

# Sustainability

## Taking a 360-degree view



Sustainability will become a defining issue for the industry in 2015 and beyond. Rising populations and increasingly scarce resources will provide a challenging business environment in which sustainability will need to be embedded within all facets of the industry, rather than regarded as a standalone issue.

### Key findings

- Sustainability is increasingly seen as a prominent factor in hospitality decision making, but is not yet fully embedded in business thinking.
- The key challenge faced by the industry in 2015 will be the adaptation of the existing asset base, which will be expensive and disruptive.
- Regulatory, economic and stakeholder pressure will drive sustainability in the industry, creating a virtuous circle that will see social and business norms change with surprising speed.
- 95 per cent of business travellers surveyed believe the hotel industry should be undertaking 'green' initiatives.

Operators must keep pace with changing social views, business norms and government regulation in order to adapt quickly to the changing expectations of stakeholders. Hospitality is a discretionary purchase, as highlighted by its volatility in the recent recession. By 2015, the consumption of goods and services seen as environmentally irresponsible is likely to be challenged by new social norms. Luxury items that fall into this category risk being seen as increasingly unacceptable.

*"Current global consumption patterns are unsustainable ... it is becoming apparent that efficiency gains and technological advances alone will not be sufficient to bring global consumption to a sustainable level: changes will also be required to consumer lifestyles, including the ways in which consumers choose and use products and services."*  
Sustainable Consumption Facts and Trends from a Business Perspective, World Business Council for Sustainable Development, 2008.

By 2015 we are likely to have reached a tipping point. Those who have not kept pace may struggle to effect change across their businesses and their competitive positioning and profitability may be adversely impacted. Operators need to develop business models that incorporate a 360-degree view of sustainability, embedding environmental responsibility at the core.

**The bigger picture – convergence of agendas**

Over the past five years sustainability has risen up political, consumer and business agendas faster than any other issue.

Sustainability is now an accepted dynamic in the socioeconomic and political environment of the 21st century, although it remains the subject of much debate and there is still often a gap between what governments say and what they do.

In 2015 the cornerstones of political debate are likely to remain similar to those of the post war period: economy, health, justice, defence and social welfare will maintain their dominance of the agenda. However future policy will also actively consider the implications of sustainability far more than in the past, seeking to change both corporate and individual behaviour.

Today's consumers see sustainability as desirable but not yet as a key driver of activity and, as with government, there is often a clear gap between what people say and what they do or buy. However we are in the midst of a significant cultural shift. At the start of the last decade there was little consumer recognition, yet a recent survey<sup>1</sup> by Deloitte found that in most countries 30 per cent of consumers now buy with sustainability in mind and a further 30 per cent are aware of the issue.

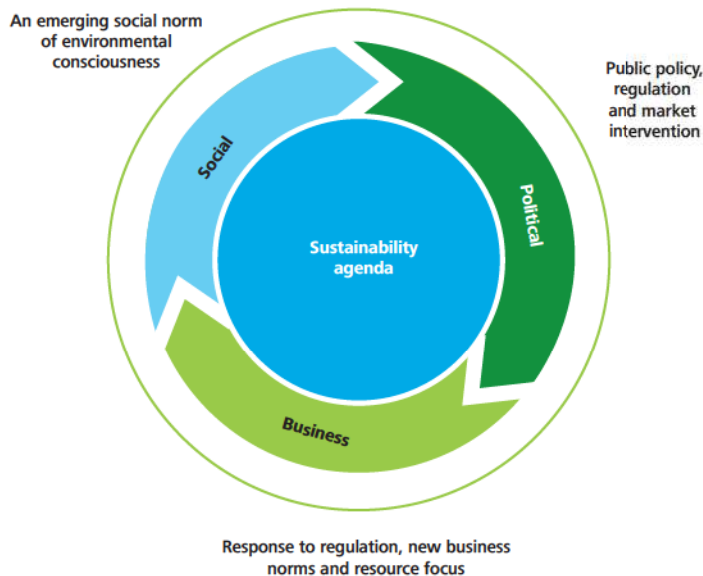
In 2015 the cornerstones of consumer choice will remain similar to those of the last decade. Price, quality, brand and convenience will continue to drive consumer spending, but sustainability will also play an increasing role in determining consumer preferences long before the point of consumption.

