

# OPPORTUNITIES FOR SMEs IN HOSPITALITY SECTOR IN INDIA

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## Hospitality Overview

Hospitality Industry, which primarily comprises of hotels and restaurant chains and related services, is perhaps one of the largest service industries in the world. Hotel comprises of almost 75% of the total market size. Historically viewed as an industry providing a luxury service valuable to the economy only as a foreign exchange earner, the industry today is one of the major employment generator not only in India but globally. Global hospitality Industry together with travel and tourism Industry is estimated to be around 3.5 Trillion dollar industry and generated approximately 231.2 million jobs in year 2007. The fortunes of hospitality industry are inextricably linked with the growth of travel and tourism industry. And like tourism industry, hospitality industry is also cyclical in nature and highly susceptible to macro environmental changes. Till 2007/08, the industry was showing a high growth rate but the year 2008/09 has been a year of challenge. This is majorly because of the decline in international tourist arrivals due to the impact of the global economic recession and slowdown. Tourist footfalls in India further declined in the aftermath of terror-strike at Taj, the premier hotel in Mumbai, and several other places in the country. Hospitality Industry in general is projected to see a steep decline in its

revenue in 2008/09 and 2009/10 as compared to 2007/2008. As per the estimates of HVS, the Indian hotel industry may face a consolidated revenue decline of around Rs. 90,620 million between 2008/09 and 2009/10, from its base year (2007/08) revenues. But the situation is not so grim in the long run. With the improvement in travel and tourism Industry, hospitality industry is also going to get positively impacted. As per the report published by World Travel and Tourism Council, global travel and tourism was forecast to account for US\$5,890 billion of economic activity, equivalent to 9.9% of total global GDP and was

### Exhibit 1.1- Travel and Tourism Demand

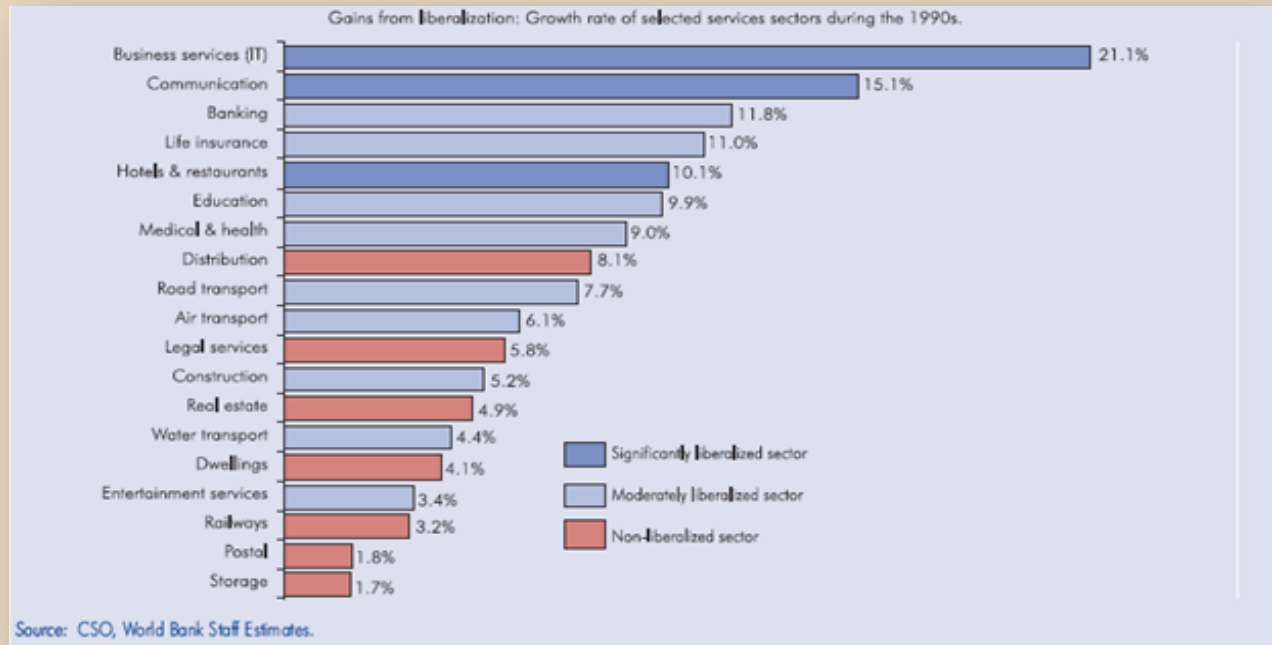
ON A RELATIVE SCALE		
Countries expected to grow their Travel and Tourism Demand most rapidly between 2008-2018		
T&T Demand,2008-2018(% annualised real growth)		
1	India	9.4
2	China	8.9
3	Libya	8.1
4	Vietnam	8.1
5	Montenegro	7.4
6	Romania	7.1
7	Macau	7.1
8	Nambia	6.9
9	Croatia	6.9
10	Czech Republic	6.8

