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What triggered the boom in the Indian mid-tier hotel segment?

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Post the 2008 global economic slowdown, there has been an exponential and on-going rise in the mid -tier hotel segment in India. Besides the rush of newer players, even seasoned luxury majors are tapping the potential of this emerging market that has outdone the growth of the luxury and the budget segments.

At the end of the day, the question hinges on what has triggered this boom in a country like India where hospitality has predominantly meant luxury or budget? Is the mid-tier segment a means to achieve higher occupancies and a safeguard against precarious global economic situation for the luxury hotels rather than a phenomenon? In this feature, **India Hospitality Review** delves into the issue to find out some of the answers.

Trends

- Low-cost hotels in smaller cities will see a growth of about 50 % in the next four years.
- 51 mid-tier hotels will be opened in India with investments of INR 525 bn by both international and domestic players in 2012.
- Foreign brands have a 19 % share in India's mid-priced hotel segment and they compete with local brands such as Pride, Lemon Tree, Royal Orchid, Fortune and Ginger

Source : Multiple sources

The mid-tier hotel segment, at present, accounts for 30 per cent of the organized Indian hotel industry *(Grant Thornton)*. Moreover, according to a Business Standard report, 60 percent of new hotel rooms to be built in India by 2015 will cater to the mid market only. This is expected because the mid segment ensures faster breakeven and hotels turn profitable faster than their peers in the luxury space; hotels have reasonably low price points that can be maneuvered according to the changing market conditions, thereby leveraging higher occupancies and RevPAR, higher return on capital employed (RoCE), lower debt levels, and so on.

However, there are other reasons for the recent boom in this sector.

According to Kapil Aggarwal, Director of Sales and Marketing, Hyatt International South West Asia, one of the major factors that have contributed is "the gradual increase in the number of domestic tourists every year. India's rapidly expanding middle class; its buying power and the growing infrastructure make it a lucrative inbound and outbound tourism destination leading to a growing need for affordable yet quality hotel rooms as 5 stars may not be the viable option for one and all. Over the next few years, India will see an experienced and aware middle class that will want consistent quality for stay and food, and a mid-scale hotel will provide an environment conducive to this traveller, apart from business or the long-stay official."

The World Travel and Tourism Council report states that there were 740 million domestic tourists in India in 2010, 10.7per cent up from the year earlier. Domestic travel spending in India generated around 83.8per cent of travel and tourism's total contribution towards GDP in 2011. Foreign tourist arrivals in May 2011 were also slightly up by 7 per cent from the previous month though remaining around 500 million mark.

"The domestic tourism has been in double digit over the last five years, which has triggered the boom in the mid-market segment. While the foreign tourists prefer to live in the luxury segment normally, the domestic tourists prefer the budget or mid-scale hotels only," said Kamlesh Barot, President, FHRAI.

A report by HVS says that in 2010, there were 1,28,771 rooms in the classified sector and 25,83,519 rooms in the unclassified sector. By 2016, there would be a requirement of 3,10,523 rooms in the former and 46,61,807 in the latter segment due to this growth in the inbound and domestic tourism.

The Chief Operating Officer, South West Asia of InterContinental Hotels Group that has over 75 per cent of its development pipeline in India in the mid-scale segment through its Holiday Inn and Holiday Inn Express hotels, Chris Moloney says, "Hotels in India historically have catered for either the luxury 'five-star' segment or the budget end of the industry. Just 15 per cent of current hotel rooms in India fall in the mid-market segment, compared to 43 per cent in the United States and 35 per cent in Britain. With companies continuing to be more cost-conscious, and leisure travellers looking for value-for-money options that don't compromise on quality, there is a clear opportunity for the mid-scale market to expand exponentially."