In the business world sustainability is already changing the commercial landscape. Business, in the main, has not led this change but must be responsive to it. The hospitality industry may not be able to counteract the structural effect of limited natural resources or the increasing cost of energy supply. However, a reluctance to acknowledge those issues and to address their long term consequences may increasingly be seen as a failure to adapt to new commercial realities.

In 2015 the cornerstones of business decision making are likely to remain similar to those of the last decade, but sustainability will also be built into the market within which those decisions are made. Sustainability will become the 'business norm' and increasingly be seen as part of a 'license to operate'.

Sustainability is a social issue that impacts us all collectively. By 2015, shifting consumer and voter attitudes will have continued their current trajectory, forcing governments and political parties to address the socio-economic landscape and 'real' market in which businesses operate. We believe that the convergence of political, consumer and business agendas around sustainability will be a major historical landmark in the development of our society.

**Figure 12. Building towards a tipping point**



**“IHG views sustainability as a business issue and it is core to the company’s five year strategic plan.”**

**David Jerome**, Senior Vice President, Social Corporate Responsibility, InterContinental Hotels Group

### Growing importance in hospitality

Sustainability has been important in the hospitality industry for some time. The broader tourism sector contributed an estimated five per cent of total global CO<sub>2</sub> emissions in 2005.<sup>2</sup> Although air travel was the largest component of this, accounting for 40 per cent of tourism emissions, accommodation also made a significant contribution with 21 per cent.

Hospitality is vulnerable to water shortages, relies heavily on built assets, consumes significant amounts of electricity and, generally speaking, is an item on which spending is discretionary. These factors ensure that hospitality will be significantly impacted by sustainability issues in the future.

Sustainability began to gather momentum as a mainstream competitive issue in 2006, with the launch of the environmentally conscious luxury brand '1' by Barry Sternlicht, Chief Executive Officer and Chairman of Starwood Capital Group. Since then, almost all major hotel chains have launched some form of environmental sustainability programme.

This trend is not just visible in the west; hotels in India and China are also catching on. In India, ITC Limited's new luxury hotel in Bengaluru was awarded the US Green Building Council's Leadership on Energy and Environmental Design (LEED) platinum rating, making it the first hotel in India to achieve the highest rating for green buildings.<sup>3</sup>

Sustainability initiatives currently range from operational changes such as linen and towel re-use programmes, energy management projects or using green cleaners to development initiatives such as pursuing green building certifications like LEED.

Our interviews with hospitality executives confirm that sustainability is no longer considered primarily as a marketing issue and is now increasingly seen as a prominent factor in decision making, although it is yet to be fully embedded into business thinking. By 2015 we expect sustainability to become a business imperative, requiring companies to educate their organisation on the changing consumer and regulatory environment and to derive strategies to maximise their market position.

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**“Sustainability is one of our top five strategic priorities because it impacts our business and reflects our core values.”**

**Faith Taylor**, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

**Table 11. Sustainability trends at major hospitality companies**

	Publicly announced sustainability targets?	Target summary
Hilton	Yes	Five year reduction targets (energy, waste, water, and CO <sub>2</sub> emissions) from direct operations.
IHG	Yes	Three-year energy reduction targets per available room night and plans to launch 'Green Engage' programme in 100% of owned and managed facilities.
Marriott	Yes	Ten-year energy and water consumption reduction targets per available room Established green building targets and implementing green-sourcing programmes.
Starwood	No	No formally announced targets – however the company has launched the Element brand which incorporates the LEED construction standards.
Wyndham	No (In-Progress)	Defined sustainability strategy and identified core focus areas. In-process of establishing sustainability targets.

Source: Based on information on company websites and Deloitte interviews

## Sustainability drivers for hospitality

### 1. Hospitality is an asset-heavy sector with a large environmental footprint

Hotels rely on a wide range of natural resource inputs and generate significant waste through their lifecycle. Once built, buildings are expected to last for decades and major retrofits can be expensive.<sup>4</sup> Since existing buildings contribute almost 80 per cent of the carbon emissions in some large cities<sup>5</sup> through their energy use, there is significant risk of economic cost and negative media publicity as marketplace concern around climate change grows. As consumer attitudes and public policy continue to change the sector will not be able to hide.