Source: WTTC report

expected to contribute to 238.3 million jobs in

the year 2008. This figure is likely to go up to 296.3 million by 2018. In terms of demand, Africa, Asia Pacific and the Middle East are expected to experience higher growth rates

projection of the 10 fastest growing countries in terms of total travel and tourism demand for the period 2008-2018 and India tops the list with expected annual growth rate averaging



than the world average. Within Asia Pacific, India and China are going to be the star performers. While China is already ranked second in the world in both growth and absolute size of its travel & tourism economy, India is also becoming an increasingly important player in the global tourism economy climbing to fourth place in the contribution of its travel & tourism economy to total GDP growth over the next ten years, with annual growth of 7.6% forecast. Over the next ten years, emerging tourism markets will start to reap greater benefits from their investment in travel & tourism development. Exhibit 1.1 gives a

Exhibit 2.1- Gains from liberalization: Growth rate of selected services sectors during 1990s

9.4% per annum followed by China at 8.9% per annum. Hospitality Industry, being closely linked with the travel and tourism Industry is expected to show similar trends and will be hugely benefited by the growth of tourism industry.

## Sector Outlook in India

### The Past

Prior to 1980s, Indian hospitality Industry was growing at a slow pace. However, the Asiad,

held in New Delhi in 1982 and the subsequent partial liberalization of the Indian economy gave a boost to this sector by generating interest in Indian tourism amongst international tourists as well as in the investors. The growth continued through 1990s following the initiatives taken to liberalize the Indian Economy in FY 1991. Exhibit 2.1 highlights the growth rate of selected service sectors during 1990s. It can be seen that the growth rate in more liberalized sectors have been more as compared to the less liberalized sectors.

## The Present

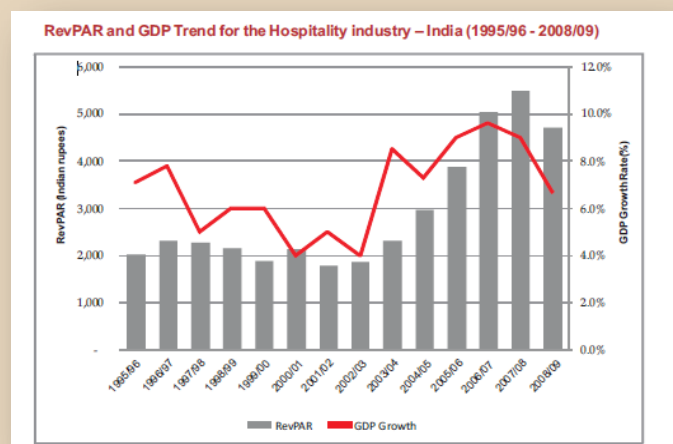
The Indian hospitality industry is valued at \$23 billion (Rs 113,976 crore). The hotel market is expected to double in size by 2018. About \$12 billion (Rs 59,442 crore) is likely to be invested in the next two years. By 2011, there will be around 40 new international hotel brands operating in India. Many international hotels including Sheraton, Hyatt, Radisson, Meridien, Four Seasons Regent, and Marriott International are already established in the Indian markets and are still expanding. Brands like Ritz-Carlton are entering Indian market.

