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Rooms in Moscow and in Murmansk

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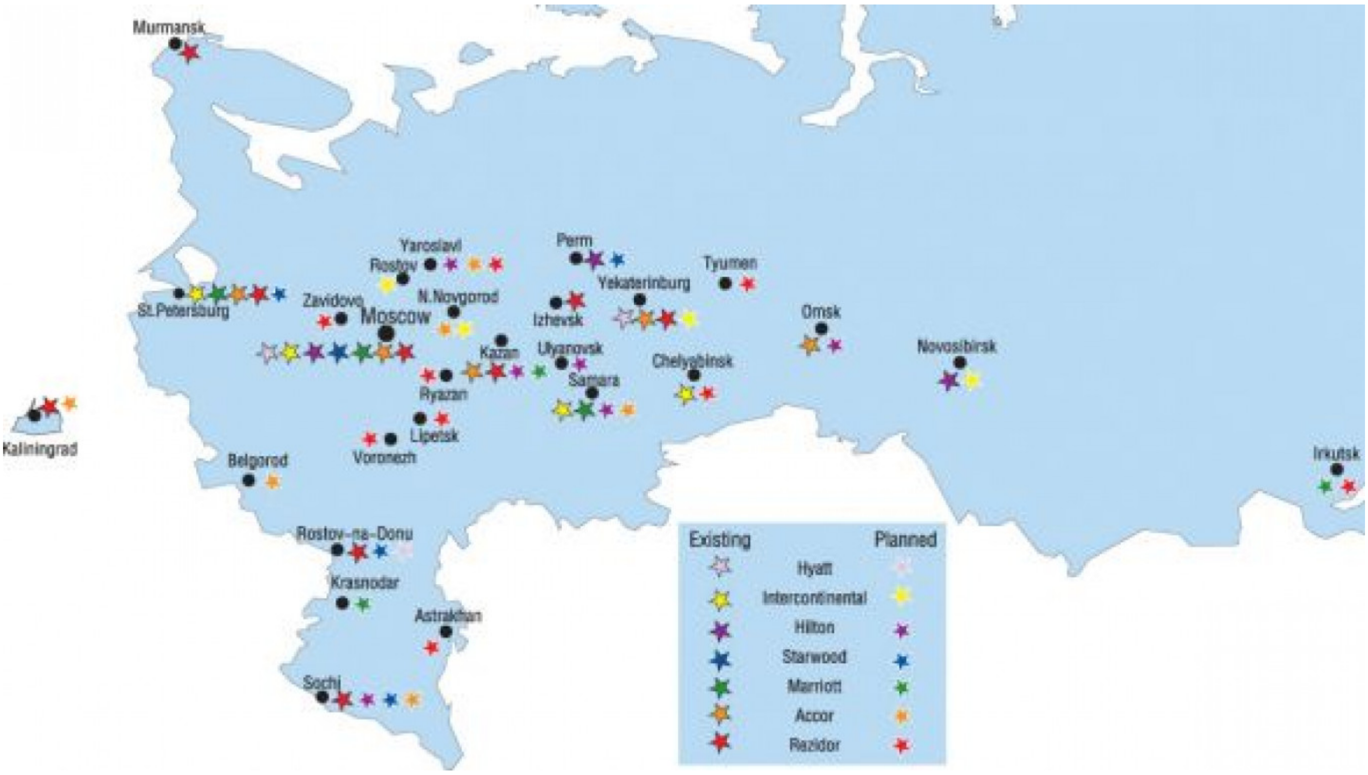

Finding a hotel room built to international standards and priced at Western rates is a challenge in the nation's high-cost capital. That begs the question: Why are Western hotel chains hesitant to fill the gap in Moscow ⊠ and why are some rushing to open in Russia's smaller cities?

The answer comes straight from the Western hotel playbook. A Russian city with a population of several hundred thousand people is a prime destination for hotel development, said international and regional executives from Western hotel companies. At the same time, however, hotel chains' plans to open and rebrand hotels in Moscow just have not borne fruit yet.

