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An Inhospitable Environment: Covid-19 and the future of the UK's leisure and hospitality industries

The Covid-19 pandemic is having a profound impact on every sector of the UK economy. The need to restrict movement and limit social interaction has changed the working life of almost every employee in the UK. However, the impact is not equal; some sectors are able to continue operating much as before; but for others, the current situation poses an existential threat to their business model, none more so than leisure and hospitality businesses.

Leisure and hospitality businesses that rely on face to face contact, travel and large gatherings of people in enclosed spaces have seen their sources of revenue disappear almost overnight. This impact of Covid-19 has been immediate and felt acutely across the four nations of the UK. Tourism – an industry of particular importance to comparatively deprived coastal and rural communities – has been devastated. The support offered by the Government is generous in scope but largely sector agnostic. Although the challenges facing leisure and hospitality may ostensibly resemble those facing other sectors, they are in fact far greater, and will persist for much longer.

> Hospitality was one of the first sectors affected by the crisis, leading into a fall in revenues from mid-February, the hardest hit in terms of revenue declines with a 97% decline over the last 6 weeks and will be one of the last to re-emerge.
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> Kate Nicholls, CEO, UK Hospitality in a letter to Cabinet Office Minister Michael Gove, 22nd April

Status quo ante bellum

The UK is among the most popular places on Earth to visit. From the mountainous peaks of Snowdonia to the Royal Mile in Edinburgh, the Giant's Causeway in Northern Ireland to Stonehenge in England, the UK's unique cultural heritage has long been a magnet for domestic and foreign visitors alike.

The industry's growth over the past 30 years has been one of the great British homegrown success stories and has played an integral role in transforming the UK into a global hub for leisure and business.

The sector's economic contribution to UK PLC is significant. According to Visit Britain, at the start of 2020 the sector was worth £127bn to the economy annually, was the third largest sector and provided approximately 10% of all jobs across the UK while accounting for 200,000 SMEs. The success of tourism and hospitality businesses also has a positive knock-on effect on other sectors such as retail, transport and the creative industries. Following a strong year in 2019, VisitBritain had been forecasting inbound tourism to grow by 2.9% to 39.7m visits and for spending to grow by 6.6% to £26.6bn, setting new records in each case.

A smorgasbord of issues

Despite consistent growth and a reasonably supportive policy environment, the industry had a wide array of issues prior to the arrival of Covid-19.

These included concerns about access to unskilled and seasonal labour from abroad post-Brexit, a lack of support from Government to promote long-term careers in hospitality through training and apprenticeships, the imposition of comparatively high VAT rates and the perceived injustice of the existing business rates structure for the hospitality sector.

The Tourism Sector Deal, published in June 2019 by Theresa May's Government, attempted to address these issues. It set out how the Government and industry would work in partnership to boost productivity, develop the skills of the UK workforce and support destinations to enhance their visitor offer. While the industry welcomed the Sector Deal,

the upheaval in government that followed its publication consigned it to the political backburner as more pressing matters filled the inbox of Boris Johnson and his new ministerial team.

A crushing blow

Fast forward a few months from the early days of 2020 and the rosy forecasts of continued sector growth have been thoroughly dashed by the arrival of Covid-19.

Tourism was the sector hit first and arguably the hardest by the sudden and all-encompassing impact of the virus. Businesses of all sizes, ranging from multinational hotel chains to small bed & breakfast providers, saw cash flow evaporate in a few short weeks as lockdown measures and social distancing guidelines were implemented at speed across the country. This unprecedented and abrupt cessation of business has been compounded by customers cancelling trips for months ahead and demanding refunds – with reasonable legitimacy - en masse.

The Covid-19 pandemic has precipitated a collapse both in the demand and supply of hospitality services. The latest modelling from Visit Britain suggests there will be a 55% drop in expected inbound tourism income combined with a 24% fall in domestic tourism resulting in a £37bn decrease in sector revenues.

The timing of the arrival of Covid-19 was a further body blow to the hospitality industry. Most tourism businesses in the UK make the vast majority of their income between March and October – peaking in July and August – with that money then used to support businesses through the fallow months. Easter tends to mark the beginning of open season and so the explosion in Covid-19 cases and subsequent lockdown arrived at precisely the wrong moment.

A helping hand

Bearing in mind the intensity and rapidity of the onset of Covid-19, the support measures provided by the Government have been warmly welcomed by the industry.

The economic support most relevant to the tourism and hospitality sector largely falls into two categories. To support businesses struggling with liquidity, the Government has announced the deferral of VAT payments for firms, £330bn worth of government backed and guaranteed loans, a hospitality cash grants scheme, a business rates relief programme and protection for commercial tenants at risk of eviction. To protect employees, the Government established the Job Retention Scheme where employers can apply for a government grant to cover 80% of workers' salaries, a scheme to support Self-Employed workers and have also launched a £1.3m emergency fund to support local tourism management organisations.

Apart from the funding to aid tourism management organisations, the support provided by the Government has thus far been sector agnostic despite extensive industry lobbying efforts for specific assistance. As the pandemic drags on and other industries are permitted to ease restrictions, it is likely that calls from the hospitality sector for bespoke help will grow louder and more frequent.

Where next?