Performance of the industry has been more or less cyclical in nature. The first cycle peaked in 1997, after which it started a downward trend hitting the bottom in the year 2001/02. The second cycle started with the recovery of the economy in 2002/03, peaking in 2007/08 after a

period of continuous growth. And again once again in Year 2008/2009 the growth rate declined steeply due to global economic slowdown.

Exhibit 2.2 presents the RevPAR (Revenue Per Available Room) trend for fourteen years, from 1995/96 to 2008/09 along with the GDP growth rate for the same years.

Exhibit 2.2- RevPAR and GDP Trend



Source: HVS Trends and Opportunities, 2009

## Demand and Supply Scenario

Currently there are around 1783 hotels with a capacity of around 92,005 rooms approved and classified by Ministry of Tourism, India. Another 112 new hotels project have already been approved at the project stage which will add approx 16,431 rooms. But the availability of hotel rooms has not kept pace with the increasing demand. The upsurge in tourists' arrivals in recent past has increased the demand of accommodation and there is a

deficit in the supply side. Exhibit 2.1 highlights the number of foreign tourist arrivals in India from the period 1996- 2009.

Exhibit 2.3

Foreign Tourist Arrival (FTAs ) in India,1996-2009		
Year	FTAs(in million)	% change over the previous yr
1996	2.29	7.7
1997	2.37	3.8
1998	2.36	-0.7
1999	2.48	5.2
2000	2.65	6.7
2001	2.54	-4.2
2002	2.38	-6.0
2003	2.73	14.3
2004	3.46	26.8
2005	3.92	13.3
2006	4.45	13.5
2007	5.08	14.3
2008(P)	5.37	5.6
2009	2.47	-9.3 @

(Jan-June)(P)  
P: Provisional, @ Growth rate over Jan-Jun,2008

Source: (i) Bureau of immigration, Govt. of India, for 1996-2007 (ii)Ministry of Tourism, Govt. of India, for 2008-2009

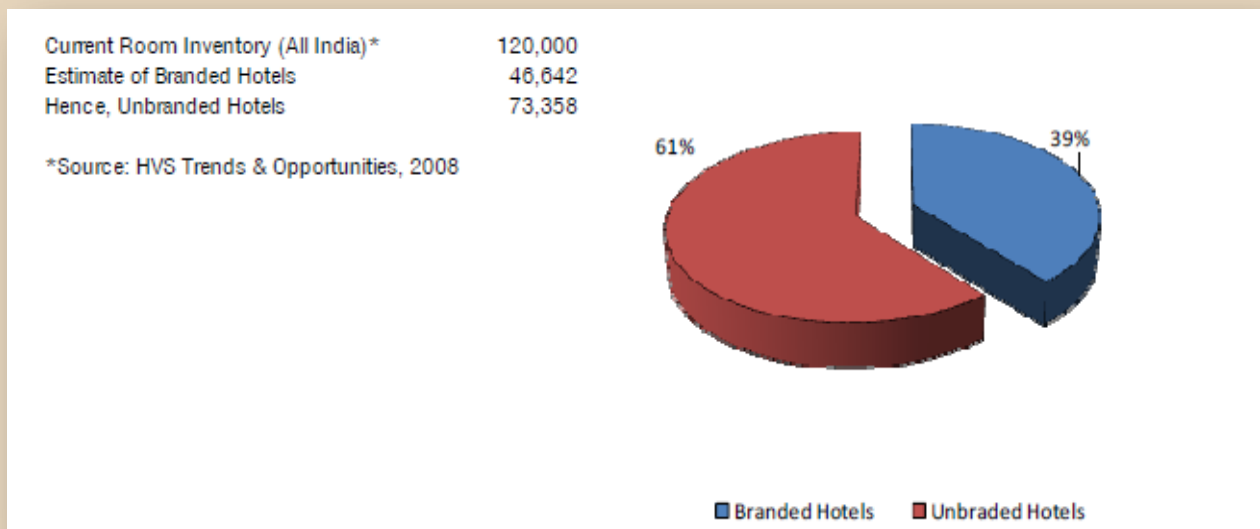
Exhibit 2.4 highlights the total number of registered hotels in India and their rooms’ inventory (across all categories). As can be seen,

approximately 61% of the entire room inventory of hotels in India falls in the unorganized sector of unrated, one star and two-star hotels. This sector, while witnessing the bulk of domestic consumption, has a major shortfall of quality hotels and ancillary facilities.