The strategy of matching hotel counts to headcounts is common with various chains from the United States and Western Europe. And big hotel operators are trying a similar policy in Russia.

Rezidor Hotel Group, which operates Radisson and Park Inn, and Starwood Hotels and Resorts Worldwide, the owner of Sheraton, plan to open hotels in all Russian cities with a population of 500,000 or more, Rezidor chief executive Kurt Ritter and Starwood CIS development director Anatoly Kondratenko said in separate interviews.

But InterContinental Hotels Group, which operates five Holiday Inns and a Crowne Plaza in Moscow, is looking at a somewhat narrower market. Its corporate strategy in Russia is to target a select number of cities with populations of more than 1 million and substantial infrastructure and industry.

"Our strategy for the past five years, and recently reconfirmed for the next five, is to stay very focused on a small number of cities with populations above 1 million; infrastructure; international airport access; and identifiable light, service and heavy industry present and growing," said Michael Cooper, the company's vice president for strategic development in Russia and the CIS.

A similar strategy is being followed by Accor Hospitality, which owns the brands Sofitel, Novotel, Ibis and Etap and Ibis. It is interested in Murmansk and other cities with more than 1 million people.

Moscow is both an opportunity and a puzzle. The city has slightly more than 13,000 hotel rooms consistent with international standards, with only 3,300 more in the development pipeline for the next three years, according to a report by Jones Lang LaSalle, the Chicago-based global real estate consultancy. That's in a city of 10 million to 15 million people that receives about 4 million foreign tourists per year. It sounds like a perfect market in which to develop ⊠ so why aren't hotel operators quick to catch up?

"Development is not a science ⊠ it is all about opportunity," said Mike Collini, Hilton Worldwide's vice president of development for Northern Europe.

He said in an interview that his company is anticipating substantial growth in cities other than Moscow and St. Petersburg because, according to a Western model, "you usually get a variety of hotels" in a city of 300,000 people.

Moscow Madness

Figures for Moscow's hotel market are an odd mix. Overall, it appears that the capital has low occupancy rates compared with Western European capitals. The average occupancy of hotels in Moscow was 58.5 percent during the second quarter, compared with 75.4 percent in Paris, 84.7 percent in London, and 65.8 percent in Warsaw, according to research by real estate consultancy Knight Frank.

But some hotels report full rooms. Alexis Delaroff, managing director in Russia and the CIS for Accor, said the Ibis hotel in Moscow that opened this year hasn't seen the occupancy rate fall below 80 percent in its entire time in operation. In September, occupancy stood at 90 percent.

Delaroff said occupancy in Novotel Sheremetyevo, next to Sheremetyevo Airport's Terminal E, often exceeds 100 percent, as rooms are sold more than once in a 24-hour period to customers with long layovers.

There is one definite deficit: hotel rooms priced in the mid-range. Booking a room considered economy class in Moscow will remove far more money from your bank account than those in similar hotels in large cities elsewhere in the world.

Typically, a city's hotel market is like a pyramid: Luxury rooms are fewest in number, making up the tip of the pyramid. There are a number of business-class rooms and a wider base of economy rooms, often booked by rank-and-file business travelers. But the widest selection of hotel rooms in any Western market is traditionally in the budget hotel sector, to be booked by thrifty tourists.

In Russia, though, budget brands of Western hotel chains are not represented. In Moscow, the demand for hotel rooms is different from any other major travel destination city, said Cooper of InterContinental. While Moscow's weekday demand from businesspeople is high, weekends and holidays actually show a dip, because there aren't as many tourists. Cooper blames this trend on the difficulty of obtaining a Russian tourist visa, deterring many would-be visitors from choosing Moscow for a vacation.

Another factor is that the cost structure of operating a hotel in Russia is different from that in Europe, Delaroff said. Accor does the bulk of its business in Europe and the United States under its budget brands: Etap and Formule 1 in Europe and Motel 6 in the United States and Canada. But it hasn't brought any of those brands to Russia, and it is hesitant to do so.