Facts and Figures
➢ The mid-priced segment now accounts for 30 per cent of the organized Indian hotel industry. ➢ Mid-sized hotels have an average occupancy rate of 68 % and revenue per room of Rs 4,624. High occupancy rates and revenue per room and low debt will drive the growth of mid-sized hotels in the coming years. ➢ Foreign tourist arrivals in May 2011 were up 7 % from the previous month. The rise in foreign tourist arrival in India will boost revenues for budget hotels in smaller towns. ➢ The return on capital employed (RoCE) of mid-sized hotels was more than 15 % in the past five fiscals while larger peers such as Indian Hotels, EIH, and Hotel Leela Venture had RoCE of below 15 %. ➢ The average per key cost of budget and mid-market hotels are about Rs 30-50 lakh compared with Rs 85 lakh to Rs 1 crore for first class and luxury hotels. ➢ Travel and Tourism Industry's market Size was INR 1970 bn in 2010 and is expected to grow to INR 6211 bn by 2020. *(Netscribes)* ➢ Foreign Exchange Earnings in Sep 2009 were INR 37.9 bn and grew to INR 57.4 bn in Sep 2011. *(Netscribes)* ➢ The market accounts for ~ 6.23 % to the overall GDP of the country and 8.28 % employment *(Netscribes)* *Source : Multiple sources*

On the other hand, not amused by the idea of having all the eggs in one basket, the international luxury brands are aggressively tapping this segment. Hyatt, InterContinental Hotels Group Plc, Carlson, Marriott and Hilton, which started expanding in India after the global recession in 2010, are trying to fill the shortage of branded rooms, particularly in the mid segment.

Netscribe's *Hotel Industry in India 2011* report states that international luxury brands generate approximately 40-50 per cent of their revenues from international tourists. With global financial meltdown there has been a dip in the number of business travellers and tourists as well. Since mid-tier hotels are considered least vulnerable to economic slowdowns, this measure will help in safeguarding against any slowdown in the luxury segment. Therefore, due to apprehensions of further slowdowns, luxury majors are strengthening their foundations by diversifying into mid-tier segments as they provide newer and safer opportunities for revenue generation.

Moreover, according to Deepak Sharma, former Secretary General of Lobby Group Federation of Hotel and Restaurant Associations of India, foreign brands now have a 19 per cent share in India's mid-priced hotel segment, and they are competing with local brands such as Pride, Lemon Tree, Royal Orchid, Fortune and Ginger – a trend likely to continue.

The other reason for boom in this segment, according to Grant Thornton, is thus quite naturally the global economic uncertainty. "With a slowdown almost always lurking at the horizon, there would be renewed interest in providing quality hospitality options in the mid-tier market. Corporate business has already started to shift towards serviced apartments and mid-priced hotels," says a senior consultant.

A report by Cygnus Business Consulting and Research says that India has around 10 prominent foreign hotel brands operational, and 40 more companies may enter the country in the next five years with an investment of Rs. 44,800 crore.

However, according to Aly Shariff, MD, Premier Inn Hotels, a UK based company in India, says that the mid market segment in India is in its infancy due to which there is plenty of headroom for everyone in the market. “By 2020-25, 40 per cent of the population would be sitting in this little sector. As of now the segment remains fairly unrepresented. But between now and 2025, mid-range hotels are likely to grow by 200 per cent. Properties are getting consolidated across the globe; smaller brands are getting upgraded to bigger brands; bigger brands are taking over smaller ones for economy of scales and so on. All this, according to me, is just tip of the iceberg and going to be absolutely massive.”

He further opines that we need more players to come in and define this segment as an attractive option capable of offering over-the-board facilities. “In the long run even better players would come in with an enhanced understanding of this segment which has huge potential in India.”

Challenges

Though the segment promises growth, there are pressing concerns causing anxiety across the industry. According to Ken Greene, President and Managing Director, Asia Pacific, Wyndham Hotels Group, “India is one of the most difficult places in the world for a hotel to do business. It takes enormous time to develop a property, licensing is a major impediment, projects quite often get delayed; besides the lack of proper infrastructure and land for development.”