For a country of India’s size and potential, it is astonishing to see the ratio of hotel rooms in comparison to the population. India has approximately 2,000 registered hotels with a total room count of approximately 120,000 rooms. As evident from Exhibit 2-5, there is a dearth of hotels across every category and city in India. Tianjin, a suburb of Beijing has more rooms than Indian cities like Mumbai and New Delhi.

While the Indian economy is growing at a record-breaking pace, the cities remain starved for quality hotels and room accommodation.

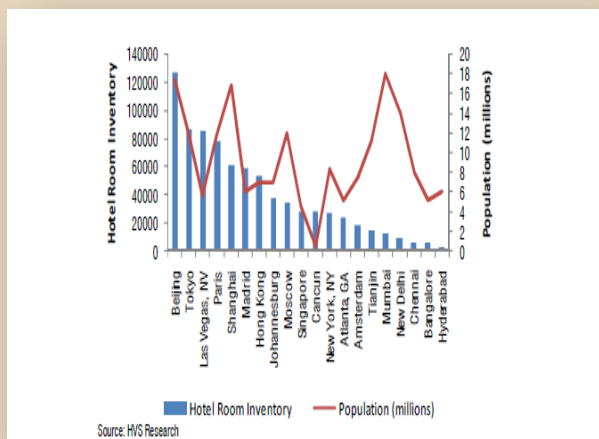
Exhibit 2.4- Registered Hotels and Rooms Inventories -2007



Apart from the four major cities noted in Exhibit 2-5, there are at least 35 other cities in the country with a population of one million and more. Thus, demand fundamentals for the country are strong.

Exhibit 2.6 highlights the distribution of existing and proposed branded hotels in major cities of India.

**Exhibit 2.5- Hotels inventory Vs Population: Major**



### International Cities

## Government Initiatives to promote this Sector

The upsurge in tourist arrivals intensified government's efforts towards augmentation of tourist accommodation. Following steps have been taken by the Ministry of tourism to overcome shortage of accommodation for the tourists.

**Land banks for hotels-** The Ministry of Tourism has advised all state/UT governments and other land agencies to create to create land banks for hotels and to allow such hotel sites on Public-Private Partnerships or Revenue sharing basis. They have also been advised to allow additional FAR/FSI, more commercial utilization and to create Single Window Clearance system for promoting investment into hotel sector.

**Subsidy to Budget Hotels-** In order to encourage expansion of hotel accommodation in the country, the Ministry of Tourism provides incentives for the construction of hotels in the budget category and Heritage basic category by way of subsidy.

**Incredible India Bread and Breakfast scheme-** To meet the demand of accommodation during the forthcoming Commonwealth games in New Delhi in 2010, Ministry of Tourism has come out with this scheme. To motivate house owners to apply for this scheme, an integrated publicity campaign was launched. Such registered houses are being promoted through the e-commerce platform of the 'Incredible India' website. On the request of the Ministry of Tourism, the Government of NCT of Delhi has exempted such establishments from various taxes by treating them residential

**Availability of External Commercial Borrowing(ECB)-** Earlier, entities in the service sector like Hotels, Hospitals and Software companies were allowed to avail of (ECB) up to US\$ 100 million per financial year for import of capital goods under the automatic route. Later on, the ECB facilities for the hotels were discontinued. In order to solve the liquidity crunch being faced by the hotel industry for setting up new hotel projects, the Finance Ministry has now allowed hotels to avail of ECB up to US\$ 100 million per financial year both for foreign currency and /or rupee capital

than for land acquisition, under the automatic route.

