1 clearly illustrate the over expansion of these years and its effect on occupancy, income, and rates. While new construction remained at a constant (high) level between 1969 and 1971, sharp declines were registered by occupancy (-6.3%), income (-23.8%), and room rates (-1.4%). New construction then advanced to even higher levels in 1972 and 1973 instead of allowing demand to catch-up. As a consequence, room rates had to be kept low (they actually declined by an additional 1.8%) and occupancy increased only modestly (not even to the 1964 level).

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[33] Ibid., p. 293. Holiday Inns also expanded overseas in 1967. According to then-president Kemmons Wilson this was done as part of a global mission. Wilson believed: "I think we can do more for world peace through tourism and building Holiday Inns around the world than anything else. We get to know other people that way, and they get to know us, and that's good."

Incomes per available room failed to make any real gains at all.

Thus the cardinal rule of the lodging industry that new construction must be predicated on rising occupancies and room rates was broken. Construction proceeded in anticipation of a rate of increase in demand such as occurred in the 1960's. Instead, the 1974-75 recession brought a wave of bankruptcies and foreclosures. The situation was further aggravated by the fact that new construction continued at its relatively high level in 1974 (as the result of previous commitments) even while occupancy, rates, and income were plummeting.

The Arab oil embargo of 1973-1974 and ensuing gasoline shortages severely crippled many road-side operations. Figure 3 traces occupancy levels for transient hotels, motels with restaurants, and motels without restaurants. As can be observed, motels without restaurants -- which are primarily highway locations -- suffered a sharp decline in occupancy during 1973 even though the all-industry average was moving upward. The "gas-crisis" of 1973-1974 makes the investment expansion seem even more surprising.

Several possible explanations may be advanced to explain the investment glut of 1972-1974. In the first instance, the hotel-motel industry was merely "following the herd." Aggregate investment in all industries increased sharply in 1973-1974 despite declining profitability and a falling volume of internal funds. William L. White offers the following assessment of this phenomenon:

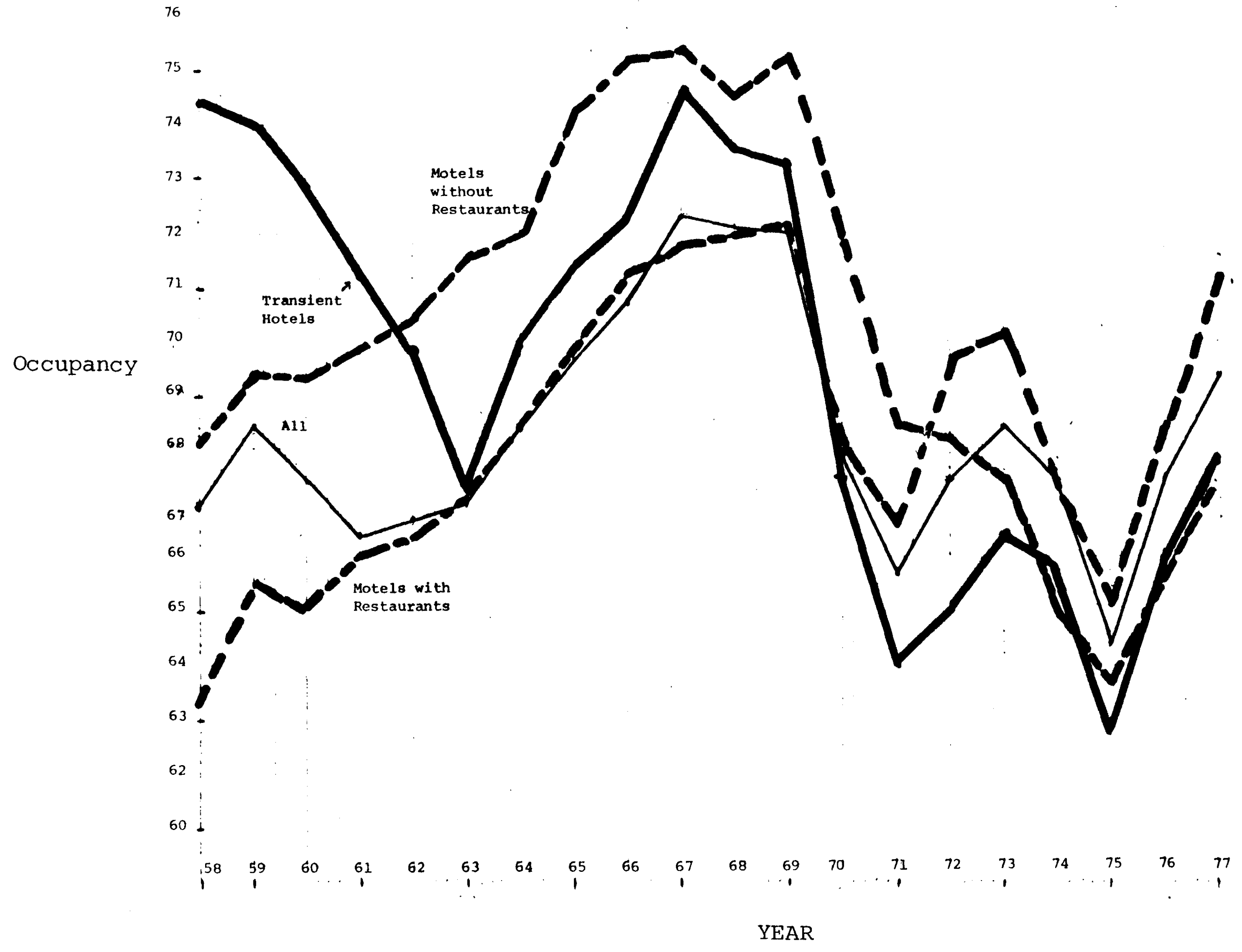

Figure 3:
Occupancy by type of Operation, 1958-1977

> To some extent, corporate managers may have been emphasizing growth and market share goals, and paying relatively little attention to profitability and cash flows. To some extent, they may have been temporary misled by the higher levels of reported profits, despite the erosion of cash flows caused by inflation. To some extent, they may have believed in the future profitability of this investment, despite the levels of current profitability and the clear signals from financial markets.[34]

To a large degree, this accurately describes the hotel-motel industry. With a declining rate of growth in industry receipts, firms emphasized increasing their market shares. This translated into beating their competitors to possibly (though still unproven) profitable locations.

"Signals" from the financial markets were, if anything, encouraging the trend to expansion. Equity capital continued to flow into hotels and motels via real estate syndicates, partnerships, and REITs. Debt capital remained freely available through the insurance companies and, occasionally, through commercial banks as well.*

Hotel-motel developers were busily reaping the benefits from what was to them the best of both worlds: enthusiastic equity investors and uncritical lenders.** Real-estate magnate Harry Helmsley put it, perhaps

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[34] William L. White and Jay Light, The Financial System (Homewood, Ill.: Irwin, Inc., forthcoming), p. 34.

*The Crocker National Bank, for example, supplied $16 million to Royal Inns. The chain entered bankruptcy in May, 1975. "The Hotel Investor Turning Innkeeper." Business Week (May 12, 1975), p. 25.

**According to Stephen W. Brenner: "An oversupply of money was pumped into the industry, without careful analysis of location and product." Business Week (May 12, 1975), p. 29.

more charitably, when he remarked:

> Hotel builders are optimists, not economists. If a guy can get [someone else's] money, he'll build a hotel and hope for the best....If over-building is controlled, it will be because of the lenders.35

The lenders were not controlling. Life insurance companies were under considerable pressure to invest an ever increasing amount of capital. By 1973, their annual rate of asset growth approximated $15 billion, or six percent per year compounded.[36] During the early 1970's, the insurance companies turned with increasing frequency to commercial mortgages. By 1973, these instruments accounted for fully 33 percent of net acquisitions of external financial assets -- up from 20 percent in 1970.[37]

Insurance company investment analysts were, of course, quite familiar with hotels and motels by then. Risk was considered to be managable and return often superior.* Between 1969 and 1975, the fifteen largest insurance companies regularly surveyed by the American Council of Life Insurance placed 6.3 percent of their total multi-family and nonresidential

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[35] "No 'vacancy' means big profits for U. S. hotels," Business Week (July 17, 1978), p. 71.

[36] Herbert E. Dougall and Jack Gaumnitz, Capital Markets and Institutions (Englewood Cliffs: Prentice Hall, 1975), p. 79.

[37] From Flow of Funds data, cited by Robert A. Renme, "Investment Strategy for the Life Insurance Company," in J. David Cummins, editor, Investment Activities of Life Insurance Companies (Homewood, Ill.: Richard D. Irwin, Inc., 1977), p. 7.

*These long term assets matched the long term liability structure of the insurers. High interest rates meant better yield, income participation clauses offered a hedge against inflation, and higher capitalization rates and debt coverage ratios provided additional security.

investment in hotels and motels.[38]

The actual flow of insurance company capital into hotel-motels became largely dependent upon the yield spread with alternative investments. The top four alternatives included conventional apartments, office buildings, commercial-retailing complexes, and corporate bonds. Of the four, corporate bonds constituted the most significant competitor since between 20 and 50 percent of life insurance companies' acquisitions were in this category.

Figure 4 traces the comparative yields for hotel-motel mortgages and corporate bonds. The total value of new construction contracts was used as a proxy for insurance company investment in hotels and motels. The comparison shows that during each period in which hotel yields exceed corporate bond yields investment flowed into the lodging industry.* Conversely, investment declined during the periods in which corporate bonds outperformed hotel mortgages.

The growth of REIT's in the early 1970's also contributed to overbuilding. During the period 1969-1972 alone, some $21 billion was pumped into the REIT's through equity investment and debt capital. By 1973, the Trusts had invested $1.3 billion in hotels and motels. Of this total, $516 million were in first mortgage construction loans.[39] According to

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[38] cited in Lawrence D. Jones, "Investment in Income Property Mortgages by Life Insurance Companies," in Cummins, op. cit., p. 88.

