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PERFORMANCE OF EXCHANGE-LISTED LODGING FIRMS DURING THE GREAT LODGING DEPRESSION OF THE 1980s AND EARLY 1990s

Arun Upneja

ABSTRACT

Extensive literature in hospitality finance indicates that the lodging depression of the 1980s spanned the years 1980–92 and that the entire industry was losing money for most of that period. For example, Hanson (1994) claims that "after operating at a loss in every year since 1982, the U.S. lodging industry will again be profitable in 1993." However, there are many reasons to believe that exchange-listed lodging firms may have had a different picture than the industry as a whole. This paper discusses some of those reasons and focuses on the profitability of lodging firms listed on the major stock exchanges. The results presented show that the exchange-listed lodging firms were generally profitable during the depression years and that the percentage of lodging firms reporting losses during this period was not very different from the overall percentage of all listed firms reporting losses.

Introduction and Purpose

Extensive evidence indicates that the lodging depression of the 1980s spanned the years 1980–92. For example, Hanson (1994) claims that "after operating at a loss in every year since 1982, the U.S. lodging industry will again be profitable in 1993." Rushmore (1996) claims that the depression started in 1980 and there was a decrease in absolute demand between 1980–83. The demand for rooms picked up after 1983 but overbuilding due to tax laws caused overall losses for the lodging industry. As per Hanson (1994) the lodging industry started losing money in 1982, at the rate of approximately $1,000 per room per year. The losses peaked in 1990 when an average room lost a little more than $5,000. 1993 was the first profitable year for the lodging industry when an average room generated approximately $1,000 of profits.

If, on average, each room was losing money then it is reasonable to conclude that the lodging industry as a whole was also losing money. Again extensive research (Hanson, 1994; Beals & Engel, 1995) indicates that the industry was indeed losing money. This is a very grim picture of the industry. It is difficult to imagine that in one of the most efficient markets in the world, an entire industry could lose so much money over such a long period.

Were there some winners in this picture of losses? For example, the losses incurred per room are an average number for the industry and it is reasonable to assume that there were some properties generating profits. Even if we assume that all properties were losing money, some sector of the lodging industry had to make money because new

development continued unabated during the entire depression years. In the search for the winners during the depression of the 1980s, this research focuses on the profitability of lodging firms listed on the major stock exchanges. There are many reasons to believe that exchange-listed firms may have had a different picture than the industry as a whole. Publicly traded lodging firms enjoy many advantages that give them an edge over the independently owned properties. The following discussion sums up some of the reasons why the performance of exchange-listed firms should be different from independently owned operations.

The stock market monitors the financial performance of listed firms very closely. This intense and close scrutiny is a major reason why the losses could not have persisted for so long without a major restructuring of the way in which these firms conduct their business. The stock markets have a self-correcting mechanism that moves capital away from industries with returns lower then those commensurate with the risk of the industry. This also holds true for individual firms with sub-par performance, i.e. performance below that of comparable firms.

McDonald's Corporation, a large multinational restaurant firm, has demonstrated clearly that the promise of familiarity will sell even in unfamiliar surroundings. "McStores" can be found everywhere in the world serving consistent food. In the lodging industry, firms have used this concept to lure customers into staying at branded properties where they can be assured of a certain level of amenities and service.

With their central reservation networks, lodging firms can more effectively capture a larger share of the business. A big lodging firm can spread the advertising cost over a large group of hotels. A smaller property can afford advertising in a limited fashion, a big chain can roll out nation-wide advertising campaigns to increase brand-awareness. As far as the costs are concerned, economies of scale in every part of the operation can make these firms more cost efficient while maintaining standards.

Finally, a big part of the revenue of the lodging firms is derived from a percentage of franchisee revenues. Even if the franchiser is losing money, the firms are getting their share of the total revenue. For hotel firms with extensive management contracts, the fees generated from managing properties can also be a significant source of revenues. Sangree and Hathaway (1996) provide evidence that the bulk of the management fees during the decade of 1980s consisted of a percentage of revenues whereas the trend in the 1990s is on incentive-based plans.

To the extent that a significant portion of a lodging firm's revenue is derived from both franchising and the management fees (henceforth F&M revenues), the firm is not very sensitive to a slow-down in business. Therefore, it is possible that the lodging firms listed on the major stock exchanges, who are franchisors, could be the beneficiaries of such an arrangement.

The following quote from *Business Week* (1986) sums up some of the arguments to suggest that the big lodging firms may have had a different experience during the 80s depression.