**Income Tax exemption to hotels-** In his budget proposal 2007-2008, Finance Minister of India has announced a tax holiday of 5 years under Section 80-ID of the Income tax for new hotels of budget category coming up between 1st April, 2007 and 31st March, 2010 in the National Capital Territory of Delhi and the Districts of Faridabad, Gurgaon, Gautam Budh Nagar and Ghaziabad. Further, in the budget proposal for 2008-09, a five-year holiday from

**Distribution of Existing & Proposed Branded Hotels by Major City – 2007/08**

City	Existing Supply	Proposed Supply	Increase over Five years	Active Development of Supply	Luxury	First Class	Mid Market	Budget
Agra	1336	670	50%	55%	0.0%	22.4%	77.5%	0.0%
Ahmedabad	675	3664	543%	47%	6.8%	32.0%	35.7%	18.3%
Bangalore	3456	15542	450%	60%	19.4%	31.8%	30.2%	10.8%
Chandigarh	340	1813	533%	54%	15.7%	28.8%	21.1%	34.4%
Chennai	2826	7147	253%	71%	26.8%	31.2%	15.6%	16.5%
Delhi-NCR	9019	22360	248%	51%	25.1%	29.7%	30.9%	10.4%
Goa	2768	3353	121%	42%	35.4%	46.4%	7.2%	11.0%
Hyderabad	2554	8250	323%	64%	35.0%	23.3%	24.1%	24.3%
Jaipur	1556	2937	189%	53%	0.0%	16.5%	52.5%	31.0%
Kolkata	1396	5965	427%	49%	23.4%	30.1%	34.9%	9.7%
Mumbai	8454	10613	126%	62%	30.6%	29.9%	20.5%	10.5%
Pune	1346	8243	612%	66%	22.0%	29.3%	31.4%	25.0%
Other Cities	11256	23909	212%	60%	2.3%	26.0%	26.0%	30.3%
<b>Total</b>	<b>46982</b>	<b>114466</b>	<b>244%</b>	<b>58%</b>	<b>19.6%</b>	<b>28.8%</b>	<b>29.5%</b>	<b>18.0%</b>

Source: HVS International & Nimal Bang Research

expenditure for permissible end-uses, other

Income Tax to two, three or four star hotels



that are established in specified districts which have UNESCO-declared “World Heritage Sites” status had been announced. The hotel should be constructed and start functioning during the period 1st April, 2008 to 31st March, 2013. This incentive is not applicable to the revenue districts of Mumbai and Delhi.

**Open Sky Policy-** Government’s Open Sky Policy which allowed domestic airlines to commence international flights led to start up of lot of low cost carriers and fleet expansion by domestic players. This created a huge incentive for domestic travelers to explore far-off destination within and outside India. Domestic air passenger traffic grew by 16.8 per cent in 2005/06 compared to 2004/05. International passenger traffic observed a growth of 16.9 per cent in the same period and Private airlines accounted for 77.0 per cent of the total domestic traffic.

**Foreign Trade Policy -** The Foreign Trade Policy announced in April, 2006, offered following incentives to the hospitality industry

- Hotels and Restaurants are allowed to import duty free equipment and other items including liquor, against their foreign exchange earnings under the Served from India Scheme. As in previous years, this entitlement is 5 per cent of previous year’s foreign exchange earnings for hotels of one-
- star and above (including managed hotels and heritage hotels) approved by the Department of Tourism and other service providers in the tourism sector registered with it.
- The stand-alone restaurants will be entitled to duty credit equivalent to 10 per cent of the foreign exchange earned by them in the preceding financial year (instead of the earlier 20 per cent).
- Service exports in Indian Rupees, which are otherwise considered as having been paid for in free foreign exchange by RBI, will now qualify for benefits under the Served from India Scheme. Also, foreign exchange earned through International Credit Cards and other instruments as permitted by RBI for rendering of service by the service providers shall be considered for the purposes of computation of entitlement under the Scheme.
- Benefits of the Scheme earned by one service provider of a Group company can now be utilized by other service providers of the same Group Company including managed hotels.
- The measure aims at supporting the Group service companies not earning foreign exchange in getting access to the international quality products at competitive price and providing services of international standards. This new initiative

allows transfer of both the script and the imported input to the Group Service Company. The earlier provision allowed transfer of imported material only.

