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## Growth drivers and challenges in Indian hotel industry

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### Abstract

India's travel and tourism industry has huge growth potential. In the long run, the demand-supply gap in India is very real and that there is need for more number of hotels in most cities. The present study explores a qualitative and quantitative view to examine the hospitality industry trends in India. The quantitative approach is applied to collect data and figure from published reports and articles related to the industry by accumulating descriptive statistics whereas the qualitative method has been employed for examining the content of collected reports, intercepts of industry expert's interview and articles on methodology, research areas and results. The study examined that mid-market hotels are likely to be the driving force due to the fact that both domestic and international hotel chains are looking for a fruitful experience in this segment. The luxury segment has a market of its own and the emergence of the budget hotels would not affect the luxury consumers. The two segments are mutually attractive to both the domestic as well as international visitors. Hotels in both the segments have to face the challenges by uniqueness of the product. The study further concludes that one way to make a good return on investment (ROI) would be to look at the hotel business in different light. This could be done by taking a multiuse development approach and make the hotel project more viable. With the potential and future growth of this industry the full utilization of established infrastructure can be ensured by increasing occupancy percentages. Hotel industry may have increased number of hotels to be centered on upcoming tourist spots as well as commercial hubs. Reduction of operating expenses can further be ensured by borrowing other firms with more efficient strategies. The best option to invest for a foreign player is through hospitality focused private equity funds who understand locally the dynamics of the industry.

**Keywords:** Budget Hotels, Luxury Hotel Brand, Demand-Supply Scenario. CAGR, ROI

### Introduction

The hospitality industry has emerged as one of the key industries driving growth of the services sector in India. The growth of the hospitality industry has always been linked to the prospects of the tourism industry and tourism is the foremost demand driver of the industry. The Indian hospitality industry has recorded healthy growth fuelled by robust inflow of foreign tourists as well as increased tourist flow within the country and it has emerged as one of the leading players in the global industry. The travel and tourism sector has revealed surprising resilience to geopolitical tensions, threats of terrorism, global pandemics and stagnant economic growth in developed economies. While international tourist arrivals are correlated with economic fluctuations and sensitive to security issues, these tend to impact specific countries or regions; if one country is hit by instability, others will be expected to receive more tourists. Globally, the trend for growth seems continue. Increasing purchasing power in emerging and developing countries is one of the major new trends driving demand for travel experiences. UNWTO shows that China is the largest market in terms of international tourism expenditure and is still growing at a double digit rate. Brazil has become the 10<sup>th</sup> largest market, while in India, the Philippines, Saudi Arabia and Qatar; expenditure grew by approximately 30% from 2013 to 2014. Another major trend in travel and tourism is shifting demographics. The number of travelers above the age of 60s in the world is estimated to rise from 900 million in 2010 to almost 1.4 billion by 2030. These travelers seem to prefer higher standards of quality and sophistication, to have somewhat larger budgets to be immune to seasonality. Younger travelers wish to increase their knowledge by exploring the world and experiencing everyday life in other countries, according to a recent survey by the World Youth Student and Educational Travel Confederation. They like to spend more time exploring remote destinations and have shown

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less interest in luxury. Younger travelers depend especially on new technologies and online services to gain their travel experience. UNTWO Yearbook of Tourism Statistics makes it clear that, the Travel and Tourism sector can have a significant impact on countries at all stages of development. It shows that T&T sector is not only relatively labor intensive, it has also potential to employ more women and young people than most industries, and creates more opportunities for SMEs. Tourism has now become a significant industry in India. As per the World Travel & Tourism Council, the tourism industry in India is likely to generate US \$121.4 billion of economic activity by 2015, and the hospitality sector has the capacity to earn US \$24 billion in foreign exchange by 2015. The growing tourism industry has had a cascading effect on the hospitality sector with an increase in the occupancy ratios and average room rates as well.