### 2. Regulatory changes and commodity prices will impact the bottom line

Reliance on scarce resources such as water, electricity, and natural gas for building operations exposes the industry to commodity risks and falling margins as prices rise. Planned and pending regulation around the globe targeted at increased efficiency and putting a 'price' on carbon will further impact the industry. For example, in the UK, the CRC Energy efficiency scheme will see hotel brands required to participate in a new cap and trade scheme aimed at reducing carbon emissions and creating a market mechanism to facilitate this. A public league table will also explicitly measure performance and seek to influence consumer attitudes. Sustainability will become a driver of improved profitability as the regulatory landscape evolves and resource prices increase.

### 3. Marketplace awareness of environmental sustainability is growing

Recent studies by Deloitte indicate a growing consumer preference for green hotels. Rating agencies are recognising this growing trend and plan to introduce EcoRating of hotels in 2010. Current consumer behaviour suggests that location and price remain the most important selection criteria and guests will only select a green hotel if all other things are equal. However this is changing. In the next five years sustainability will increasingly become the norm and part of consumer expectations. Strategy and operations that are considered environmentally irresponsible will negatively impact stakeholder decision making from investors through to consumers. As consumer attitudes continue to change, expectations that influence choice and inform perceptions about product and brand will also change.

## Economic drivers of sustainability

In the US an average hotel spends about US\$2,196 per available room in energy costs, representing six per cent of all operating costs.<sup>6</sup> The Energy Information Administration expects most fuel prices to continue rising in 2010 and beyond. These prices will increase further with forthcoming CO<sub>2</sub> regulations, making energy efficiency an important issue for hotel operators.

Water is an additional concern for many luxury hotels. As water resources become more constrained, governments will begin charging higher rates or limiting water use at commercial properties. Water use reductions will limit a hotel's ability to use fresh water for landscaping, spas and swimming pools.

Just a ten per cent reduction in energy consumption would have the same financial effect as increasing the ADR by US\$0.60 in limited-service hotels and by US\$2.00 in full-service hotels.<sup>7</sup>

Given the importance of these features for resort guests, such reductions may have an impact on revPAR. However, improving water efficiency can also lower a hotel's sewage bill, which is sometimes even larger than the cost of water.

As input prices rise, the industry is exposed to commodity risks and margin reductions, so hoteliers will need to focus on operational efficiency. Modifying existing properties is expensive and, in the short term, we expect the industry to focus on efficiency initiatives primarily on new construction and major retrofits.

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**“Technological improvements have progressed so quickly that it is possible to save money and protect the environment – so I am optimistic for the future.”**

**Laurence Geller**, Chief Executive Officer, Strategic Hotels Capital

Operational efficiency has always been central to effective hotel management but sustainability is refocusing attention on this area and raising the bar for new builds. The City Center development in Las Vegas, one of the largest single site hospitality projects ever completed, has sustainable practices at its core, with Gold LEED certification and operational focus in this area.

The key challenge that the industry will face in 2015 and beyond is the adaptation of the existing hospitality asset base, which will be expensive and disruptive. Companies that do not address this may find themselves displaced by new assets and large operators will need to watch this dynamic carefully. A weak portfolio from the perspective of sustainability is likely to have an increasingly detrimental impact on brand perception and profitability.

Structural changes take time to implement and some operators may fail to keep pace if they do not address these changes proactively. Additional value should be generated through enhanced efficiency, shared services and sustainable supply chains. Current portfolios present an opportunity for system-wide sustainability that can differentiate businesses from their competitors right across the operating model from distribution to asset management. However, without action, these portfolios will quickly become a burden.

### Emerging regulations

Regulation will continue to be an important initiator of change and driver of momentum in business sustainability between now and 2015. This is particularly evident in the hospitality sector.

The building sector accounts for 30-40 per cent of global energy use, according to the UN Environment Programme's Sustainable Construction and Building Initiative (SBCI).<sup>8</sup> In larger cities, such as New York, buildings represent 80 per cent of green house gas emissions. There is increasing consensus among scientists and regulators that climate change cannot be addressed without stricter new building construction and retrofit programs.

