

A SEGMENT TOO IMPORTANT TO IGNORE, PART TWO



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In [my last post](#) I asked why the world's largest hotel groups are all ignoring the hostel market segment, leaving independent groups to reap the benefits of this lucrative market.

Maybe it is because demographics don't stack up and there is a lack of scale. However, 17.6% of the world's population is aged 15 to 24 years old (11.7% in Europe and 14% in the United States), so this market segment is not very different from any other age segments in terms of volume.



Say Cheese Leipzig, Germany

It must be a matter of unappealing total revenue. Maybe ADRs are much lower than in conventional hotels. The reality is exactly the opposite. If one takes into account that hostel ADRs are measured on a "per guest" basis and that rooms have mostly between one bed and six beds in many markets, ADR levels in hostels are often higher than in conventional hotels.

Perhaps occupancy levels are lower than in traditional hotels. One would think that in principle this is a leisure product concept. Clearly, properties have to be located in large cities to sustain good occupancy levels from Monday to Friday (not only during the weekends). So is this market only viable then in few hundred cities across the world? Mind you, Hostelbookers distributes 20,000 properties globally, WRI distributes 35,000 and Hostelz covers 53,600 listings in 9,475 cities worldwide, so maybe there is more to it than leisure travel.

Investment per property cannot be a barrier to entry — on the contrary. Street-level floors are not mandatory, many rooms share bathrooms (as a consequence staff ratios are lower than in standard hotels), service levels are minimal, product standards are flexible, FF&E is cheaper, interior decor is no-frills and F&B is marginal or can be shared with local franchises.

Maybe the operational margins do not make sense to large hotel groups. But, as a result of good ADRs and decent occupancy levels with very low operating costs, GOP levels are significantly higher than in conventional hotel operations — nothing that cannot be reinforced with large volume properties. The latest **Generator** property in Barcelona can accommodate 726 guests.

It could be that this segment involves a higher level of risk. The risk, however, doesn't seem to be financial or operational, based on the above premises. It could be there is a risk of brand “contamination” or “cannibalization,” but I think it would be misleading to position a hostel only as a lower segment relative to the focused-service segment (say, a Hampton Inn). A hostel is in theory a lower “age segment,” and as such, hotel groups are simply acquiring clients at a younger age than they currently do. Similarly, the Mini brand (owned by BMW) is not contaminating the BMW 7-Series. These two product segments co-exist in the same product family and often are acquired by the same clients. Brand cannibalization, or overlap, already exists between a Marriott and a JW Marriott.

Wouldn't the head of Marriott Rewards, SPG or Hyatt Gold Passport be thrilled to be able to target a segment that could account for, say, 10% of the world's population, and is currently neither accruing nor redeeming loyalty points with these programs? I think they would love to reach this segment, turn this crowd into loyal and repeating customers and start feeding their respective product lines at a much earlier stage in the life cycle.

To make things more appealing, the hostel market is largely owner-operated, hence ideal for the deployment of franchising development. A company like Wyndham or Marriott should thrive in this environment.

So why does it look like the largest hospitality franchisers in the world are ignoring this segment, even when they could set the bar of only entering large-asset deals?

Well, I think some of these groups must be already looking into this market segment very seriously. They haven't done anything about it yet, as market data and operational performance metrics are not widely available, but my bet is they are already analyzing whether to enter this segment, probably by acquisition. Of course, some of the large groups will be late adopters, since they are still trying to fill in unfulfilled market gaps at the higher end of the spectrum, but the rest of the large brands realize the risk of doing nothing is simply too high. The risk is really that these hostel brands go upstream to compete with the Premier Inns, Motel Ones, Hampton Inns, Ibises, Travelodges and Tunes of the world, the much appreciated focused-service segment, a trend that is already starting to become a reality in some markets.

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