(Hotel News Now, 2008), points out that, the demand supply gap is huge and in the years to come is expected to rise, not decrease. The situation is a boon in disguise for the economy and mid-market segment hotels, which are going to experience a period of boom due to this imbalance. The requirement is, effectively designed products to serve value for money concepts. Since the demand for low cost and affordable rooms is expanding. During this period of economic slowdown many companies are cutting down on their accommodation cost. There will be more cost cutting among corporate and there will be a higher demand of low-cost hotels.

Press Trust of India, (2008), states that, the mid-sized segment was the fastest growing one in the hotel industry and the key players in the field were pumping investment to cash in on this growth.

It shows enormous potential in the mid-market segment in the Indian hospitality sector, over other Asian countries. The growth of this segment will be shaped by the increasing number of corporate travelers who are shifting from luxury to midmarket hotels, and also due to growing domestic demand for the mid-market segment. Although the regional tourism sector is likely to face some challenges over the next few years on the back of the economic slowdown, India's attention on domestic tourism and its growing middle class with increased disposal income are certainly strong advantage points. The mid-market players are confident of the sustainability of domestic demand driven by the tourism and business sectors.

Gupta (2009), states that with excellent hospitality at affordable rates, budget hotels can be the approach of the hoteliers. He further agrees that it's unlikely for the luxury segment to be phased out as it has a well-defined target audience and a loyal customer base. He is of the view that the luxury segment will always be the choice of the top bracket leisure tourists who travel in style on holiday, as also jet-setting senior business travelers, however, the same segment is willing to downgrade and stay at mid-priced hotels when economic conditions are not favorable. There will always be CEOs and heads of state that require luxurious accommodation; in fact, as India gets richer, Indians too will like to go in for luxurious accommodation. It would seem to be the industry's perspective that the luxury segment equals foreign tourists, while the mid-market is aimed purely at the domestic traveler, however, not true. The two segments are mutually attractive to both the domestic as well as international traveler.

Hotel Development Cost Trends in India (2010), shows that, while it is fair to assert that hotels in India are currently showing several overlaps between the budget and mid-market and upscale segments, it is expected that the picture will become clearer with time. It is further anticipated that as the industry matures, each segment will carve its niche in terms of the product as well as service deliverables and there will thus be a rationalization of development costs, which will be in line with their respective market positioning.

Mohan Kumar, PK (2014) explains that the government needs to come out with different set of rules for the mid-market, economy and budget categories, otherwise it will not be sustainable for these segments. He further says that, the entire cost structure for these segments is different, the tariff structure is different, the investment structure is different and also the ability to return on investment is altogether of a different nature. He further stated that, there has to be some differentiation in government policy to attract more investment.

### **Objectives of the Study**

1. To examine the emergence and growth of tourism and hospitality industry. 2. To identify the various factors which are driving the growth and those which are critical to the industry. 3. To highlight the future challenges and possible solution with respect to hotel business in India.

### **Scope of the Study**

Study covers all the facets of the industry performance and future prospects. The study includes demand-supply scenario in the Industry, Proposed investments by domestic and foreign players, Factors driving growth, Issues & Challenges, Key operating characteristics like occupancy rates, revenue per available room (RevPAR) and average room rates (ARR), Emerging trends such as MICE, service apartments, spas, medical tourism, wildlife resorts, mixed land usage and Budget Hotels, Government Regulations for the sector in Indian market, Key players and Market Concentration.

### **Methodology**

The present study provides a qualitative and quantitative view to examine the current study trends with respect to luxury segment and budgetary segment hotel business in hospitality industry. The quantitative approach is used to collect data and figure which were published in academic articles on luxury and budgetary segment hotels which were helpful to study the growth of industry by accumulating descriptive statistics whereas the qualitative method was employed for examining the content of collected articles i.e., methodology, research areas and results.

### **Tourism and Hospitality Industry Trends in India**

India is a large market for travel and tourism. It offers a diverse portfolio of niche tourism products - cruises, adventure, medical, wellness, sports, MICE, eco-tourism, film, rural and religious tourism. India has been known as a destination for spiritual tourism for domestic and international tourists.