Governments around the world are using both 'carrot' and 'stick' approaches to improve building efficiency. US and European governments offer a variety of lower cost financing, tax credits and tax deductions for sustainable development. While none of these incentives are specifically targeted at the hospitality sector, many would apply.

In cities like San Francisco, pursuing a LEED certification can expedite site plan permits. Carbon taxes and cap and trade schemes are in place for energy intensive industries already and, across Europe, plans are in place for these to be extended to 'normal' business operations. The UK Carbon Reduction Commitment (CRC) energy efficiency scheme, which came into force in April 2010, is an example of this. For hotels this will lead to brand owners becoming responsible for carbon reduction, not just at their managed hotels but at the franchise properties as well.

Regulations are not just limited to energy efficiency. The UN has described the global situation surrounding water availability as 'a disaster in the making'. Legislative actions are being considered to address this problem. Some US states, facing more immediate concerns, have taken water scarcity issues to the courts. Construction recommendations related to water conservation are also emerging in large cities like Mumbai, where voluntary use of dual-flush Water Closet (WC) and grey water recycling systems<sup>9</sup> is becoming more common.

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**“New property development by 2015 will increasingly be impacted by regulations and codes requiring buildings to be built more sustainably. It is already happening in Europe.”**

**Faith Taylor**, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

We expect the pace of regulation to increase in the future. We believe the industry needs to be more proactive in helping to shape these regulations, not to minimise their impact, but to help educate regulators and ensure that sensible, balanced actions are taken. Given the lifespan of most hotel properties and current and pending regulation, it is in the best interest of developers and operators to consider sustainable design, construction, and operation principles in any new development or major retrofit project in order to avoid future penalties and future retrofitting costs.

### Changing social norms

Marketplace awareness of the environmental challenge is increasing and an overwhelming majority of consumers express concern about environmental sustainability. According to a survey by Deloitte of US business travellers, 95 per cent of respondents believe the hotel industry should be undertaking 'green' initiatives.

While consumers express interest in sustainability, this interest does not necessarily translate into purchasing decisions which may result in a price premium or significantly higher occupancy rates for 'green hotels'. Such hotels have enjoyed increasing media publicity which helps to lower marketing costs and generate awareness. However green hotels cater for only a niche segment of socially conscious and upwardly mobile consumers who seek out sustainable properties and demand higher standards of themselves and the companies they do business with.

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“Carbon reporting will become increasingly regulated by Governments. This will allow consumers to make more informed decisions.”

Faith Taylor, Corporate Vice President, Sustainability & Innovation, Wyndham Worldwide

Consumer awareness of and interest in sustainability is rising, but this will not be the primary driver of sustainability in 2015. The definition of sustainability remains unclear to many consumers today and, whilst they are ‘conceptually aligned’, they are sceptical about sustainability’s direct impact on them as individuals.

Regulatory, economic and stakeholder pressure will drive changes in the industry, creating a virtuous circle that will see social and business norms change with surprising speed.

Operators who fail to keep pace with this change will not only incur additional regulatory costs but, in the longer term, risk losing a ‘missed generation’ in terms of consumer recognition of sustainability performance. The majority of consumers may not require a ‘green’ hotel as such, but will increasingly prefer brands that are environmentally responsible, requiring sustainability to be embraced throughout the organisation. As this expectation becomes the norm it will be a defining factor in suppressing those brands that are seen as less environmentally responsible.

Over time we believe consumer preferences will start to drive sustainable consumption, not through a premium on sustainability but through a reluctance to consume in a way that is considered to be environmentally irresponsible. This dynamic has already emerged in other sectors, notably car sales where 4X4’s have seen negative sentiment in many markets for this very reason, having in many cases previously been seen as aspirational.

In the short term, whilst brands and operators will have to balance sustainability against other competing initiatives aimed at gaining market share, sacrificing environmental responsibility should be avoided. As social norms change and attitudes towards sustainability become more acute, brands and properties will need to operate within redefined boundaries in relation to sustainability. Resistance to this change may generate short term savings, but it poses significant risks of longer term damage to product and brand, coupled with higher adaptation costs.

Starwood’s mid-market Element brand, which incorporates LEED construction into the brand standards, recognises this dichotomy. LEED certified buildings improve efficiency and lower operational costs, allowing the hotels to maintain price competitiveness while catering for consumer interest in green hotels and capturing niche market share. Markets such as this will remain niche, but they can be used to develop sustainability practices and business models that can be applied across the broader business in due course. This helps to position companies for the future whilst recognising the needs of the existing business.