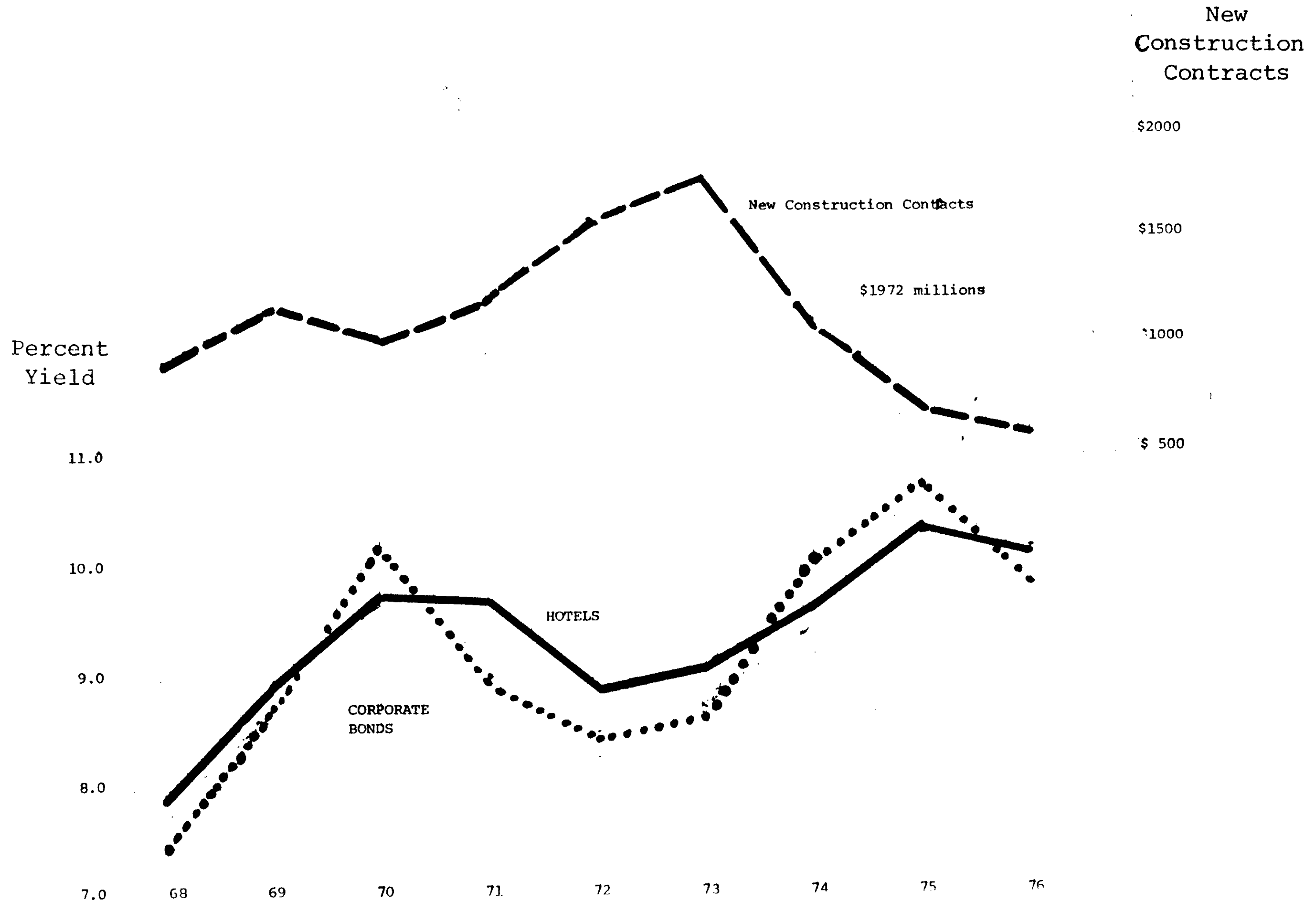
[39] National Association of Real Estate Investment Trusts, cited in Robert Kiener, "REITs: Lodging's latest bedfellows," Lodging Hospitality (May 1975), p. 47.

*Yield for conventional apartments was higher than hotels in 1976.

Figure 4

New Construction Contracts and Relative Yields

1968 - 1976



Source: Lawrence D. Jones, op.cit., for construction contracts see Table .

one analyst:

> the emergence of REITs had a negative effect on the underwriting standards applied to new project development....During this period, the principal objective of many of the trusts was to expand their asset bases. In order to do this quickly, the management of the trusts sought out construction loans without requiring the existence of take-out permanent financing....
>
> Little attention was paid to the long term viability of the projects. Such "stupid" competition induced a competitive response on the part of many banks. The result was massive overbuilding. The overbuilding in some areas was on such a scale that it affected both new construction and the existing seasoned properties.[40]

While the insurance companies, REITs, and commercial banks stood willing to pour debt (and some equity) capital in the lodging industry, the true catalyst for the overbuilding which ensued were the real estate syndicates and partnerships. Theirs was the so-called "funny-money" which brought expansionism to a fever pitch. Although their number did not increase drastically over the 1969-75 period (see Table 2), their influence over investment activity was felt in a dramatic fashion.

Table 3 depicts the amount and proportion of total reported industry receipts for proprietorship, partnership, and corporations for 1969-1975. The share of the total market captured by partnerships expanded from 11.5 percent in 1972 to 20.1 percent in 1975. During the same three year period proprietorships lost two percent of the market and corporations declined by 6.6 percent.

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[40] Howard H. Stevenson, "Equity Real Estate Investments of Life Insurance Companies," in Cummins, op. cit., pp. 166-167.

Table 3

1969-1975 Total Reported Business Receipts: Proprietorships, Partnerships, Corporations

($1972)

Year	Proprietorships	Partnerships	Corporations	Total
1969	1,353.0	1,080.3	6,338.4	8,8771.7
(%)	(15.4)	(12.3)	(72.3)	(100.0)
1970	1,261.3	1,083.1	7,086.8	9,431.2
(%)	(13.4)	(11.5)	(75.1)	(100.0)
1971	1,263.8	1,124.8	6,465.5	8,845.1
(%)	(14.3)	(12.7)	(73.0)	(100.0)
1972	1,524.9	1,178.6	7,508.8	10,212.3
(%)	(14.9)	(11.5)	(73.6)	(100.0)
1973	1,312.9	1,547.2	7,888.4	10,748.5
(%)	(12.2)	(14.4)	(73.4)	(100.0)
1974	1,259.2	1,768.5	7,544.0	10,571.7
(%)	(11.9)	(16.7)	(71.4)	(100.0)
1975	1,385.3	2,043.2	6,828.0	10,181.5
(%)	(12.9)	(20.1)	(67.0)	(100.0)

Source: Internal Revenue Service, Statistics of Income Business Tax Return (Washington: GPO), 1969-1975.

The rationale for this expansion of partnerships was the attractiveness of tax shelters provided by the rapid depreciation of hotel structures, furnishings, and equipment. Partners were buying tax losses which could then be applied to their ordinary income. This process is clearly illustrated in the figures listed below:

For Years 1969-1975

Type of Business Organization	Cumulative Before Tax Net Gain (Loss) ($000's)	Percent Change in Number of Businesses	Percent Change in Total Industry Receipts
Corporations	+ $761,225	-11.3%	-5.3%
Proprietorships	+ $428,573	- 0.3%	-2.5%
Partnerships	- $481,944	+11.0%	+7.8%

Source: Internal Revenue Service, *Statistics of Income*, 1969-1975.

Operating profits were obviously not a prime consideration for new investment. Moreover, since these are aggregate figures (adding net gains with losses) they mask the true magnitude of the tax losses generated by partnerships. IRS data show that for the years 1974-1976, hotel-motel partnerships registered before tax losses of over one billion dollars*, which -- if fully utilized -- could have resulted in $500 million of tax avoidance.

The overbuilding created by generous lenders, enthusiastic developers, and uncaring investors resulted in falling occupancy, declining income per available room, and flat room rates. This instability was, of course, intensified by fluctuations in demand caused by the recession. Another destablizing force on the industry was the rapid build-up of debt and the burden of huge interest payments.

The interest expense of all hotel-motel businesses increased yearly from $471.9 million in 1969 to $1,139.5 million in 1975.[41] Interest payments accounted for 9.06 percent of all industry receipts in 1975, up from 6.25 percent in 1969.

Figure 5 traces the proportion of total business receipts going to interest for proprietorships, partnerships, and corporations during 1969-1975. The heaviest burden of debt was sustained by partnerships -- in

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* The figures are ($ millions): 1974 (-$315.9); 1975 (-$384.5); and 1976 (-$306.0). I. R. S. Statistics of Income. These partnerships succeed only too well in generating tax losses -- the number of partnerships with losses declined by 778 over the three year span.

[41] IRS, Statistics of Income, 1969-1975.

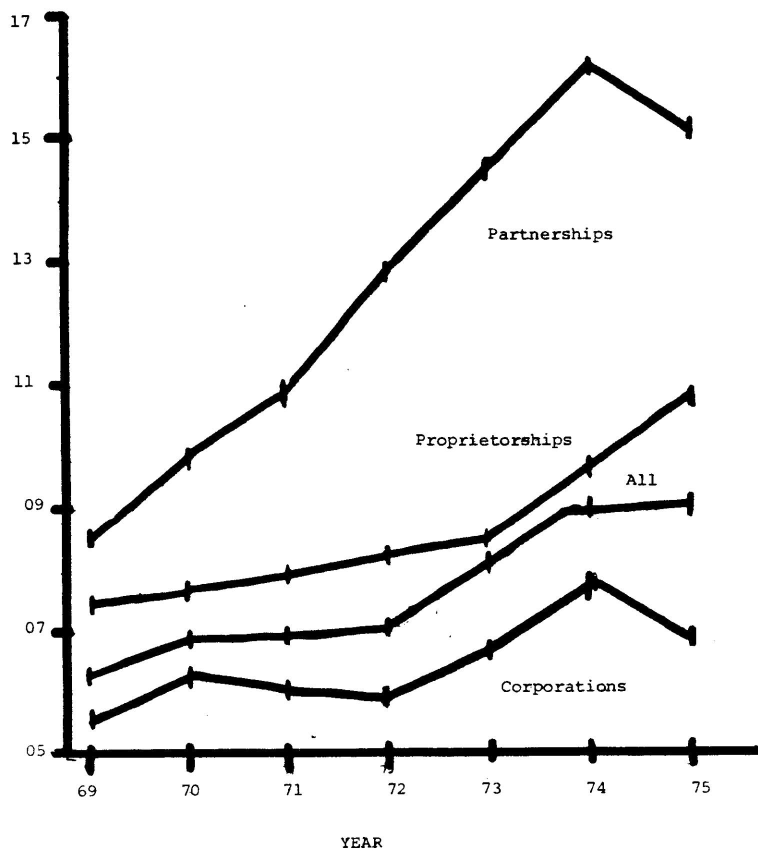
Figure 5

Debt Burden:

Partnerships, Proprietorships, Corporations

1969 - 1975

Interest Payments
As Percent of
Business Receipts



Source: Internal Revenue Service, Statistics of Income, 1969-1975.

1974 an astounding 16.18 percent of all receipts went to interest payments. This reflects the fact that these deals were all highly leveraged, and that interest payments (which are deductable expenses) are ordinarily higher in the earlier years. During 1975 it was found that, if not for the crushing burden of debt service, many of the newer properties could have broken even with occupancies as low as 35% (rather than 65%-70% with the interest expense).[42]

Yearly interest payments made by corporations increased by 90.8 percent between 1969 and 1975. This represents a slower rate of growth than for the industry as a whole. Expressed as a percentage of receipts (see Figure 5) interest payments grew from 5.59 percent in 1969 to 6.91 percent in 1976. However, if we aggregate rent payments with interest (which is only another form of rent) the difference between corporations and the rest of the industry becomes much less marked:

Percentage of Total Business Receipts

	Interest + Rent		Interest	
	1973	1975	1973	1975
Corporations	12.8	14.7	6.73	6.91
Proprietorships	13.0	14.4	8.56	10.82
Partnerships	24.4	19.6	14.51	15.14

Source: Internal Revenue Service, Statistics of Income.

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42 "The Hotel Investor Turning Innkeeper," Business Week (May 12, 1975), p. 25.

Proprietorships were not immune from the lure of debt financed expansion. Having tasted the potential for great profits during the boom year of 1969, proprietorships made increased use of debt capital to improve and expand their operations. In part this was dictated by higher construction and operating costs. To a large, albeit unmeasurable, extent, this development was probably determined by prevailing market conditions.