As per the press releases of DIPP, Ministry of Commerce and Industry, the total contribution by travel and tourism sector to India's GDP is expected to increase from US\$

136.3 billion in 2015 to US\$ 275.2 billion in 2025. Travel and tourism is the third largest foreign exchange earner for India. In 2014, the country managed foreign exchange earnings of USD 19.7 billion from tourism. The launch of several branding and marketing initiatives by the Government of India such as Incredible India! and Athiti Devo Bhava has given a focused impetus to growth. The Indian government has also released a fresh category of visa - the medical visa or M visa, to encourage medical tourism in the country. India is expected to receive nearly half a million medical tourists by 2015, implying an annual growth of 30 per cent. In November 2014, Government of India launched Tourist Visa on Arrival (TVoA) which is enabled by Electronic Travel Authorization (ETA), known as the e-Tourist Visa scheme. According to the data released by Ministry of Tourism, at present this facility is available for citizen of 113 countries. The facility is likely to enable 7.5 percent growth in the tourism sector in 2015. The Government of India has also been making serious efforts to boost investments in tourism sector. In the hotel

and tourism sector, 100 per cent FDI is allowed through the automatic route. A five-year tax holiday has been offered for 2, 3 and 4 star category hotels located around UNESCO World Heritage sites (except Delhi and Mumbai). The investment in tourism sector is expected to be US\$ 12.4 billion in the 12th Five Year Plan; of these, private investments are likely to total US\$ 9.2 billion.

**Increase in foreign tourists arrivals**

As per the data released by Ministry of Tourism, FTA during the month of October 2015 6.80 lakh as compared to 6.68 lakh during the month of October 2014 and 5.98 lakh in October 2013. It has shown growth of 1.7 per cent in October 2015 over October 2014. Figure 1 shows that Over 7.757 million foreign tourist arrivals were reported in 2015. Foreign tourist arrivals increased at a CAGR of 7.1 per cent during 2005-15. According to World Tourism Organization, by 2025, foreign tourist arrivals are expected to increase to 15.3 million.



Fig: 1

**Contribution of Tourism and Hospitality to GDP**

Figure 2 indicates that the tourism in India accounts for 6.8 per cent of the GDP and is the third largest foreign exchange earner for the country. The tourism and hospitality sector's direct contribution to GDP has been

reported US\$ 44.2 billion in 2015. Over 2006-15, direct contribution is expected to register a CAGR of 10.5 per cent. The direct contribution of travel and tourism to GDP is expected to grow 7.2 per cent per annum to US\$ 88.6 billion (2.5 per cent of GDP) by 2025.