> Any bloodbath will hurt the Hiltons, Hyatts, and Marriotts—but they won't be devastated. Big chains have limited their risk by enlisting investors to build new hotels, which the companies then manage for a fee. Sheraton Corp., for example, has converted almost completely from owner to manager. Fast-growing Radisson Hotel Corp. has its name on 77 hotels yet owns only three. Profits at these chains will undoubtedly decline, but, as the neutron joke suggests, outside investors may suffer greater pain.

The possibility that big lodging firms can be profitable even at the expense of individual properties is very intriguing for academic researchers, hotel owners, and financial analysts. If lodging firms are not as susceptible as individual properties to a downturn in business then any valuation research on lodging firms has to account for this phenomenon. For example, given a forecast of recession, we would expect higher current returns from lodging firms with a lower proportion of direct ownership and a higher proportion of management contracts. However, in years where occupancies and REVPAR are rising, lodging firms with a higher proportion of owned properties will reap higher rewards. Therefore, the focus of this research is to examine the profitability of exchange-listed lodging firms during the lodging recession of the 1980s.

Data and Methodology

Financial data were collected from the 1995 Full Coverage Compustat tape, including all firms trading in the NYSE, AMEX, and NASDAQ. Firms in the SIC code 7011 (Lodging sector) were included in the study. Although there is no consensus on the exact beginning of the recession for lodging firms, 1980–82 is the most common time period mentioned in various studies as being the beginning of the recession. Therefore, this study covers data for the period 1977 (before the beginning of the recession) to 1995. If one of the ratios could not be calculated due to missing data then that firm year was eliminated. This procedure results in a uniform set of firms for each year. For example, the median ROA and median ROE for a particular year are calculated over a uniform set of firms. Net income (NI), return on assets (ROA) and return on equity (ROE) were tracked for all the exchange-listed firms for years 1977 to 1995. ROA was operationalized as the net income divided by total assets of the firm at the fiscal year-end. ROE was operationalized as the net income divided by net equity of the firm at the fiscal year-end. The income from operations before unusual items and extraordinary items was used as the measure for net income.

Results and Analysis

Descriptive statistics on 'net income from operations' are shown in table one. During the years in which the hospitality industry is commonly believed to be in a recession, at least 50% of the firms had positive net income from operations in all years. The percentage of firms (over all firms) that report losses ranges from 7.69% to 50%. The mean of net income for the industry is also positive in all years except 1991. This result is surprising because many existent studies claim that, collectively, the entire industry was losing

Table 1
Descriptive Statistics for Net Income before Unusual and Extraordinary Items for Lodging Firms for Years 1977–1995

Year	Mean	Median	Standard Deviation	Minimum	Maximum	# of firms	%L[1] NI<0	%ALL[2] NI<0
77	4.217[3]	0.224	10.908	-0.220	40.065	13	15.38	8.77
78	6.886	1.390	18.382	-0.171	67.594	13	15.38	7.9
79	9.425	2.340	27.090	-0.109	99.283	13	15.38	11.3
80	10.307	0.535	28.930	-0.304	106.132	13	7.69	14.2
81	11.168	1.765	30.710	-0.467	112.623	13	23.08	18.1
82	9.246	0.679	22.696	-0.381	83.373	13	38.46	25.1
83	12.057	1.679	30.595	-0.224	112.637	13	30.77	25.8
84	12.562	2.076	30.906	-0.340	113.983	13	15.38	26.7
85	9.860	0.124	25.924	-3.311	100.163	15	33.33	32.0
86	10.696	0.128	26.249	-5.864	97.839	15	26.67	33.0
87	9.566	0.089	32.787	-11.357	139.856	20	50.00	33.5
88	8.747	0.059	32.094	-15.608	130.900	21	47.62	32.3
89	9.023	0.115	29.351	-24.837	110.100	22	40.91	33.3
90	3.078	0.119	26.486	-41.909	112.500	22	40.91	31.7
91	-11.990	0.101	56.963	-246.110	84.300	23	47.83	
92	2.859	0.006	29.256	-71.965	103.900	24	50.00	
93	5.896	0.836	19.904	-7.721	102.700	28	35.71	
94	10.920	0.764	26.032	-6.261	121.700	31	22.58	
95	17.716	3.017	41.552	-5.421	172.800	29	20.69	

1. Percentage of lodging firms that reported losses for that year.
2. Percentage of all *COMPUSTAT* firms that reported losses for that year (from Hayn, 1995). Her sample does not go beyond 1990.
3. All amounts (except the percentages) are in hundreds of millions.

money at this time (e.g. Hanson, 1994; Rushmore, 1996). The proportion of firms that report losses compares well with data reported by Hayn (1995) for all firms on the *COMPUSTAT.* In addition, Hayn (1995) presents supplemental tests that indicate that the proportion of firm-years reporting losses is susceptible to firm size. She shows that when portfolios are formed on firm size, there is a monotonic relationship between size and proportion of firms with losses.