The tradeoff for the independent proprietorships was that first they became indebted to finance capitalists; and, second, they became dependent upon the chains for marketing assistance. As the figures below indicate, the percentage of total receipts going to net income and interest remained fairly constant between 1969 and 1976 (with the exception of the three recession years). However, the distribution between income and interest became skewed sharply in the favor of lenders.

Percent of Proprietors Business Receipts

Year	Net Income (Before tax)	Interest	Total
1969	7.5%	7.5%	15.0%
1970	5.3%	7.7%	12.8%
1971	7.1%	7.9%	15.0%
1972	5.5%	8.2%	13.7%
1973	5.2%	8.6%	13.8%
1974	1.1%	9.7%	10.8%
1975	1.5%	10.8%	12.3%
1976	3.6%	11.3%	14.9%

Source: Internal Revenue Service, Statistics of Income, 1969-1976.

Lenders have clearly assumed a control over a majority of the surplus being produced by the proprietors. Their proportion of the take increased steadily throughout the period; the proprietors own share, however, fluctuated according to business conditions while pursuing an overall downward trend. Since the debt holders have the preferred (secured) position, proprietors' control over their own businesses has become increasingly tenuous. They are, increasingly, working for the finance capitalists.

The net result of the economic insecurity caused by overbuilding, recession, and excessive debt has become a greater reliance on the national chains. Operators and lenders alike have come to believe that the chains, with their extensive marketing and nation-wide reservation systems, provide greater income security for hotels and motels. The fact that powerfully entrenched lenders believe this is alone a sufficient reason to explain the phenomenal growth of the chains over the past nine years.

Table 6 shows the growth of chain properties and rooms between 1972 and 1977. Much of this growth represents the reorganization of existing (independent) operations. Numerous national chains actively market their services to independents as "referral groups." Other chains look for existing properties which might join their systems as new franchises. While impossible to fix precisely, we estimate that approximately 38 percent of total chain growth between 1974 and 1977 can be attributed to

Table 6

Growth of Chain Properties, Rooms
1972-1977

Year	Chain Properties	Chain Rooms	Average Rooms/ Chain Property
1972	4,999	754,254	150.9
1973	5,482	824.810	150.5
1974	6,322	950,953	150.4
1975	8,667	1,123,212	129.6
1976	9,302	1,158,038	124.5
1977	10,912	1,276,922	117.2
% Change 1972-1977	118.3%	69.3%	-22.3%

Source: American Hotel and Motel Association

Table

Chain Properties, Rooms as Percent of U.S. Total
1972-1977

Year	Chain Properties	Chain Rooms
1972	13.4%	39.8%
1973	14.6	42.5
1974	16.9	48.2
1975	23.0	56.1
1976	24.6	57.2
1977	29.2	63.1

Source: American Hotel and Motel Association

conversions.*

The increase in chain affiliated properties follows a pattern which indicates that growth has been directly attributable to the economic uncertainty prevelant in the 1970's. Data presented below portray the yearly percentage changes in industry receipts and chain properties for 1972 and 1973. A comparison shows a strong negative correlation (-.876), indicating that property owners flock to the chains when economic times turn bad.

Percent Change From the Preceeding Year

Year	Hotel-Motel Receipts**	Chain Properties
1973	3.72	9.35
1974	-1.09	15.29
1975	1.73	18.11
1976	8.43	3.10
1977	2.79	10.26

correlation coefficient = (-.876)

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*We base our estimate on the following assumptions: average cost/room ($1972) of $15,000; total new construction expenditures ($1972) of $3,300 million (see Table 1); total chain growth of 325,000 rooms. Assuming that 90 percent of new construction went to chain properties, this gives us a "shortfall" (not explained by new construction) of 125,000 rooms. We assume that these were conversions. The total stock of non-chain rooms declined by 275,000 during the period. If our assumptions are reasonable, this would suggest that 150,000 rooms were lost through demolition, fire, or conversion to other uses, and 125,000 were absorbed by the chains.

**These figures are from the Bureau of Domestic Commerce, deflated to $1972.

Chapter V: Economic Trends in New England

The hotel-motel industry services travel, and travel has always been an important facet of American life. Before America was a nation it was a destination. In the post-war era, the development of new marketing techniques and advanced electronic communications systems have precluded the necessity of a portion of domestic and international travel. Nevertheless, the period has witnessed an intensification of both business and recreational travel. The volume of domestic intercity passenger traffic has approximately tripled since 1950 to some 1,441 billion passenger miles in 1976.

Travel is clearly the most immediate source of demand for the lodging industry. Total receipts in the hotel-motel industry are largely dependent on the volume of intercity travel. As Table 1 shows, industry receipts per passenger mile have varied only slightly since 1954, increasing from 75¢ (1972 dollars)/mile in 1954 to 79¢ (1972 dollars)/mile in 1976.

Table 1

Total Traffic Volume and Hotel-Motel Receipts

For Selected Years and 1972-1977

Year	Domestic Intercity Traffic Volume (Billions of Passenger Miles)	Hotel-Motel Receipts (Thousands of $ 1972)	Receipts/ Passenger Mile
1954	673	5,073	.75¢
1958	760	5,676	.75¢
1963	853	6,509	.76¢
1967	1,021	8,029	.79¢
1972	1,300	10,088	.78¢
1973	1,356	10,463	.77¢
1974	1,331	10,349	.78¢
1975	1,352	10,528	.78¢
1976	1,441	11,413	.79¢

Source: For traffic data: Statistical Abstract of the United States, 1978, 1970 (Washington: Goverment Printing Office), table 1070 (1978), table 824 (1970).

For Hotel-Motel receipts: See page 46.

Purpose of Travel

A comparison of New England with other regions based on the 1972 National Travel Survey and 1972 Census of Selected Service Industries yields some rather significant results. For the United States as a whole, the distribution of trips by main purpose is fairly evenly divided between visiting friends and relatives (31.6%), business and convention (31.8%), and all other reasons (31.6%). New England receives significantly less business and and convention travel (24.4%), and much more travel for "other" purposes (44.0%).

Among all regions, New England had the lowest proportion of trips for business and convention purposes, and the highest share for outdoor recreation:

Table 2

Percent Distribution by Main Purpose of Trip

Region	Visit Friends and Relatives	Business and Convention	Outdoor Recreation	Other
U. S.	31.6%	31.8%	10.0%	26.6%
New England	30.8%	24.4%	15.2%	29.9%
New Jersey/New York	30.4%	36.3%	7.5%	25.7%
Mid-Atlantic	34.3%	33.5%	9.4%	22.8%
South	32.7%	34.1%	7.1%	26.1%
North Central	35.3%	31.1%	10.9%	22.7%
Northwest	27.1%	36.0%	11.9%	25.0%
Southwest	34.2%	31.8%	9.0%	25.0%
Pacific	27.8%	31.4%	12.1%	28.7%

Source: Bureau of the Census, National Travel Survey, 1972.

This distribution (by purpose) of trip has had a very important impact on the lodging industry in New England. Trips conducted for business and convention purposes contribute proportionately more nights in commercial establishments than in other types of accomodations. New England's smaller share of business and convention trips has resulted in a much lower percentage of total overnight stays in commercial establishments (27%) when compared to the U. S. as a whole (34%). This lower level of demand for commerical lodging is also partially due to the fact that, proportionately, twice as many visitors to the region use their own cabins and trailers:

Table 3

Overnight Accomodations (To/Through New England)
Percent Distribution of Person Nights By
Where Night Is Spent: U. S. and New England

	Commercial Establishment	Friends and Relatives	Own Cabin or Trailer	Other	Total
U. S.	34%	47%	13%	5%	100%
New England	27%	42%	26%	6%	100%

Source: National Travel Survey, 1972.

Seasonality of Demand

Because of a relatively smaller business and convention demand, and despite the relative preponderance of cabins and trailers, New England innkeepers have oriented themselves more towards the recreational segment of the lodging market. Fifty-three percent of all commerical establishments in New England describe themselves as "resorts" compared to only 26% in the U. S. as a whole. These establishments are generally smaller than the national average, and face a demand for services which is much more seasonal.

As Table 4 illustrates, in 1972 New England experienced twice as much variability in total person-nights spent in commercial lodging as did the U. S. as a whole. It is the most seasonal region in the U. S., with peak demand in the third (summer) quarter equalling 4.1 times that of the first quarter (see Table 5).

Table 4

Seasonality by Season

Region	Total Person Nights (000's)	Variability*
U. S.	606,539	.404
New England	25,079	.795
New York/New Jersey	34,621	.611
Mid-Atlantic	42,819	.465
South	148,326	.264
North Central	72,256	.479
Northwest	31.286	.630
Southwest	63,323	.334
Pacific	90,588	.276

* coefficient of variation

Source: National Travel Survey, 1972.

Table 5

Person-Nights in Commercial Establishments

By Quarter, 1972

	I	II	III	IV	Total
New England	3,340	4,375	13,719	3,645	25,079
New England as Percent of U. S.	2.92	3.09	5.69	3.33	4.13

Source: National Travel Survey, 1972.

This seasonal fluctuation is due, in part, to climatic conditions, and partially because of an industrial and school schedule set during an earlier agriculturally dominated epoch. In any event, the strongest effect of seasonality on recreationally orient hotels-motels is that it requires a higher profit margin during the peak season in order to carry the business during slower (or closed) months.

Seasonality and Establishment Size

The vulnerability of any given enterprise to a single "bad season" is directly dependent upon the amount of fixed costs carried by the business: capital charges, operating expenses (i.e. heat, maintenance) and taxes

Sufficient revenues must be generated to cover these fixed costs; otherwise, the business faces bankruptcy or reorganization.

Generally speaking, larger hotel-motel enterprises carry higher fixed costs than smaller businesses and are therefore more vulnerable to seasonal variability in demand. As we have seen in Chapter Four, this is not universally true for all hotel-motels. Larger enterprises often have access to a line of credit which is unavailable to smaller businesses. In addition, small proprietorships have become increasingly burdened with larger fixed debt costs, and some large projects have been able to reduce their fixed costs through various public programs. Nevertheless, as industry accounting data clearly shows, fixed costs tend to be larger on a per available room basis, for larger properties:

Table 6

Two Categories of Fixed Costs: Median Amounts Per Available Room

	Size of Property			
Cost Category	Under 150 rooms	150-299 rooms	300-600 rooms	Over 600 rooms
Undistributed Operating Expenses	$2336	$2353	$3265	$3969
Property Taxes and Insurance	344	387	551	720
Total	$2680	$2740	$3816	$4689

Source: Laventhol and Horwarth, U. S. Lodging Industry, 1978 Edition (Philadelphia, 1978).

Decisions based on these three inter-connected factors -- seasonality of demand, vulnerability of larger enterprises to seasonality, and proportionately smaller businesses and convention market -- are largely responsible for keeping down the size of the average operation in New England. The average number of rooms for all establishments with payroll in 1972 was 39.8 in New England versus 48.8 in the U. S. The New England region had the smallest proportion of establishments with over 100 rooms (7.7%), and among the largest percentage of enterprises with less than 25 guestrooms (49.8%) (see Table 8).