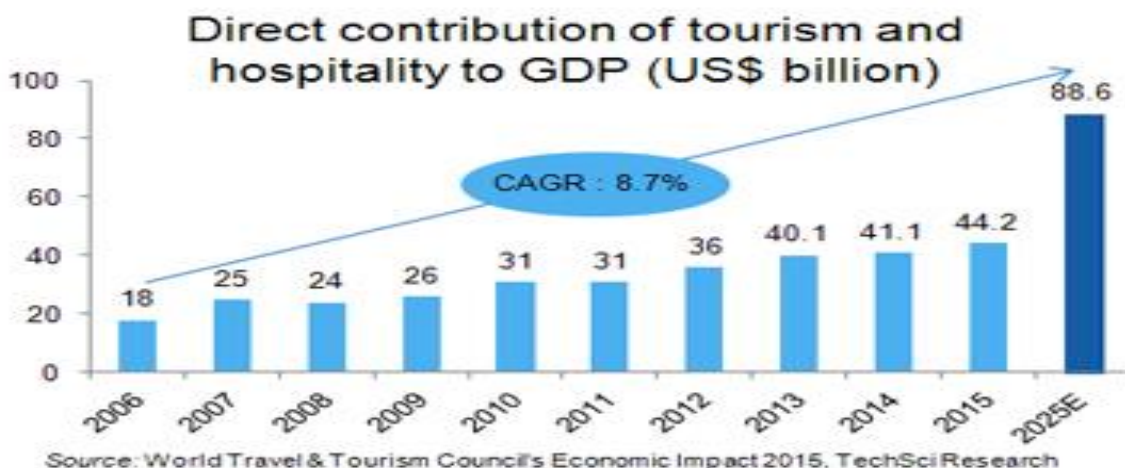


Fig: 2

The Indian tourism and hospitality industry has been recognized as one of the key drivers of growth among the services sector in India. The third-largest sub-segment of the services sector comprising trade, repair services, hotels and restaurants contributed nearly US\$ 187.9 billion or 12.5 per cent to the Gross Domestic Product (GDP) in 2014-15, while growing the fastest at 11.7 per cent Compound Annual Growth Rate (CAGR) over the period 2011-12 to 2014-15. Tourism in India has significant potential due to the presence of rich cultural and historical heritage, variety in ecology, terrains and places of natural beauty spread across the country. Tourism is potentially a large employment generator besides being a significant source of foreign exchange for the country.

## Growth Drivers of Indian Hotel Industry

### 1. Market Size

- As per data released by DIPP, the number of Foreign Tourist Arrivals (FTAs) has grown steadily in the last three years reaching around 4.48 million during January–July 2015. Foreign exchange earnings (FEEs) from tourism in terms of US dollar grew by 3.2 per cent during January–July 2015 as compared to 1.9 per cent over the corresponding period of 2013. FEEs during the month of July 2015 were Rs 11,452 crore (US\$ 1.74 billion) as compared to FEEs of Rs 10,336 crore (US\$ 1.57 billion) in July last year.
- Further, Press releases of DIPP reported that, the Foreign Exchange Earnings (FEEs) between January–July 2015 were US\$ 11.41 billion compared to US\$ 11.06 billion in the same period last year. The growth rate in FEEs in rupee terms in January–July 2015 was 6.9 per cent.

### 2. Investments

As per DIPP, the tourism and hospitality sector is among the top 15 sectors in India to attract the highest foreign direct investment (FDI). During the period April 2000–May 2015, this sector attracted around US\$ 8.1 billion of FDI. With the increase in the number of global tourists and keeping in view the India's potential, many companies have invested in the tourism and hospitality sector. Some of the recent investments made in tourism and hospitality sector are listed below:

- Fairfax-owned Thomas Cook has acquired Swiss tour operator Kuoni Group's business in India and Hong Kong for about Rs 535 crore i.e., US\$ 85.6 million in order to scale up inbound tour business.
- US-based Vantage Hospitality Group has entered into a franchise agreement with India-based Miraya Hotel Management for the establishment of its mid-market brands in the country.
- Thai firm Onyx Hospitality and Kingsbridge India hotel asset management firm have established a joint venture (JV) to start seven hotels in the country by 2018 for which the Joint Venture will raise US\$ 100 million.
- ITC is in the process to invest about Rs 9,000 crore (US\$ 1.42 billion) in coming three to four years to enlarge its hotel portfolio to 150 hotels. ITC wish to launch five other hotels - in Mahabalipuram, Kolkata, Ahmedabad, Hyderabad and Colombo by 2018.
- Goldman Sachs, New-York based multinational investment banking fund, has made an investement of Rs 255 crore (US\$ 40.37 million) in Vatika Hotels.

- Japanese conglomerate SoftBank will lead the Rs 630 crore (US\$ 95.6 million) funding round in Gurgaon based OYO Rooms.
- MakeMyTrip has been reported to acquire the travel planning website Mygola and its assets for an undisclosed sum, and decided to focus on innovating the online travel segment.