Tables two and three provide descriptive statistics on ROA and ROE. Except for 1992, at least half the firms had positive return on assets in all the years. At least half the firms also had a positive return on equity in all years. Figure one reveals that the decline on return on assets started after 1984 and continued until 1992. The increase in ROA for 1986

Table 2
Descriptive Statistics on Return on Assets for all Lodging Firms for Years 1977–1995

YR	Mean	Median	Standard Deviation	Minimum	Maximum
77	0.031	0.024	0.033	-0.012	0.092
78	0.039	0.033	0.045	-0.042	0.115
79	0.035	0.028	0.054	-0.043	0.156
80	0.055	0.038	0.073	-0.087	0.193
81	0.025	0.020	0.069	-0.142	0.138
82	0.014	0.008	0.067	-0.134	0.136
83	0.021	0.025	0.053	-0.084	0.103
84	0.077	0.053	0.169	-0.177	0.580
85	0.006	0.009	0.124	-0.312	0.231
86	-0.065	0.030	0.320	-0.907	0.321
87	-0.057	0.001	0.294	-1.176	0.319
88	-0.035	0.004	0.174	-0.500	0.299
89	0.043	0.016	0.213	-0.480	0.729
90	-0.117	0.008	0.415	-1.660	0.220
91	-0.091	0.004	0.294	-1.001	0.235
92	-0.025	-0.006	0.168	-0.559	0.296
93	0.016	0.017	0.174	-0.501	0.619
94	0.030	0.019	0.063	-0.113	0.220
95	0.026	0.030	0.046	-0.092	0.105
All years	0.0015	0.019	0.150	-0.422	0.269

is possibly a tax effect due to the elimination of some tax shelters in that year (Chon, 1993). The median return on equity was never below zero and started declining from 1984 and was very close to pre-84 level by 1991. After stabilizing at approximately 10% it started climbing in 1993 and was 12.4% in 1995, the latest year for which figures are available.