Types of Operations

As Table 8 shows, the size effect is translatable into the various types of hotel-motel operations in the region. Only small hotels are "larger" than the national average. Hotels with over 25 rooms in New England are 78% of the average size, receive 75% of the average revenue per room, and only 10% of the average total receipts per establishment. Not surprisingly, large hotels are proportionately less important as a source of receipts to the industry in the region (36.4% of all receipts in New England versus 46.4% in the nation).

In New England the hotel has been surpassed in certain respects by the motor hotel. Motor hotels in New England are larger, on average, than hotels (contrary to figures on the national level). Compared to hotels, they receive 46% more receipts per establishments, and earn 45% more revenue per available room. The motor hotel exceeds the national average

Table 7

Distribution of Establishments by Room Size, 1972

Region	Percent of All Establisments within Region				
	Less Than 25	25-49	50-99	100+	Total
New England	49.8	28.6	13.8	7.7	99.9*
Middle Atlantic	40.5	30.5	15.4	13.6	100.0
East North Central	49.4	25.0	12.3	13.3	100.0
West North Central	54.4	26.2	10.0	9.4	100.0
South Atlantic	43.4	27.0	14.8	14.8	100.0
East South Central	43.3	27.6	14.1	15.1	100.1*
West South Central	44.5	29.3	13.4	12.8	100.0
Mountain	50.7	30.3	11.2	7.8	100.0
Pacific	44.2	31.8	13.3	10.3	99.9*
U.S.A.	46.2	28.5	13.3	11.9	99.9*

*Differs from 100.0 due to rounding.

Source: Census of Selected Service Industries, 1972.

Table 8

Types of Operations: New England and the U. S., 1972

	Types of Operation				
	Hotels, 25 Rooms or More	Hotels, 25 Rooms or Less	Motels, Tourist Courts	Motor Hotels	Total
Distribution of:					
Establishments					
New England	17.8	11.0	65.5	5.6	99.9*
U. S.	18.1	8.2	67.9	5.7	99.9*
Rooms					
New England	33.0	4.2	52.1	10.7	100.0
U. S.	35.2	2.6	51.8	10.3	99.9*
Receipts					
New England	36.4	3.6	42.8	17.1	100.0
U. S.	46.4	1.9	39.2	12.6	100.1*
Average:					
Rooms Per Establish.					
New England	74.7	15.8	31.3	75.0	39.8
U. S.	95.2	15.6	37.3	87.8	48.8
Receipts (000's) Per Establish.					
New England	$368.1	$ 61.2	$ 115.1	$ 535.9	$178.00
U. S.	618.1	54.2	139.0	522.7	240.8
Receipts Per Room					
New England	$4,931	$3,878	$3,672	$7,144	$4,469
U. S.	$6,492	$3,475	$3,727	$5,987	$4,928

* Differs from 100.00 due to rounding.

Source: Census of Selected Service Industries, 1972.

in receipts per available room. We can attribute the performance of this type of operation to several factors -- motor hotels are generally newer than hotels (although some are converted hotels), are located on major highways (with an identifiable local demand as well), and are usually within metropolitan areas.

The particular success of the motor when when compared to the hotel in New England, is tied to the fact that travellers depend on the automobile more heavily in New England than in any other region. According to the National Travel Survey (1972) 79.9 percent of all trips to New England were made by automobile, compared to a national average of 72.5 percent.

Establishment Size and Competition

An inter-regional comparison based on the 1972 Census shows that lodging industry receipts are much less concentrated among larger firms in New England than in other areas. Both New England and the Mountain states, for example, have approximately the same proportion of larger (over 100 guestroom) establishments. Yet, these larger enterprises account for 73.3 percent of all receipts collected in the Mountain region versus only 50.4 percent in New England (the national average is 68.2 percent). This means that there is a wider potential market available to smaller firms in New England.

Competition among New England's smaller firms for this wider market appears to be intense. The form that this competition takes is perhaps more visible in terms of the range of facilities offered (product differntiation) than in a highly competitive rate structure (the exception

being the budget motels). This tends to put an additional capital requirement on New England firms. Hotel-motels in New Englnad are more likely to have swimming pools, restaurants, and public meeting rooms than their national counterparts. It is unclear as to whether or not these additional facilities actually produce more revenue. The industry in New England has 2.1% more establishment with public meeting rooms for a market share which is 2.5% smaller. Yet, to compete effectively in a given area, firms feel that they must have these facilities. Similiarly, swimming pools may be rarely used, but popular thinking is that guests desire to know that such a facility is available.

Table 9

Facilities Available: U. S. and New England, 1972

	% of Establishments with Facility		% Revenues in Establishments with Facility	
Facility	New England	U. S.	New England	U. S.
Swimming Pool	55.9	51.1	78.4	77.7
Public Rooms for Meetings, etc.	29.2	27.1	76.4	78.9
Restaurants	42.1	37.5	89.9	85.4

Source: Census of Selected Services Industries, 1972.

Competition seems to be especially keen in the recreational sector. In the New England region in 1972, there was a relatively larger number of firms competing for the resort dollar than in the U. S. as a whole. As has been mentioned previously, 53.6 percent of all New England establishments designated themselves as "resorts," compared to 26.0 percent of the national total. However, the difference between the proportion of total receipts captured by these establishments on the regional and national level is much narrower. In New England, those 53.6 percent of all establishments (resorts) were chasing after only 29.7 percent of regional receipts; while in the U. S. 26.0 percent of all establishments designated as resorts received 27.2 percent of industry revenues.

Data show that New England resorts are much smaller than their national counterparts (average receipts per resort establishment in New England are only 39 percent of the national average). Conversely, however, establishments which are not "resorts" (those aimed at primarily business trade, or a combination of business and recreational markets) tend to be larger in New England. This is consistent with our earlier assertion that the extreme seasonality of recreational demand in New England increases risk for larger establishments with higher fixed costs. Usage (i.e., recreational/non-recreation) is a relatively more important factor in determining the size of any given establishment in New England than in the U. S. Usage is based on seasonality, which influences risk, which is an important factor in determining size.

Table 10

Comparison of Resort and Non-Resort Establishments:

New England and U. S., 1972

	All Establishments	Resorts	Non-Resorts
Percentage of Establishments:			
New England	100.0	53.6	46.4
United States	100.0	27.2	72.8
Percentage of Receipts:			
New England	100.0	29.7	70.3
United States	100.0	27.2	72.8
Average Receipt per Establishment: ($000's)			
New England	$ 178.0	$ 98.8	$ 269.3
United States	$ 240.8	$ 252.2	$ 236.8
New England/United States	.74	.39	1.14

Source: Census of Selected Service Industries, 1972.

Growth of the Industry Across the Nation

Although hotels-motels constitute a growth industry of some significance within the New England region, their importance on the national level is much less striking. As Table 11 illustrates, New England is the third slowest growth region in the country. The 1958-1972 growth rate in New England is approximately 71 percent of the national rate, and only 31 percent of the fastest growing (Mountain states) region. Moreover, the data presented in Table 11 show that the market share of the New England region declined by 0.7 percent in the 1958-1972 period.

Between 1958 and 1972 the distribution of industry receipts became altered along the lines of the snowbelt/sunbelt split. In the aggregate, the North last approximately 12 percent of the total lodging dollar to the Southern regions. Whereas in 1958 the North captured 51.3 percent of all lodging receipts, that total has shrunk to 39.5 percent in 1972. During this timeframe, the South and West grew at a rate equalling 3.4 times that of the North (116 percent for the South and West versus 34 percent for the North).

This regional shift in the lodging industry can be attributed, in part, to the relative growth of the sunbelt in total population and income. However, as Howard Morgan noated in his 1964 treatise, "the fortunes of the industry are not as closely related to population and income changes of the region in which they are located as might be true of the other service industries."[1] This is because hotels and motels depend on

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[1]Howard E. Morgan, The Motel Industry in the United States: Small Business in Transition (Tucson: Bureau of Business and Public Research, University of Arizona, 1964), p. 31.

Table 11

Distribution of Receipts by Region
1958-1972: Hotels, Motels, Tourist Courst, Camps

Region	Percent of U. S. Total				Change 1958-1972
	1958	1963	1967	1972	
Northeast					
New England	5.8	5.7	5.4	5.1	-0.7
Middle Atlantic	22.7	21.5	18.9	15.4	-7.3
Total Northeast	28.5	27.2	24.3	20.5	-8.0
North Central					
East North Central	15.6	14.5	14.0	12.5	-3.1
West North Central	7.2	6.8	6.5	6.5	-0.7
Total North Central	22.8	21.3	20.5	19.0	-3.8
South					
South Atlantic	15.9	16.2	17.7	20.4	0.8
East South Central	3.4	3.4	3.7	4.2	0.9
West South Central	6.8	6.9	7.3	7.7	6.2
Total South	26.1	26.5	28.7	32.3	4.5
West					
Mountain	8.5	9.5	10.7	13.0	1.1
Pacific	14.1	15.5	15.7	15.2	5.6
Total West	22.6	25.0	26.4	28.2	0.0
Total	100.0	100.1	99.9*	100.0	0.0

*Differs from 100.0 due to rounding

Source: Census of Selected Service Industries, selected years.

mobility and -- to a large degree -- inter-regional travel. In 1972, the South, Northwest, and Pacific sections of the country received a net inflow (region as destination minus region as origin) of 19.9 million person trips. The growth of the lodging industry in the sunbelt, therefore, can be primarily ascribable to those developments which have faciliated inter-regional travel -- specifically the Interstate Highway System and the growth of the air transportation network. The growth of these transportation systems coincided with the expansion of vacation time during the 1960's to give the four-season sunbelt a distinct advantage in attracting customers to its lodging facilities. In addition, the convention market, which had previously been concentrated in Chicago and New York, spread to secondary cities, including those in the sunbelt.

The growth of hotels and motels in New England suffered from the fact that the two major transportation developments had a relatively less favorable impact on the industry in the region. Between 1962 and 1977, New England's share of completed miles of the Interstate Highway system declined from 4.7 percent to 4.1 percent. Since the industry in New England is relatively more dependent on auto-travellers , and since the expansion of the Interstate Highway System increased the substitutability of travel to other regions; the net effect of national highway development on New England was probably less favorable when compared to other areas of the country. This seems particularly true in view of the fact that, in 1972, New England had the highest proportion of travellers (41.3%) whose round-trip distance was less than 400 miles of any region in the country.

The lodging industry in New England -- more than any other section -- serves a regionally local market. While this characteristic has tended to work against New England during periods of tremendous economic growth (particularly the 1960's), it serves the region well during "dull" times. During recessionary periods, a family is less likely to drop vacation plans calling for a trip of 400 miles than they would for a journey of several thousand miles. Moreover, the industry in New England seems less likely to suffer from any reduction of long-distance highway travel caused by higher gasoline prices or fuel shortages. The New England vacation may prove to be a more attractive alternative during the "energy crisis."

The story is much less ambiguous with respect to air travel. Between 1960 and 1976 the share of domestic inter-city passenger traffic (measured in passenger-miles) via domestic airways increased from 4.33 percent to 11.45 percent.[2] New England received proportionately fewer trips by means of this mode of transportation than any other region. Furthermore, air travel resulted in a much lower percentage of overnight stays in commercial accomodations (27%) than for the U. S. as a whole (47%). Thus, it appears probable that the lodging industry in New Englnad (when compared to other regions), has not realized significant increases in revenues as the result of the recent movement towards discount airfares and increased air travel.