**FDI in Hotel Sector-** 100 per cent FDI is permissible in the sector on the automatic route. The term hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and/or catering and food facilities to tourists.

**Infrastructure Development** -The government's decision to substantially upgrade 28 regional airports in smaller towns and privatization & expansion of Delhi and Mumbai airport has improved the business prospects of hotel industry in India. Also, the upgrading of national highways connecting various parts of India has opened new avenues for the development of budget hotels in India.

## **Emerging Trends in Hospitality Industry & Opportunities for SMEs**

Historically, hospitality industry was dominated either by few big players or otherwise by a large number of unbranded and unstructured players. But the changing dynamics of the industry and the reforms initiated by the government has opened up a plethora of opportunities for the Small to Medium Enterprises(SMEs). Understanding the needs of the highly demanding customers and

continuous innovation is what is going to help the SMEs in establishing themselves in this competitive industry. Some of the emerging trends in the hospitality industry have been discussed below. Way forward for SMEs is to take advantage of these opportunities survive and grow in this highly competitive industry.

**Changing face of Budget hotels-** With the growth in Indian economy in last one decade, middle class has emerged as one of the most lucrative customer segment for the hospitality industry. To attract this segment of customers, budget hotels are going through a complete makeover. Ginger hotels from the Tata group of companies, is in the forerun and has kind of changed the definition of budget hotels. Ginger hotel is the new version of budget hotels and has shaken up the hospitality industry for the better. It differentiates itself from other budget hotels by its SMART BASIC features. Almost all the services offered by the hotel are self-service based. There is no valet to park the car but the parking lots are marked well for convenience, no porters to carry the luggage but have airport style trolleys to carry luggage, no doorman to open the door but have sliding doors and no room service. There are coffee and tea making kits with electric kettle in the room. There is a vending machine in the lobby which dispenses snacks, drinks, soap, and toothpaste. For water, there is a Water Purifier in the restaurant where guests can fill their own bottles. All this helps

the hotel to keep the cost low and pass on the benefit of the same to the customer. Guiding principle behind the concept of this chain of hotels is to meet the key needs of today's travelers at affordable rates or in other words provide complete value for money to the guests. Launched in 2004 in Bangalore, today they have presence in more than 20 cities in India and are extremely popular amongst both the Business travelers as well as the leisure travelers. The ICHL group is the first to come up with this new concept but is soon to be adopted by other Hotel groups.

**Emergence of "Service Apartment"**- The boom in IT and ITES services in India popularized the concept of Service Apartments in India, specifically in cities like Bangalore, Chennai, Pune and suburbs of Mumbai which are the major IT hubs. The concept essentially is borrowed from US and South-East Asia. These are more like transit homes for employees and associates of companies visiting a city or country on short term assignments. These apartments most of the services provided by hotels like laundry services, room cleaning service, food delivery services etc. but at a much lower cost than the hotels. Not only real estate builders and building such service apartments, but even 5 star hotels have these apartments for the elite customer segment. Now days, even NRIs who have properties in

India convert their apartments into Service Apartments and lease it out to companies.

**Bread and Breakfast Scheme**- Keeping in mind the forthcoming Commonwealth Games in Delhi in 2010, department of Tourism is going the western way to accommodate the tourists visiting Delhi during that time. Government of India has launched the scheme of Incredible India Bed and Breakfast where in private property owners will welcome tourists to their home. This will help guests experience the home hospitality as they will be staying at the host's place more like a member of the family. And Guests will also get an opportunity to learn about the local culture. This turns out to be an economical option for tourists and also provides a source of income for the local residents. Concept of BnB has been very popular in European countries and even USA and has come to India only now but is gaining popularity in other cities apart from Delhi. Tourism department of India estimates to have around 3000 "Incredible Bed and Breakfast/Homestay" units to be ready for the Commonwealth Games.