#### Stakeholder influence

Although consumer preference and willingness to pay for environmental features remain unclear, brands and operators cannot ignore the need to communicate progress on sustainability. Stakeholders, including corporate travel departments, government and tour operators, influence consumer hotel purchases and will increasingly do so.

Companies across all industries are now developing internal sustainability targets and asking hotels about their sustainability performance as part of the sourcing process for business travel. This trend will continue to grow as companies seek to measure, report and improve their sustainability performance in response to government, consumer, and other stakeholder demands. As the availability of environmentally-friendly hotels increases, companies are likely to direct their employees to these preferred hotels, provided they meet other important criteria related to quality, location and price. Similarly, governments in the US and Europe are already beginning to consider sustainability purchasing policies.<sup>10</sup>

Tour operators are also beginning to realise that sustainability and climate change have the potential to impact some key tourist destinations around the globe, directly affecting their revenue streams. Tour operators are developing sustainability targets to minimise their impact during excursions. Hotels that rely on large tour groups may have to demonstrate their commitment to improving efficiency and lowering their environmental impact in order to be considered as preferred properties.

**Conclusion and recommendations**

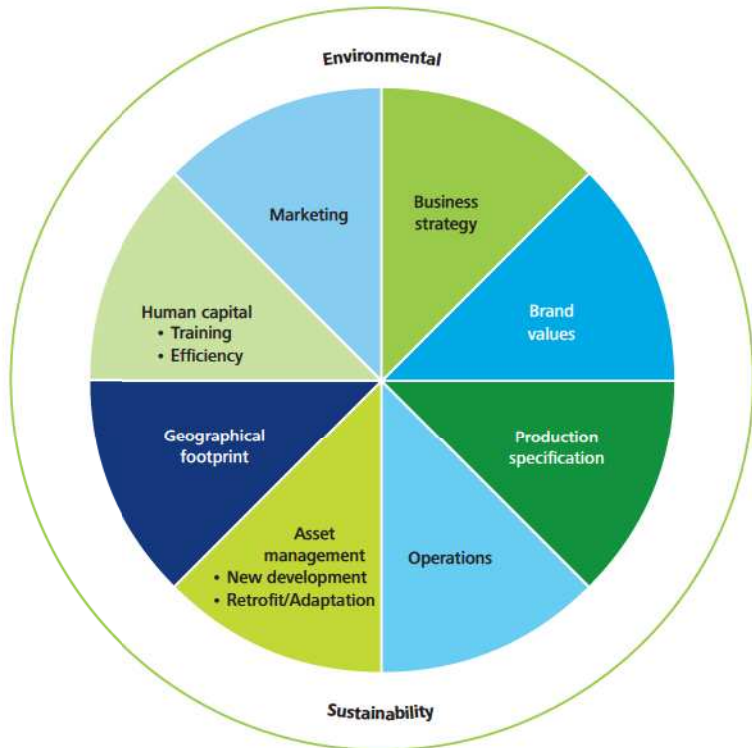
The pace of change will differ across the globe but we are approaching a tipping point. The largest opportunity and challenge today lies within the existing estates that dominate the hospitality sector in the developed world. It is here that the pace of change will be fastest and the need for change greatest. Initiated by regulation and changing stakeholder attitudes, by 2015 the political, business and consumer sustainability agendas will have converged on the hospitality industry.

Looking further ahead, by 2030 the hospitality landscape will be unrecognisable compared to that of today and sustainability will be one of the pervasive drivers of change. Technology, people, business models, physical assets, operational practices and financial efficiency will all need to be harnessed to address the long term sustainability challenge from a 360-degree perspective.

Industry leaders today are engaged with the sustainability agenda but few recognise the transformational impact it will have on the way hospitality is provided and consumed. Those who keep pace and effect change, embedding sustainability across their businesses from strategy to operations, from brand value to asset management, will be prominently positioned. Those who fail to do so risk finding themselves lost in the landscape of 2015 and beyond.



**Figure 13. Embedding sustainability – A 360-degree view**



Source: Deloitte Research