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[2]Bureau of the Census, Statistical Abstract, 1978, Table 1670.

On a basic structural level, it appears as if the growth of the large recreational segment of the New England lodging industry has, ironically, been constrained by its own success. Growth in this sector of the industry has -- in the past -- generally meant increased revenues during the third (summer) quarter. This accentuates seasonality and makes the enterprise appear, from the investment standpoint, to be even more risky. This becomes particularly important when owners approach institutional lenders for debt capital to finance expansion or new construction. Many New England innkeepers are placed into a Catch-22 type situtation. Those entrepreneurs seeking large loans on the basis of actual or projected revenues which peak sharply in a single season may be rejected as being too risky by large lenders (i.e., insurance companies) who will not finance projects under some minimum size (i.e., 100 guestroom). Conversely, they may be refused by smaller, local lenders who consider large hotel-motel projects to be either too expansive for the institutions own resources, or who wish to diversify away from that type of investment.

In cases such as these, hotel-motel entrepreneurs are constrained more by the amount of personal collateral they can bring to bear than by the growth potential of their businesses. This tends to put a "cap" on the productive capacity of the industry. As the following table shows, this phenomonon seems to have occured in New Hampshire and Vermont. During 1963-1972, motels in these two states achieved a receipt/room ratio approximately equalling the national average, but saw their room/establishment ratio fall rather sharply when compared to the average for the total U. S. By way of comparison, establishments in South

Carolina -- a state not affected to the nearly same degree by seasonality of demand -- increased in average size to a figure well above the national average, though with a receipt/room ratio approximately the same as New Hampshire and Vermont (the least seasonal New England state in 1977).

	Average Rooms/ Establishment		Average Receipts/ Rooms		Ratio of State Average to U. S. Average for: Rooms/Establishments		Receipts/ Rooms	
	1963	1972	1963	1972	1963	1972	1963	1972
U. S.	25.4	37.3	$1,923	$3,727				
Vermont	18.7	26.1	1,700	3,612	.73	.70	.88	.96
New Hampshire	21.0	25.3	1,852	3,540	.83	.68	.96	.95
South Carolina	19.3	41.7	1,461	3,593	.76	1.11	.76	.96

Source: Census of Selected Service Industries, 1972.

Characteristics of the Industry in New England and Criteria for Investment

1. Size and Chain Affiliation

As we observed in Chapter 4, the capital market for hotel and motels is highly segmented. Insurance companies, the primary source of capital for the industry, invest only in large properties with chain affiliation. Since the industry in New England consists primarily of small properties, it has less access to this important source of capital. State finance agencies have been set up in Maine and Rhode Island, but much of their capital has gone into larger projects as well.

An analysis of census and industry data shows that New England has the lower proportion of establishments which are chain affiliates. (see Table 12). In 1972 only 8.1 percent of establishments in the region were chain properties. Looking only at motels and motor hotels, we note that, again, New England has a significantly lower percentage of chain rooms, receipts, and establishments.

Data for 1975-1977 indicates that the growth rate for chain expansion in other regions may be slowing. For example the number of chain properties in the Mountain region grew by 137 percent between 1973 and 1975, but by only 36.1 percent in the 1975-1977 period. New England, on the other hand, seems to be growing at a relatively more rapid rate (32.0 percent and 37.7 percent for the two periods).

The reason for this new growth of chain properties in New England appears to be twofold: (1) other regions are becoming progressively more saturated with chain properties; and (2) there are fewer large properties available for chain aquisition because existing properties are already affiliated, and because existing properties are already affiliated, and

Table 12

Chain Concentration By Region, 1972

Region	Number of Chain Properties	Percent of All Establishments With Payroll in Region
New England	217	8.1%
South Atlantic	1212	15.2
Pacific	695	11.5
East North Central	689	13.4
West North Central	529	14.4
Middle Atlantic	521	10.5
Mountain	380	8.6
West North Central	356	9.4
East South Central	400	18.8

Table 13

Chain Concentration, Motels and Motor Hotels

U.S. and New England

	U.S.	New England
Total Establishments	14.3	8.4
Total Receipts	50.4	36.1
Total Rooms	36.1	24.5

Source: American Hotel and Motel Association, Census of Selected Service Industries, 1972.

because the slowdown in new construction caused by the oversupply of the early 1970's.

The latter explanation for chain growth is evidenced by the progressively declining size of chain properties in the U.S. and New England:

Average Number of Rooms Per Chain Property

	1972	1973	1974	1975	1976	1977
U.S.	150.9	150.5	150.4	129.6	124.5	117.0
N.E.	134.2	137.5	126.3	126.3	131.3	110.3

To a greater extent this shrinkage undoubtably reflects the economic insecurity experienced by independent operators during the 1974-1975 recession. Moreover, the actual value of chain affiliation for smaller properties in accessing private capital appears problematic at best. The owner of one hotel in Western Massachusetts stated in an interview that: $3,000 in initiation fees and chain membership not only failed to open banker's doors, but gained him only 30 reservations over the full year.

2. Market Growth

Past trends in market growth are often used as indicators of future performance. By this standard, New England is a poor performer. Table 13 and Figure 1 display the growth in industry receipts over the 1954-1972 period. The New England region has failed to grow as rapidly as the national average during any of the four time periods surveyed. The regional growth rate ranked New England fifth (out of nine) during the 1954-1958 period, but dropped back to seventh during 1967-1972.

Table 13

Growth of Receipts by Region 1965-1972

Hotels, Morels, Tourist Courts, Camps*

Region	Receipts ($1972) 1954	1958	1963	1967	1972
North East					
New England	311	355	404	486	542
Middle Atlantic	1,281	1,391	1,512	1,692	1,638
Total North East	1,592	1,746	1,916	2,178	2,180
North Central					
East North Central	910	955	1,022	1,253	1,333
West North Central	404	438	477	582	687
Total North Central	1,314	1,393	1,499	1,835	2,020
South					
South Atlantic	776	966	1,142	1,585	2,174
East South Central	178	206	241	329	446
West South Central	391	417	483	651	819
Total South	1,346	1,592	1,866	2,565	3,439
West					
Mountain	390	517	669	956	1,387
Pacific	671	863	1,091	1,401	1,612
Total West	1.061	1,380	1,760	2,357	2,999
U. S. Total	5,132	6,111	7,042	8,933	10,638

*Camps account for approximately 7 percent of the total receipts.

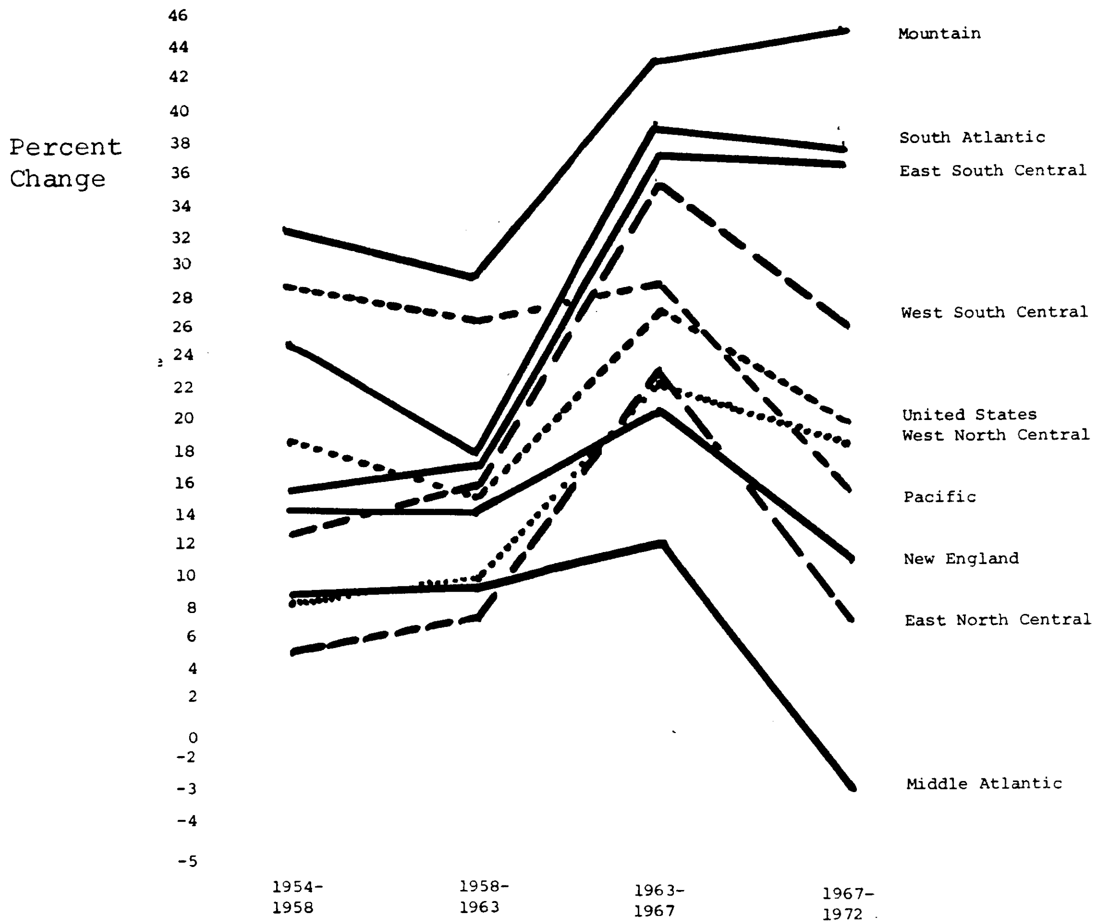
Source: Statistical Abstract of the United States, selected years.

Figure 1

Change in Receipts By

Hotels, Motels, Camps

1954 - 1972



Source: See Table 13.

When compared to the national average, New England's greatest lag period occurred during the 1963 - 1967 period. This was also the greatest period of road building under the Interstate Highway Act. As was mentioned earlier, the region's reliance on the automobile seems to constitute a relative disadvantage during boom times.

Figure 2 shows the relative growth of receipts within the region. Vermont, the most recreationally oriented state, experienced the most rapid rate of growth. This reflects the expansion of the ski industry over the years.

The erratic growth pattern exhibited by Connecticut reflects business cyclicality. The lodging industry in Connecticut is New England's most busines-demand oriented. According to the 1972 Census, Connecticut accounted for 5.6 percent of total receipts. The sharp decrease in business activity in 1972 compared to 1967 was mirrored by a decline in real growth of the hotel-motel industry in that state.