"In Europe, Formule 1 hotels often don't have a receptionist at all, and Etap hotels are staffed only during certain hours, while the rest of the time they operate automatically on a credit-card basis," Delaroff said.

In Russia, that would not be possible in the near future because of hindrances like personal security, he said, noting that that has remained a major concern for guests in Moscow, as well as across Russia, and hotels are forced to hire extra personnel to provide it. In addition, the country's wintry climate demands more heating and lighting than in much of Europe and the United States.

Delaroff said those factors make the standard European budget-hotel model impossible to implement in Russia: Operating costs would be so high that hotels would need to charge higher prices ⊠ eliminating the budget part of the formula.

Accor has one project under review for Moscow that would combine an economy-class Ibis hotel and a budget Etap hotel under the same roof. If the project, whose fate remains up in the air, goes ahead, it will be the first attempt to introduce a budget brand in Russia.

A Haphazard Invasion?

Despite the hurdles, a number of Western hotel operators want to enter the market, and many have plans to do so. Rezidor is the most prolific player in Russia, followed by Marriott, InterContinental and Accor. Meanwhile, Hilton, Starwood and Hyatt have opened development and sales offices in Moscow in an effort to catch up.

In the portfolios of the chains operating today in Russia, there are more hotels in various stages of development than in operation. A construction and real estate boom was halted by the 2008 financial crisis, but the hotel industry overall is showing signs of emerging from the economic downturn. Many hotel operators said developers from across the country are now approaching them, seeking to redesign various projects into hotels.

This has produced what looks like a haphazard approach to brand development across Russia. The chains themselves have said many hotel openings that they carried out in small or obscure cities were developer-driven, with the chain reviewing and then accepting an offer from a land owner, a building owner, an investor or even an existing hotel operator.

Accor said it looks to cities where a Western-owned enterprise exists, such as the car and car-parts factories in Kaluga or the anticipated Shtokmann gas field development near Murmansk.

None of the brands, however, plan to open their doors in Vladivostok, the far eastern city with a population of 600,000, or in Sakhalin Island's capital, Yuzhno-Sakhalinsk, where ExxonMobil and Royal Dutch Shell projects draw a stream of Westerners.

Both cities are popular destinations for business travelers, said Vadim Zelensky, chairman of the Business Travel Agencies Association. But Zelensky said the Far East is a territory where Asian brands are trying to expand, and South Korea's Hotel Hyundai opened a hotel in Vladivostok more than a decade ago.

As for the Western brands, most said Yuzhno-Sakhalinsk and Vladivostok are just too far-flung. Currently, Novosibirsk and Irkutsk are the easternmost destinations on any hotel chain's future development map.

In regions within easier reach of Moscow, new and sometimes surprising development locations for Western brands have recently sprouted up.

Leading travel companies named Voronezh, Astrakhan, Nizhny Novgorod, Krasnodar, Saratov and Volgograd as regional destinations underserved by quality hotels. In fact, major hotel brands have charted four of those cities in their development plans for the near future.

In all, 88 international-brand hotels are due to open in Russia from 2011 to 2014, according to a report published in September by Ernst & Young.

The Game in Sochi

Quite a few of those 88 planned hotels are intended for Sochi, where a construction boom is unfolding as Russia prepares to host the 2014 Winter Olympics there and in surrounding towns. State corporation Olimpstroi is directing construction and development.

At a recent hotel investment conference in Moscow, Olimpstroi placement director Dmitry Kanunov described the perks that the corporation would give hotel developers to make sure that "Sochi in 2014 will be a very different city from Sochi today."

The developers who take on hotel projects in Sochi and guarantee their opening for the 2014 Olympics will get a plot for basically free, Kanunov said. Olimpstroi also will handle all communications for those who build a hotel and will ensure the hotel's functioning during the Olympics, he said.

Some players, such as Rezidor, which has been running Sochi's flagship hotel, Lazurnaya, under the Radisson brand for a number of years, just cannot get enough of Sochi. Others are climbing on the bandwagon reluctantly.