Due to their reliance on travel and high-density social gathering, the leisure and hospitality sector is likely to be the last to fully reopen. These businesses will not only have been the first to see a reduction in demand, they are almost certain to be the last to return to normal trading. This extended sector-specific lockdown will be particularly damaging given the predominance of SMEs that do not have the cash reserves of larger businesses.

After reopening, the sector will face immense challenges for some time to come. The most obvious is the need for social distancing. Restaurants and bars depend on operating at or near full capacity in order to make a profit. The need to observe social distancing guidelines within such a setting would leave most of these businesses unable to make a profit without substantially increasing prices, a move that would likely deter potential customers. More broadly, although some businesses such as self-let cottages and homes may be able to adapt to the new reality with relative ease, visitor attractions such as amusement parks, museums and historical monuments will not be able to make a profit whilst operating at a fraction of their intended capacity.

This crisis is likely to leave a deep mark on the public psyche, affecting consumer behaviour for a considerable period of time. The perception of danger associated with gatherings of people will remain until a vaccine is found and lingering unease is likely to persist for even longer. Alongside this, many consumers will see a reduction in their disposable income leading to a sustained drop in non-essential spending. One possible side effect of the crisis could be a growing number of day trips and fewer overnight stays as people prefer the comfort, safety and economy of returning to their own home. This could permanently undermine the viability of hotels and guesthouses in tourist hotspots. Although it is possible that demand for domestic travel will increase as foreign travel becomes more difficult and expensive, this is unlikely to make up the shortfall.

The economic and political implications of this have the potential to be wide-ranging. Whilst urban centres can likely weather a short-term decline in demand for hospitality services, other communities may not. Whilst political attention is often directed towards 'left-behind' post-industrial areas, coastal communities also suffer from relative deprivation. A decline in the demand for tourism will further diminish economic opportunities in these areas and lead to them falling further behind more prosperous urban centres. Coastal communities are already amongst the most economically deprived areas of the UK and a significant drop in tourism revenue will further exacerbate the socioeconomic issues already present in these areas.

How to respond

Whilst almost all sectors of the economy are currently experiencing economic difficulty, sectoral interests will diverge as the economy emerges from the most intense phase of the pandemic. The Government has been clear that it will support businesses that would be profitable under normal circumstances. However, there is a question of where to draw the line and shift the burden back to businesses to fend for themselves. As different sectors commence their recovery at different times, the case for support packages to be tailored on a sector by sector basis will grow. This will allow the Government to reduce the overall cost to the Exchequer whilst propping up the most vulnerable sectors.

The UK can look elsewhere for ideas. Last week, the French Prime Minister, Edouard Philippe announced a €18bn 'Marshall Plan for tourism' to ensure the survival of the sector. Italy is offering its citizens financial incentives to holiday domestically with a €4bn bailout plan. In the UK a group of 85 MPs have written to the Chancellor of the Exchequer asking for more specific support for the industry including an extension to business rate relief, a VAT rebate, an extension to the furlough scheme and the introduction of a "flexi-furlough" which would give employers the opportunity to protect jobs in the event of a partial reopening. The sector's trade body UK Hospitality has set out five key areas where government support will be required: rent; employee retention; grants; loans; and insurance.

However, there will be concerns about such an approach. The Government has been clear that support measures are intended to offer a 'bridge', allowing businesses to survive the downturn and 'pick up where they left off'. The likelihood of persistently lower demand, at least in the short term, for tourism and hospitality services means that this support has the potential to be a bridge to nowhere. So far, government support has been targeted at businesses that are unable to operate normally due to government-imposed restrictions. It seems unlikely that support will be so generous when it is consumer choice, rather than government diktat, that is undermining an industry's business model. The Government will not want to put itself in a position where it is responsible for supporting an entire sector. This would militate against adaptation and make the industry less responsive to changes in consumer preferences.

In order to balance these competing interests and avoid creating a hostage to fortune, the Government will need to target any support carefully and allow some market shifts to take place. One possibility would be to taper any support measures, gradually reducing them over time so as to ease the transition to the 'new normal'. One other possibility would be to target the support regionally, injecting more funds into deprived communities. This approach would align with Boris Johnson's 'levelling up' agenda. Whichever choice is made, there will be unpleasant side effects for some businesses.

Conclusion

The decisions made as the UK leaves the most intense phase of the pandemic will shape the future direction of the UK economy and many businesses. There is growing concern at the highest levels that costly government intervention could become a permanent fixture of UK economic policy. The nature of the tourism and hospitality sector leaves it particularly exposed both to the immediate impact of Covid-19 and the changed environment that is likely to persist once the economy finds a new post-Covid equilibrium. The devastating impact of the virus has already forced some businesses to shut their doors for good. The challenge for the sector and the Government is to find a political and economic settlement that allows the industry to rebuild while minimising the long-term financial commitment from the Treasury.

It is now incumbent on industry leaders to make a compelling case for continued Government support to secure the survival of the UK's third largest sector. The industry's substantial economic contribution and essential role in the social fabric of many communities should ensure a fair hearing but the industry will be competing with other sectors for support. In order to be successful, the case will need to include the outline of a vision of how the sector will adapt to the new reality. This will require extensive thought and careful judgement on the part of those making the case to ministers.

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