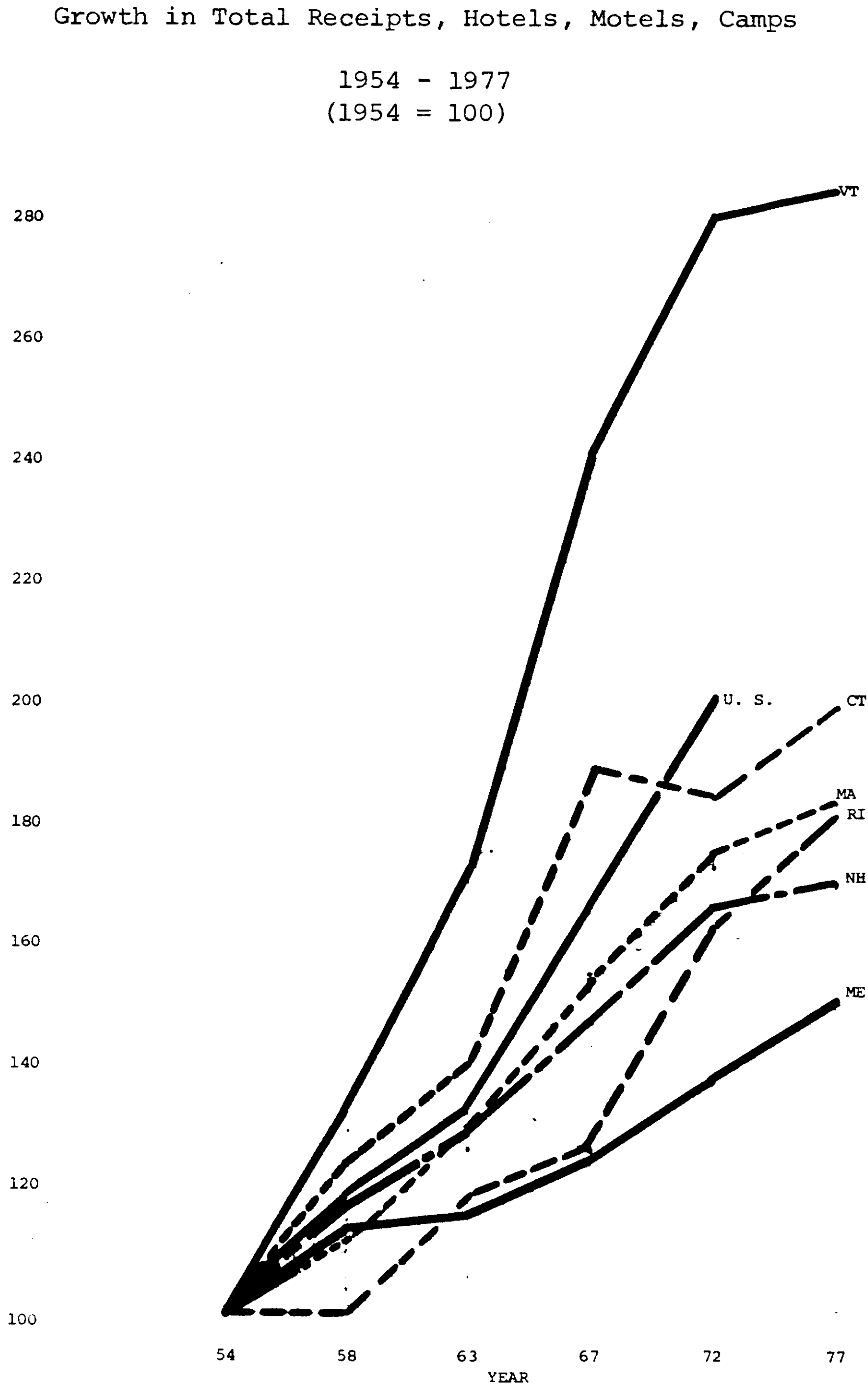
3. Profitability

Because of the fixed cost structure of the lodging industry, profits tend to vary with occupancy and dollar volume. As a rough indicator of regional profitability, we have used the "profit" rate (defined as income before capital charges as a proportion of total revenue) as reported by firms to industry accountants. We then applied these rates to regional sales volume reported by the Census Bureau. Unfortunately, the accounting firm has aggregated New England with the Middle Atlantic states.

Figure 2

Growth in Total Receipts, Hotels, Motels, Camps

1954 - 1977
(1954 = 100)



Source: Census of Selected Service Industries, selected years.

The results of these calculations are displayed in Figure 3 . To partially test the validity of this approach, the total income figure was compared with the pre-tax income total (plus depreciation and interest) as reported by the IRS in Statistics of Income. Results show that the total income figure reported by the IRS is remarkably close (1.96 billion) to the figure arrived at through our method (1.97 billion).

Figure 3 shows that the New England and Middle Atlantic region has declined from being the top income producer in 1958 to a position in 1972 which is fourth out of five regions. Total income (measured in 1972 dollars) in the region was only 4.6 percent higher in 1972 than it had been in 1958. Total income in the nation increased by 62 percent over the same period.

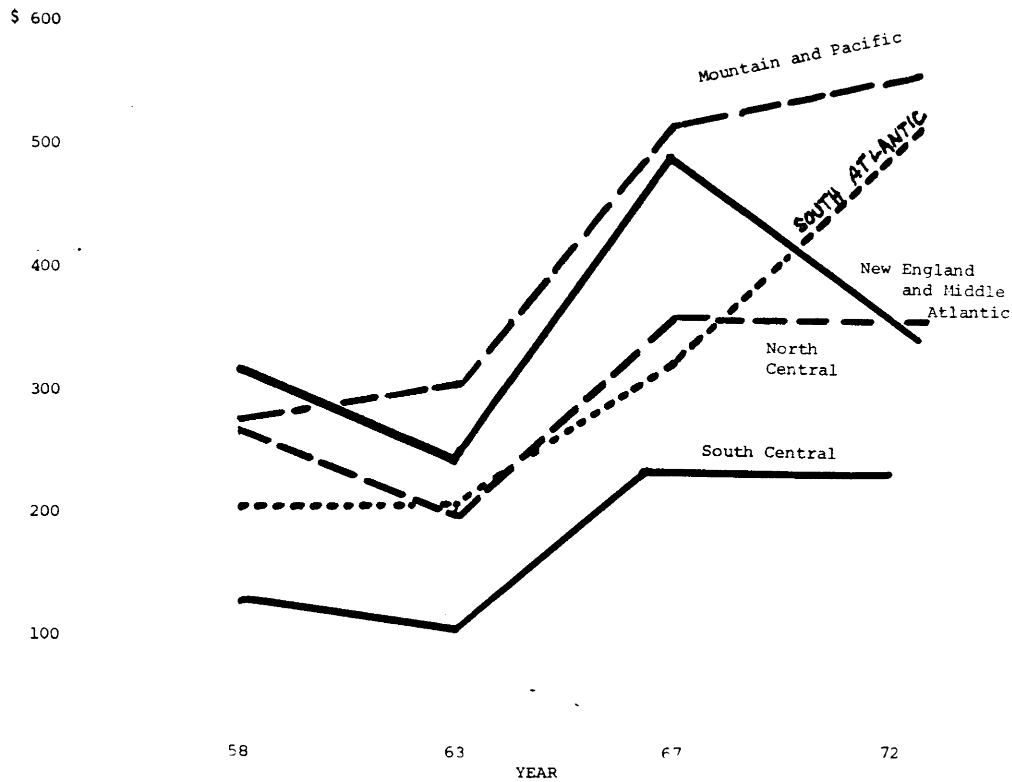
An examination of IRS data for proprietorships within the New England states shows us a picture which is somewhat different from the aggregate. These are primarily small establishments whose average yearly revenues range from $15 thousand to $16 thousand. During the years 1972 - 1974, these establishments generated proportionately more net income than their national counterparts. In 1974, proprietorships in four New England states (Massachusetts, New Hampshire, Vermont, and Maine) had a net income of $9.5 million, up 50 percent from the previous year. Aggregate net income for the nation's lodging proprietorships was only $21.6 million in 1974, down 76 percent from the previous year. This reflects the strength of the regional market.

Figure 3

Estimated Income[1] By Region:

Hotels, Motels, Motor Hotels and Camps,

Selected Years



[1]Refers to income after property taxes but before capital charges.

Source: Census of Selected Service Industries, selected years, and Trends in the Hotel-Motel Business (New York: Harris, Kerr, Forster and Co.), selected years.

It was not until 1975, when the recession deepened in New England, that local proprietors sustained losses. At that point, New Englanders were so deeply affected by the 1975 economic slowdown that they put off their vacation plans.

The response on the part of many proprietors to bad times is to close down entirely for the year (or season). Data for Maine proprietorships show this pattern clearly. Maine was hit hard by the gas crisis in 1973 (which seems to have actually helped business in southern Vermont and New Hampshire), and again by the recession in 1975. The numbers of reporting proprietorships varied in the following manner:

1972 -- 1847; 1973 -- 1170; 1974 -- 1802; 1975 -- 1014.

Proprietors can easily afford to shut down since they have very few carrying costs (although some proprietors employ caretakers during the off-season). If and when proprietors assume larger fixed costs -- either through debt, franchise fees, or other expenses involved in supporting a larger establishment -- they would no longer have the luxury of closing at will. A portion of the lodging industry's risk would have been shifted onto them, and they would have no choice but to give up their independence.

Capital Labor Substitution

In the lodging industry, the total proportion of receipts going to both capital and labor has remained fairly constant between 1958 and 1977. Measured as total industrial income without capital consumption adjustments, this figure has held at 52%-54% throughout the seventeen year period.[3] The relative distribution of returns to labor and capital have fluctuated according to the movement of occupancy rates. During both 1963 and 1972, two years in which the occupancy rate was nearly the same (67.0% and 67.4% respectively), labor (total payroll) accounted for 30% of all industry receipts.

For reasons discussed more fully in Chapter 4 , we know that new claims have been placed on total industrial income. These include an explosion of debt service, various income participation agreements, incentive fees, and other expenses not directly related to operations. In addition, payroll taxes and social security payments have increased sharply over the past decade; and increases in the minimum wage have been cause for additional pressure on the distribution of total income. Historically, room rates have been able to drift upward to satisfy these additional claims. However, periodic overbuilding, competition, price elasticity of demand, changes in the business cycle, and demands for high rates of profitability all act to maintain the tension between capital and labor over the distribution of the income pie.

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[3] The ratios are: 1958 (.52); 1963 (.53); 1967 (.52); 1972 (.53); and 1977 (.54). Sources: Statistical Abstract of the United States, various years; Census of Selected Service Industries 1958, 1963, 1967, 1972; and Bureau of Domestic Commerce, 1978.

Seen in this context, new capital investment (as opposed to capital replacement) is oriented either to: (1) expand the base of production so as to further the accumulation of profits; or (2) gain an edge in the distributional conflict with labor. The nature of production profitability and financial manipulations were discussed in Chapter 2 and Chapter 3. It is to the latter purpose that we now turn our attention.

In Chapter One, we observed that the growth of motels and motor hotels represented a long term trend towards less labor-intensive types of operations.* The proportion of total receipts going to labor was 12% to 26% less for motels and motor hotels than for hotels. Budget motels had even lower requirements. These lower labor costs -- coupled with a lower initial per/room construction cost -- made motels relatively more desirable investments than hotels. Once motels were tested in the market, the major chains, which had previously confined their operations to hotels, shifted their attention (and capital) to motels. Lenders were amenable to this change, since lower labor costs meant higher debt coverage and greater security of investment.

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*This fact did not go unnoticed by organized labor. The Hotel and Restaurant Employees Union noted: "Just as automation is forcing the machine-building unions to effect a revolution in their own thinking, so are these changes [motel expansion] in our industry requiring that we change our thinking, too." (Catering Employee, August 1957, p. 22.) George Meany expressed the opinion that "What's a motel? Why it's just a spread out hotel!" (Catering Employee, November 1958) and the HREU was "faced with the greatest organizing challenge since the thirties." Most motel workers remain unorganized today.