Results and Implications

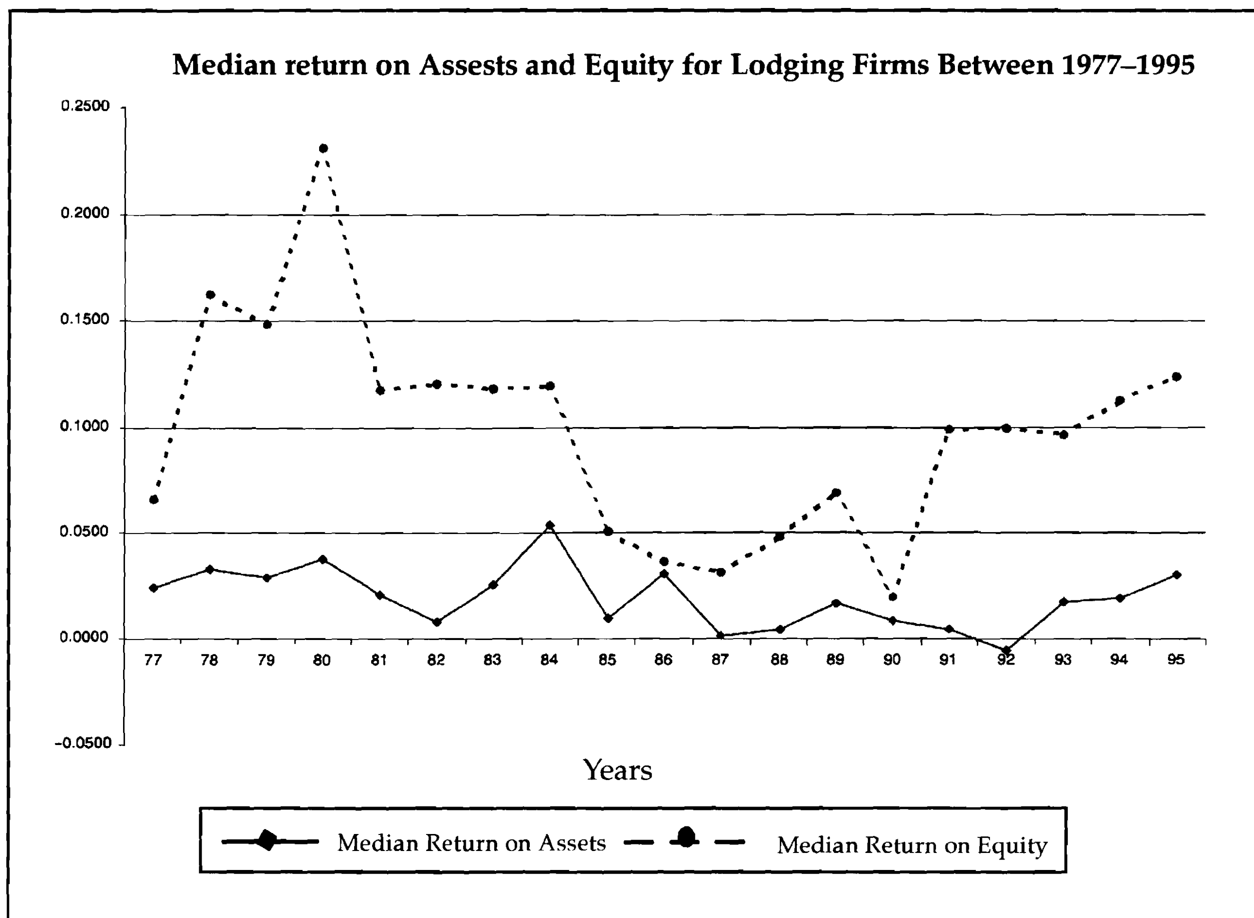
This paper describes an industry that is in some trouble but not in complete panic, a picture that is painted by previous research. However, there are some key issues that have emerged from these descriptive results. The first question is the degree to which the lodging firms benefit from franchise and management fees to tide over the recession phase of the lodging cycle. For example, Hyatt does not own any property and receives all of its revenues from franchising and management fees. Therefore, a recession will not affect Hyatt as much as another operator with many corporate owned properties.

Table 3
Descriptive statistics on Return on Equity for all Lodging Firms for Years 1977–1995

YR	Mean	Median	Standard Deviation	Minimum	Maximum
77	0.092	0.066	0.127	-0.134	0.272
78	0.058	0.163	0.470	-1.467	0.389
79	0.167	0.148	0.151	-0.106	0.487
80	0.208	0.231	0.142	0.017	0.495
81	0.187	0.118	0.235	-0.045	0.877
82	0.098	0.120	0.102	-0.080	0.259
83	0.127	0.118	0.133	-0.050	0.496
84	0.164	0.119	0.221	-0.231	0.677
85	0.053	0.051	0.232	-0.416	0.453
86	-0.152	0.036	0.608	-1.837	0.528
87	0.024	0.031	0.193	-0.498	0.463
88	0.118	0.048	0.365	-0.533	0.953
89	0.186	0.069	0.551	-0.503	1.672
90	-0.044	0.019	0.559	-1.350	1.504
91	0.205	0.098	0.461	-0.558	1.564
92	0.157	0.099	0.448	-0.750	1.688
93	0.060	0.096	0.485	-1.425	1.528
94	0.114	0.113	0.144	-0.189	0.460
95	0.106	0.124	0.227	-0.556	0.586
All years	0.101	0.098	0.308	-0.564	0.808

However, during the time the economy is expanding, Hyatt will not fully participate in the expansion. In other words, the total revenue line plotted over time will be relatively flat as compared to lodging firms that own properties. This fact is crucial to making investment decisions for both individuals and professional investors. To the extent that a firm relies on franchising and management fees, its revenue stream is more stable and less susceptible to a downturn in the economy. A part of the finding may also challenge the notion that firms with high operating leverage take a proportionally greater hit during depression. The proportion of F&M revenue over total revenue may act as a moderating variable to partly mitigate the effect of a depression on firms with high operating leverage.

The second issue that emerges is the economies of scale argument for both revenues and costs. For example, one implication is that independently owned properties would have higher operating expenses than franchised properties. Additionally, franchised properties would get a larger share of increased business in a particular region due to the



marketing and reservation clout of the chain. These issues are empirically testable and deserve more attention by academic researchers.

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