### 3. Government Initiatives

The Government of India has recognized the country's potential in the tourism industry and has taken many steps for making India as a global tourism hub. Some of the major initiatives taken by the Government of India as per DIPP, to uplift the tourism and hospitality sector are listed below:

- Government of India has made a plan to cover 150 countries under e-visa scheme by the end of the year besides opening an airport in the NCR region in order to ease the pressure on Delhi airport.
- The sharp growth in usage of facility under the Tourist Visa on Arrival scheme, launched by the Government of India on November 27, 2014 for 43 countries has been noticed recently. During the month of July, 2015 a total number of 21,476 tourists visited on e-Tourist Visa as compared to 2,462 during the month of July, 2014 registering a growth of 772.3 per cent. During January–July, 2015 a total of 1,47,690 tourist arrived on e-Tourist Visa as compared to 14,415 during January–July, last year registering a growth of 924.6 per cent.
- The Government of India has made a provision of Rs 500 crore i.e., US\$ 79.17 million for the first phase of the National Heritage City Development and Augmentation Yojana (HRIDAY). The 12 number of cities in the first phase are Varanasi, Amritsar, Ajmer, Mathura, Gaya, Kanchipuram, Vellankani, Badami, Amaravati, Warangal, Puri and Dwarka.
- The Government of India under 'Project Mausam' has also proposed to establish cross cultural linkages and to revive historic maritime cultural and economic ties with 39 Indian Ocean countries.

### 4. Marketing Strategies

- Marketing strategies in the hospitality industry have been changed to a larger extent over the last decade. In the past the brand name of the hotel has been considered as major driver. However with the increased arrival of educated and experienced tourists, hotel companies started to change their marketing strategies which are known as differentiation, consistency, customer satisfaction, delivery of brand promises and customer retention.
- The development of new technology has also changed the way hotel companies are operating and creating the need for online marketing. Many travel portals have been developed recently and visitors are using these facilities for hotel bookings.

### Challenges in Indian Hotel Industry

While hotel investments are lucrative in developing and emerging markets like India, there are challenges as well when it comes to investing in the sector. Although investment in Greenfield projects offers maximum return, there are few challenges on the way which can be summarized as below:

- Valuations for operational properties in India are very high and do not offer a significant returns to a rational investor
- High land prices in key Tier I markets, coupled with related issues on land ownership and titles. The land titles and the governing development norms are at times unclear and require detailed legal and technical due diligence
- Obtaining approvals is time consuming and obscure as a process, especially for institutional investors
- Exit options for investments in India are also limited. Further, India has not seen too many sales of individual hotel assets or portfolios. However, capital markets in India are mature and provide a decent exit option.

Indian hospitality scenario has been dominated by premium luxury hotel segment for a long time. There was a vacuum in terms of mid-scale hotels till recently. However, a clear segmentation of sorts have come into play in the last few years with the coming of mid-scale budget brand, both international, domestic. However, there are plenty of opportunities and scope for investments in this segment in Tier II and III cities and along destinations of pilgrim importance. Hotel industry has recognized a gap in the mid-market hotel space and many hotels entered into a joint-venture with the Intercontinental Hotel chain to develop branded hotels in key Indian metro cities. It further recognized a supply gap in three and four star business hotel segment and is focused on addressing this need in the market. It states that hotel investment feasibility is primarily determined by the entry price and market. Both business and leisure segments are growing and have their own demand and investors. Given these challenges, the best options to invest for a foreign player is through hospitality focused private equity funds who understand locally the dynamics of the industry.

### Conclusion and Recommendations

The study observed that mid-market hotels will be the driving force due to the fact that both domestic and international hotel chains are looking for a fruitful experience in this segment. The study further examined that the luxury segment has a market of its own and the emergence of the budget hotels would not affect the luxury consumers. The two segments are mutually attractive to both the domestic as well as international visitors. Hotels in both the segments have to face the challenges by uniqueness of the product. The product innovations, service augmentations are necessary ways and in order to have competitive advantage, service excellence will always remain as a key area of study. The study further concludes that one way to make a good return on investment (ROI) would be to look at the hotel business in different light. This could be done by taking a multiuse development approach and make the hotel project more viable. With the potential and future growth of this industry the full utilization of established infrastructure can be ensured by increasing occupancy percentages. Hotel industry may have increased number of hotels to be centered on upcoming tourist spots as well as commercial hubs. Reduction of operating expenses can further be ensured by borrowing other firms with more efficient strategies. The best option as observed from the study is available to invest for a

foreign player is through hospitality focused private equity funds who understand locally the dynamics of the industry.

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