Within hotels and motels themselves there has been a movement away from some of the more labor intensive activities (i.e., in-house restaurants), and some elimination of services (i.e., room service). Increasing "productivity" is seen as another avenue to keep down labor costs. As one industry consultant reports:

> Employee productivity has...become a major hospitality management concern. Since it is unlikely that management can pay specific workers less, when it is already paying the minimum wage, management has to seek ways of improving their output.[4]

Historically, "improving their output" has meant either capital investment in labor-saving equipment, or devising new management techniques to "increase worker efficiency." In addition, the use of disposable products, such as paper dinnerware, has increased as their relative costs decline and quality improves. This serves to free hotel-motel workers from some repetitive operations and reduce labor costs.

Automation has come slowly to the lodging industry since Ellsworth Statler installed the first circulating ice water in his hotels.* Today, direct dialing from guest rooms reduces the need for switchboard operators, automatic elevators eliminate the elevator man, and vending machines (including automated systems for dispensing beverages in the guest's rooms) have

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[4] Bruce H. Axler, Management of Hospitality Operations (Indianapolis: Bobbs-Merril Company, Inc., 1976), p. 109.

*According to Statler, "90 percent of the calls are for a bellboy to bring ice water. With ice water in their room, we can cut down on the service staff. Also the guest is spared the annoyance of having to tip the bellboy." Donald E. Lundberg, The Hotel and Restaurant Business (Boston: Cahners Books, 1976), p. 260.

lessened the need for room service.[5]

Perhaps the greatest developments have been made in the kitchen areas. Howard Johnson pioneered the use of convenience frozen foods in his roadside restaurants. This technique quickly spread to hotel restaurants as well. This eliminated the need for food pepraration workers and effectively "deskilled" the job of cook. As Donald E. Lundberg notes:

> Commissary freezing was a milestone in large restaurant operations. It permitted impressive economies in restaurant labor. As early as 1963, Howard Johnson supervisors were being told that it was no longer necessary to hire cooks, only food warmers. In fact, food preparation in Johnson restaurants has been restricted to griddling, frying, and baking.
>
> Teenagers have been griddle and fry cooks. No intricate recipes need be followed for preparing food. Instead of paying $200 and more a week for a chef, the minimum wage is paid for a kitchen preparation staff. If a "food warmer" decides to leave, another person can be trained in a few days to take his place.[6]

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[5] James A. Urisko, "Productivity in hotels and motels, 1958-1973," Monthly Labor Review (May 1975), p. 26.

[6] Lundberg, op. cit., p. 291. Eliminating certain job descriptions has also enabled employers to keep down labor costs. This had been done at the lofty Mount Washington Hotel (a far cry from Howard Johnson's). As the New York Times (July 22, 1979, p. F3) reports: "Labor costs have further eroded profits. An average waiter will earn $220 a week; a bartender, $100 more. 'When you have to raise the dishwasher, you have to raise the chef,' says Angelo Accarino, food and beverage manager. So Mr. Accarino has blurred the division of labor somewhat among 48 employees in his 5,000 square-foot kitchen. A 50-year hotel veteran, he said he once employed more cooks. But in those days, he recalled, Your fry cook does nothing but fry. Your roast cook does nothing but roast. Well, I cut that out. I call them cooks.'"

Capital investment in physical design changes have been made in older properties to reduce labor time.* Investment in computers is greatest in the head offices and reservation centers of the national chains, and has led to the reduction of clerical staff needs. During the 1960's, some large hotels made use of computers to assist with accounting, reservations, and staff scheduling. In more recent years, the advent of cheaper systems, time sharing, and the development of mini-computers has brought computer technology within the reach of most establishments of over 100 rooms.

Part-time, Part-year

The use of computers has enabled management to make more accurate short-term forecasts of expected occupancy levels. Schedulers then attempt to match weekly occupancy forecasts with staffing needs. Organized labor supports this development as a way to stabilize the housekeeping department by assigning scheduled work on the basis of seniority. The net effect,

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* Ernest Henderson, founder of the Sheraton Corporation, details the reasoning for such changes in this discussion of Boston's Copley Plaza: "When the hotel was built, in 1912, labor was cheap and uncomplaining. Waiters were forced to cover unconscionable distances and to climb long flights of stairs to serve exacting guests, but in those days this was of little concern. Now things were different; union wages were rising sharply It would be hard to move the kitchen to the lobby floor, but if we couldn't bring the mountain to Mohammed, perhaps Mohammed would be willing to move. For sixty thousand dollars the principal dining room could be transplanted to a lower level. Waiters could halve the distance covered in their accustomed shuttle between temperamental chefs and ever-demanding diners, and avoid the endless stairs. Payroll savings and faster service would earn, we estimated, some forty thousand dollars a year, a better return at least than the more familiar three or four percent paid on government bonds." From Ernest Henderson, The World of Mr. Sheraton (New York: David McKay, Co., 1960), p. 81-82.

however, may be to increase the number of part-time ("regular part-time" in union houses) workers with, or without, the use of computers.

The average number of hours worked in a week in the nation's hotel-motel industry has declined steadily since 1958. In 1958 the average work-week was 40 hours. By 1972 it had declined to 33 hours, and in 1977 the figure stood at 30.9 hours. One third of the reported increase in the number of workers in the industry between 1972 and 1977 can be said to result from a shortened work-week.*

In addition to making use of more part-time workers, the industry has, over the years, employed temporary part-year help to meet peak demand (primarily in the summer quarter). According to the 1968-1975 LEED file analysis, the proportion of industry workers which were employed one quarter or less in New England has, on a yearly basis, ranged from 36.8% to 42.9%. Only 16.6% to 22.6% of all workers were employed on a full-year basis during the same time span.

Figure shows the flow of quarterly workers over the period. The number of workers employed four quarters remained virtually unchanged from 1961 to 1975, while the number of three quarter workers changed little from 1965 to 1975. Workers employed one quarter or less exhibited the greatest

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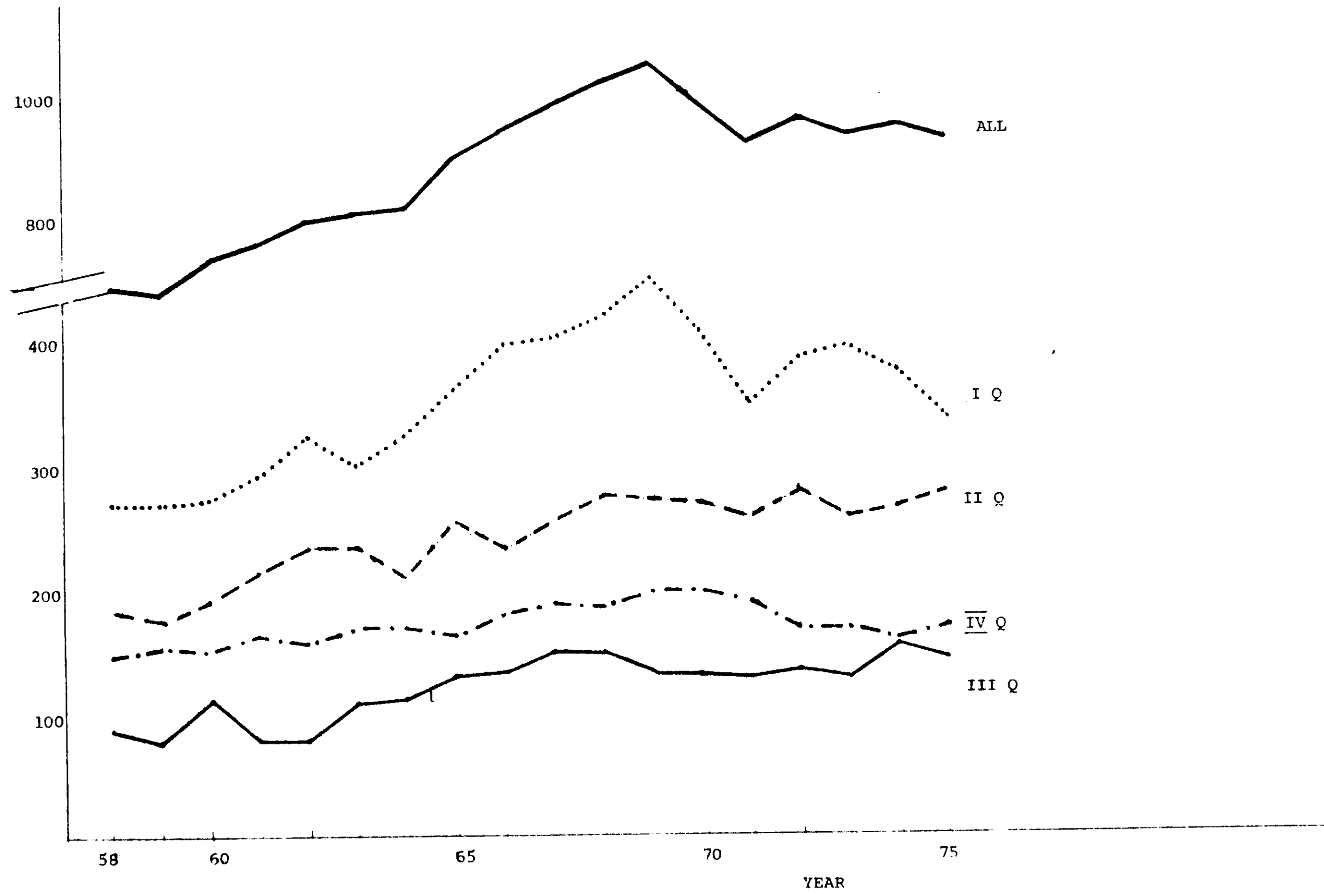
*Average annual employment increased from 697,900 in 1972 to 880,500 in 1977. Because of the dimunition in hours, 59,800 jobs were "created" by shrinking the work week from 33.14 hours to 30.88 hours.

Figure 4

Employment Levels by Number of Quarters Worked

1958 - 1975



Source: LEEDs File.

with respect to variable and fixed labor. Moreover, the reduction has been much more marked for fixed labor. Labor is becoming less of a "quasi-fixed factor of production" because of shifts in the mode of operation, deskilling, automation, and an increase in customer "self-service."

Table 14

Variable and Fixed Labor: New England

	"Variable" One Quarter Workers	"Fixed Four Quarter Workers	
1963	29,800	16,500	
1972	38,100	16,600	
	Available Hotel Rooms	Available Motel Motor Hotel Rooms	Total Available Rooms
1963	34,128	33,016	67,144
1972	39,419	66,682	106,101
	"Variable" Worker Per Room	"Fixed" Worker Per Room	
1963	.44	.25	
1972	.36	.16	
Percent Change	-18.2	-36.0	

Source: LEED file, Census of Selected Service Industries, 1963,1972.

variability, fluctuating from 44,400 in 1969, to 34,300 in 1971 (a decrease of 22.7 percent).

Variable and Fixed Labor

A comparison between the number of workers employed for one quarter or less and the occupancy level data found on page 100, show a high (.69) positive correlation. This indicates that the temporary (one quarter) worker is representative of variable labor within the firms themselves. Year-to-year fluctuations in demand for lodging services (resulting from the business cycle, transportation patterns, weather, etc.) are likely to elicit an increase in variable labor only.