Accor this fall was finalizing a contract for gaining control of two hotels in the Roza Khutor ski resort in Sochi. It had done so only at the insistence of previous business partners from other markets, Delaroff said. Delaroff said Sochi was not a priority market for Accor because resorts take too long to break even in localities where they cannot operate year-round.

Hilton, which has a Doubletree hotel under construction in Sochi, is cautiously optimistic. While Hilton executive Collini is confident about Sochi's success as a venue for 2014 Olympics, he is concerned about its long-term development as a travel destination.

InterContinental is taking an even tougher stance on Sochi. Cooper said the chain considers itself primarily a city player in the business segment and was not interested in Sochi because it is a resort.

Local Competition

Western hotel chains face a new and somewhat unexpected competitor in Russia. Azimut Hotels, the country's largest homegrown hotel chain with a strategy largely based on Western business principles, operates hotels in popular Russian hotel markets and has even gained some traction in Europe, with 18 hotels in Austria and Germany.

What's more, Azimut has hotels in the North Caucasus city of Stavropol and in Vladivostok. CEO Alexander Gendelsman said his company has had to adjust the hotel chain business model to compete with worldwide brands in Russia. For example, he said in an interview, Azimut is more flexible in its approach to older or Soviet-era hotels and is not afraid to undertake renovations of those hotels that Western brands wouldn't bother to do.

Even though Vladivostok has raised little interest from Western competitors, local demand for hotel rooms should grow 30 percent by the time it hosts the Asia-Pacific Economic Cooperation Forum in 2012, Gendelsman said.

In terms of general development strategy, Azimut plans to focus on cities with more than 1 million residents, he said.

Gendelsman also said the arrival of chain hotels in smaller cities is justified only where there is substantial industrial investment by a foreign company — such as in Samara, Kaluga or Lipetsk — that brings an influx of foreign high-skilled labor and visiting managers.

Even that does not guarantee sufficient demand, though. At a pitch session at the recent hotel conference, Gendelsman got a lukewarm reception from an audience of investors when he pitched plans to renovate the landmark Arktika hotel in Murmansk, which was built in 1983 and most recently reconstructed in 1991.

Despite the planned Shtokmann gas project and the city's successfully operating Park Inn by Rezidor, investors expressed skepticism that the hotel's 635 rooms could be filled.

The same investors expressed considerably more interest in a pitch by a Moscow-based developer raising funds for the proposed Ibis-Etap in southern Moscow. They asked about the return on investment, retail components, parking and even the career history of the people involved in the project.

An Image Problem

Attracting tourists to Moscow, though, is a challenge, to say nothing of Murmansk, Novosibirsk and other cities. Moscow still has an image problem as a destination, said Ritter, the Rezidor CEO.

Radisson opened the Radisson SAS Slavyanskaya hotel in 1990. But after 20 years on the Russian market, Rezidor only opened its second Radisson in Moscow in April after taking over the landmark Hotel Ukraina last year.

Before the Ukraina re-opened as the Radisson Royal, the number of rooms in the once middle-class Soviet hotel was cut to just 500 from more than 1,000 in order to double the size of the rooms. Now the historic building — one of Moscow's seven so-called Stalin skyscrapers — is being marketed as a luxury hotel.

Ritter said filling the hotel at upmarket rates is a challenge, but he voiced confidence that occupancy would grow over time. He said weak demand should not lead to cut rates. "Selling these rooms at 100 euros per night would be just a waste," he said.

A Swiss native, Ritter believes that many Westerners view Moscow as a potentially unsafe place to do business or spend vacations. He said the city could draw substantially more travel in the executive business and luxury leisure segments if the government invested in an advertising campaign in the West to increase Russia's appeal. Ritter said Rezidor would consider partnering with the government in such a campaign.

While it waits, Rezidor is taking matters into its own hands with plans to run ads in a number of European countries, including Britain, that tout Moscow as a destination spot, Ritter said.

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