Apart from this, there is a severe shortage of competent manpower; land prices are high and a precarious market where cautious management of risk and costs has become vital.

“There is still irrational pricing in the market. While there is demand, the expectations of the customers for lower prices have heightened and realizations have gone down,” says Patu Keswani, CMD, Lemon Tree Hotels.

Moreover, the global economic condition presents a grim picture. "Things are not expected to gain considerable pace in the coming two years as well. The advent of international luxury and mid-tier players into the mid tier segment is posing challenges for the local players," says Kamlesh Barot.

Projects in the Pipeline

- IHG recently signed a joint venture partnership with Duet India Hotels Group (DIHL), to develop 19 new Holiday Inn Express hotels, across more than 12 key cities in India, by 2016. It has invested a 24 % equity stake, making a multi-year investment of US$30 million into the partnership. It has also signed six management contracts with Amrapali Group to add two Holiday Inn and four Holiday Inn Express hotels to its pipeline. It aims to have 150 hotels in India by 2020.
- IHG opened three new hotels last year - Holiday Inn Pune, Holiday Inn Cochin and Crowne Plaza Rohini, New Delhi. It will open several more hotels including Holiday Inn Express Ahmedabad, the first Holiday Inn Express in the country, Crowne Plaza Greater Noida, Holiday Inn Calangute Goa, Holiday Inn Amritsar and Crowne Plaza Cochin this year.
- Hyatt is looking at launching its mid segment hotel brand, Hyatt Place in India by 2013 in tier 1 and tier 2 markets.
- On the domestic front, segment leader Indian Hotels would have an inventory of about 48 % in the mid-market and the budget hotels segment in the next 2-3 years. Mid-segment hotels companies such as Royal Orchid Hotels, Kamat Hotels, and Taj GVK Hotels & Resorts are also expanding presence in tier-II and tier-III cities.
- Indian Hotels Company Limited and its subsidiaries collectively known as Taj Hotels Resorts and Palaces, will add yet another brand in addition to Taj, Vivanta by Taj, Gateway and Ginger. This new brand will fall between the budget Ginger hotels and upscale-to-mid-range Gateway brand. The new brand will appeal to travelers spending Rs 3,000-4,000 a day for a room. The company is in the process of building a prototype of a mid-range hotel, says managing director Raymond Bickson.
- French hotel giant Accor will open 12 new hotels in 2012, eight of which will be in the mid-segment category under its Ibis and Novotel brands. The company already operates 10 hotels in India.
- Marriott will bring its Fairfield Inn & Suites brand to India before the end of 2012, with standard room prices likely to be Rs 4,000-5,000 per night.
- Leela is reportedly planning to have a mid-range hotel under a different brand name for religious destinations.

Source : Multiple sources

In addition, real estate players entering hotel business has rung alarm bells for the industry in some cities. "They see it as a lucrative prospect as is in Bangalore, but this cushioning for them also is soon going to be negated by the boom in the mid tier segment similar to the one in real estate in 2008. It has already begun in Pune with the oversupply of hotel rooms throwing the entire demand and supply situation haywire," he says.

There is also a question of under-confidence among some mid-tier players for not expanding into other market segments. According to a study published by Emerald Group, the mid-segment hotels do not feel confident to look beyond their existing customer base. Many of them lack knowledge and need to be educated on current trends in the international hospitality business. Also, the inventory distribution and pricing of mid-segment hotels is insensitive to the demand.

Nonetheless, this may start to improve over time as the segment matures. According to Kamlesh Barot, “Players not expanding beyond their existing customer base is because of the global economic slowdown. However, the coming time would see the industry gaining momentum especially in the luxury and mid-scale segment while the budget segment would not see much expansion.”

Promising Prospects Ahead

The opportunity lies in the fact that India is still underfed with hotels. With the growth in the domestic tourism and reasonable rate of the national GDP in which tourism accounts for 6 per cent, there are more reasons to cheer and experiment than worry and wait for markets to stabilize from top to bottom.