The fact that the number of four-quarter workers increased only slightly when the industry peaked in 1969, and then fell off again to the 1963-1964 level, suggests that new investment in facilities requiring fixed (four quarters) labor did not exceed the reduction in the need for fixed labor caused by capital contraction.

Data from the Census of Selected Service Industries show that the number of establishments with payroll in New England declined between 1963 and 1972* by 292 establishments. However, the number of rooms available increased by 38,957, with motels and motor hotels accounting for 86 percent of the gain. This suggests that the relative shift in investment away from the hotel type of operation has made the industry less labor intensive both

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*Two years with similar occupancy rates.

Low Wage

Wages for variable labor are kept at very low levels. According to LEED file data for 1975, total average wages for workers employed one quarter or less in S. I. C. 701 (hotels-motels) were only 46 percent of the average for all workers employed for the same period in the region.* The same analysis applied to workers employed four quarters shows little improvement: workers in S. I. C. 701 earned only 57 percent of the regional average.*

On the national level, data from Employment and Earnings for February, 1979, show that the average weekly earnings for a worker in the hotel-motel industry was $118.95. This amounts to only 56 percent of the average weekly earnings for all workers in private industry ($212.05). Clearly, then, hotels-motels are among the lowest paying of any industry.**

Importance to the Region, The Worker

Industry apologists and many public officials tend to downplay the low-wage, unstable job aspect of hotel-motel employment, and play-up the importance of the industry to the city, state, or region. Low wages are often glossed over as being unimportant because, as one report states:

---

*These figures represent only those wages earned in those industries supplying primary employment during the defined number of quarters.

**There are only ten three-digit S. I. C.'s paying less than hotels and motels. These figures include reported tips and service charges added to customers bills and distributed to employees. Tipped workers account for approximately 38% of all non-supervisory workers according to various BLS area wage surveys.

> studies of the commercial lodging industry...indicate that well over half of its jobs are clerical or in general housekeeping or food service occupations to which young seasonal workers are highly adaptable.[7]

Employment in the hotel-motel industry in New England is more seasonal than the nation as a whole. Comparative data for five New England states for the years 1972 and 1977 show that the region (less Maine) has exhibited greater seasonality of employment in the latter period. Data for the U. S. as a whole show the opposite trend:

	Seasonality Index (Coefficient of Variation For Monthly Employment Totals)		Mean Monthly Employment (000's)	
	Year		Year	
	1972	1977	1972	1977
Massachusetts	.102	.150	16.5	18.4
New Hampshire	.308	.267	5.1	5.6
Vermont	.131	.143	3.8	4.3
Rhode Island	.170	.192	1.8	2.2
Four state total	.140	.159	27.3	30.5
U. S. A.	.071	.066	699.3	880.5

Source: Department(s) of Employment Security for States, Employment and Earnings, 1972, 1977.

[7] "The Tourism and Recreation Story In Massachusetts," (Boston: Division of Tourism, Massachusetts Department of Commerce, 1972), pp. 26-27.

The data also indicates that employment growth in the industry has been slower in New England (11.7%) than in the country as a whole (25.9%). Of those states surveyed, Rhode Island was the fastest growing (17.9%), but Massachusetts registered the greatest numerical gain (1,900 workers, or 59% of the four-state total increase).

Figure 5 illustrates the importance of the industry to the region as an employer, and to the employee as a source of income. The solid line shows the percentage of all workers in the region employed during any point in the year in S. I. C. 701 according to the LEEDs file. The dotted line depicts the region's unemployment rate.[8] The dashed line indicates the percentage of employees who worked in S. I. C. 701 and for whom employment in the industry provided the majority of their total wages for the year.

What this shows us is that (1) the lodging industry is clearly pro-cyclical with respect to employment*; and (2) that during economic

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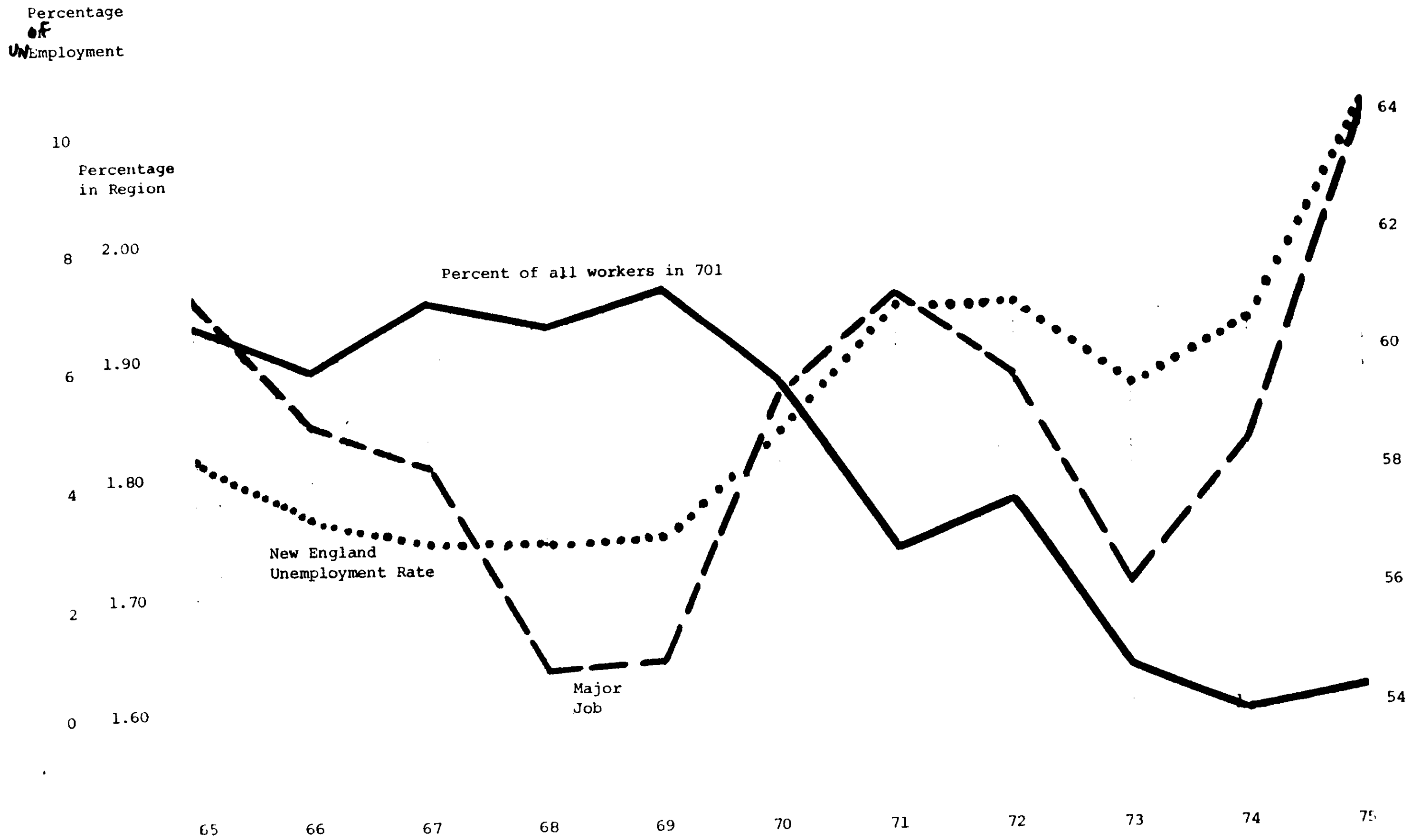
[8] See Lynn Browne, "Regional Unemployment Rates: Why Are They So Different?," New England Economic Review (July-August, 1978), p. 21.

*The only real exception was the industry decline during the gas crisis of late 1973. The fact that the industry's percentage of total New England employment rose slightly in 1975 should not be misconstrued -- it is just that employment in S. I. C. 701 did not fall as rapidly as did the region as a whole. If the percentage line was flat throughout the period, the industry would be as cyclical as the region. The fact that the percentage line is negatively correlated with the unemployment rate line shows that the effects of the cycles are exaggerated in the industry.

Figure 5

Relative Importance of the Hotel-Motel Industry in Regional Employment



Source: See text.

downturns the industry becomes a more important source of income for a greater proportion of those workers still in it. The industry is well equipped to absorb excess entrants into the labor market during boom times, but fails to serve as a refuge for displaced workers during cyclical downturns.

Organizational and Structural Trends for the Future in New England

1. Risk Shifting: Capital

The key to the structure of profitability within the industry has become the capacity to shift risk onto other actors. Income participation clauses on the part of lenders, incentive fees for management firms, and market "creaming" are all examples of the risk shifting trend. But a further intensification of risk shifting generates a series of problems for public policy -- small proprietors are progressively pushed out of the market and an increased dependence on public capital subsidies evolves. Cities, in their attempt to attract hotels and convention centers, must commit themselves to large capital subsidies. Yet the benefits from these expenditures are ambiguous:

> ...Cities are making massive investments in convention centers based on insufficient information, scarce sampling, and sketchy feasibility studies. There is a great possibility that many cities will lose out in the future, as the growing pool of facilities are constructed and as the competition for business grows more intense, cost is increasingly favorable for convention sponsors and unfavorable for cities. [9]

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[9] Gary A. Tobin, The Changing Structure of the City: What Happened to the Urban Crisis, (Beverly Hills: Sage Publications, Volume 16, Urban Affairs Annual Reviews), 1979.

2. Capital-Substitution Effect: Labor

This trend is historical both in New England and the nation. As capital intensive techniques are substituted for labor, the work force shrinks, becomes deskilled and opportunities for occupational advancement decline. The public policy area affected by this trend is the increased reliance of workers on government institutions in the form of unemployment insurance and welfare services.

The increased instability of the labor force is accentuated by the highly seasonal and cyclical nature of the demand for lodging in New England. Moreover, the labor market becomes reshaped as a result of the capital-labor substitution. Employers draw on new workers to act as variable capital. As a top corporate officer of a large chain candidly admitted in an interview:

> We prefer to locate in an area with a substantial minority base.

But the lack of opportunity for workers creates disgruntled employees, high turnover, and labor/management tension; or, as described by another executive:

> Blacks do not seem to have the proper subservient attitude anymore.

3. Economic Conditions: The "Enfranchisement Boom"

The recent trend of ownership re-organization and restructuring through enfranchisement, as illustrated by figures for the last decade, will continue. From the perspective of the chains, the increased competition for new enfranchisements makes New England attractive due to its historical low percentage of chain presence.

The other factors reinforcing this development are the marginal benefits from the standpoint of portfolio mix and diversification in investment strategies. While, on the other hand, small proprietors perceive the chains as providing instant capital accessibility. As economic conditions worsen and market growth shrinks, the national name, status and organization of the chains makes an association appear as the most secure strategy for small proprietors.

Will enfranchisement be the panacea for small proprietors? There are a number of reasons to be skeptical about this solution. First, enfranchisement raises the fixed costs of operating. And, as the study has shown, the highly seasonal demand, in conjunction with the higher fixed costs will make the break-even point even that much more difficult to achieve. Second, given the local nature of the New England market, it is unclear how important and effective it is to have an expensive national reservation system. Third, based on our interviews with managers of recently franchised hotels, the "quick" money they had anticipated due to their new status has not materialized.

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