**Customer Experience as a key driver** – Hospitality Industry is known for its service culture. But the customer needs are ever increasing. Yesterday's delighters are mandatory today.

The ability of an organization to convert a first time visitor to be your regular guest directly drives loyalty and profitability. Customer's Journey right from reservation through stay and departure are all opportunities to build loyalty. Mapping the journey of customer's through their life cycle to identify what values they expect in each interaction, barriers and gaps to deliver the values can be really helpful.

Each interaction with customer is an opportunity to build loyalty. It can be extremely difficult to track the preferences of all your customers. But Information Technology has really made it possible to collect instant information on customer preference and retrieve this information anywhere in your group properties at the click of a button. Customer Interaction Tracking Tools are available today to accomplish this.

**Happy Customers, More business!** – Measuring Customer Satisfaction is not new to this sector. But how many of your satisfied customers recommend you to their family & friends. Net Promoter Survey is robust mechanism to track many really promote you.

**Process Centric Culture** – Traditionally viewed as something to do with factories and offices, the concept of viewing everything as a process has really caught up in the Hospitality sector too. Identifying the key performance indicators, measuring performance and bridging gaps with

improvement plans is the only way to drive this culture. Linking performance incentives to these key drivers does help in this journey. Implementation of philosophies such as Six Sigma and 'Lean' in Hospitality is increasing day by day. Reducing customer wait times, profitability at menu level, wastage reduction, inventory management, process quality and inspection are practices used by some of the best brands such as Ritz Carlton, Marriott and fast food chains such as McDonalds, KFC, etc.

**Ecotel Hotels-** Being Eco-friendly is the new buzzword in any kind of industry today, be it a manufacturing, airlines or hotel industry. Not only are the companies sensitive toward environmental issues but even the consumers prefer to go the greenway. Environmentally sensitive travelers are one of the fastest growing segments in the Travel and tourism industry. Hence hotels are also taking initiatives that are environment sustainable. Environmental friendly initiatives not only help hotels to save money and resources without compromising on quality but also increase their popularity. The Orchid Hotel is the first 5-star ECOTEL (1997) in Asia. It showcases eco-friendly business practices that can be replicated in hospitality industry. Even though there are only 5 hotels in India which are ECOTEL certified, more and more hotels are applying to be one.

## **Integration of E-commerce with hospitality**

**Industry-** The development of information technology and electronic commerce (E-commerce) has led to great changes in the hospitality industry. Primarily it has made information gathering much easier for customers and hence increased the competitiveness amongst the players. Customers can now not only do the booking online but can also get reviews about the hotels, do a virtual tour of the hotel and do comparison shopping for the best deal. Online sites like Tripadvisor allow customers to know about the positive and negatives about a hotel before deciding to book. Meta search products like makemytrip or Travelocity searches for the best deal for the customers. To survive this cutting edge competition, hotels are now tying up with airlines, travel agents, car rentals etc for packages for not only the tourists but also groups, MICE as well as wedding promotions. This is expected to help ease recessionary cascading effects.

## **Future Outlook**

Even though the hospitality industry saw a steep decline in revenues in the FY 2008/2009, the long term growth seems to be stable. Despite a dip in occupancy rate and RevPAR in most of the cities in India in 2008/2009, overall impact on the industry was not as bad as compared to US or other western countries. Various initiatives taken by the Ministry of

Tourism to increase demand and towards bridging the gap between demand and supply are going to positively impact both Tourism Industry as well as the hospitality industry. The forthcoming Commonwealth games in Delhi in Oct 2010 are expected to give the industry a good boost. Infrastructure development like improving connectivity of tourists places through road or railways, privatization of airports are also going to help in attracting international as well as domestic tourists. Campaigns like Incredible India or Visit India year are helping in creating awareness about the Indian Tourism. The emergence of middle class as strong customer segment is going to govern the future trends of the industry. Developments in Tier II and Tier III cities have put these places in map of hospitality sectors. All these positive factors are going to open up lot more opportunities for the SMEs who form the backbone of the tourism and the hospitality industry.

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