Hotels in India: Short-Term Pain and Long-Term Gain?

As demand continues to outpace supply, how can travel buyers make the best deals?

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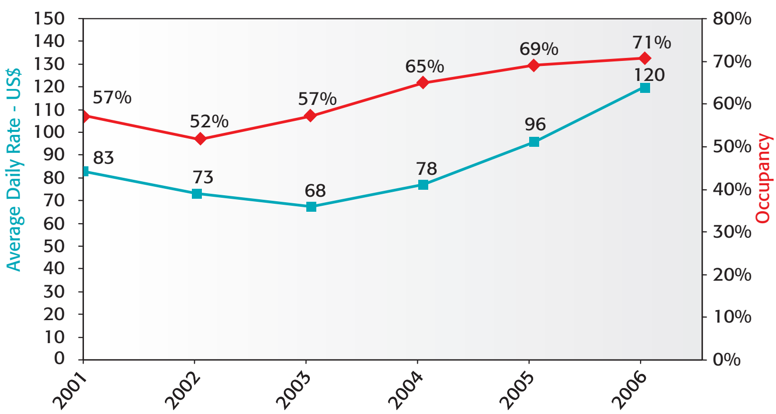
The strength and speed of the booming Indian economy have been well documented in recent times, with growth fueled by foreign investment and off-shoring, as well as significant expansion of the domestic economy. The World Economic Forum forecasts that the Indian economy will continue to grow by between 8 percent and 10 percent in the next five years, with trade earnings reaching US$10 billion in 2007, up from US$6.5 billion in 2006.

At the same time, the very growth that is bringing optimism to India is placing strain on the country's infrastructure, and in particular airports and hotels, where **supply is overwhelmed by demand.** Evidence of this is in hotels' operating performance since 2001, which features double-digit increases in occupancy rates (up from 57 percent to 71 percent) and average daily rates (44 percent higher).

Occupancy and average daily rate evolution – Indian hotels



Source: CWT Travel Management Institue, HVS International

This article lists the key questions companies are asking about hotels in India and suggests strategies and tactics for approaching hotel sourcing in the market.

The key questions surrounding hotels in India today are:

1. Is the supply/demand equation going to change, and if so, when?
2. How will hotel buying conditions evolve for companies?
3. Which strategies and tactics will enable companies to obtain the best rates and conditions?

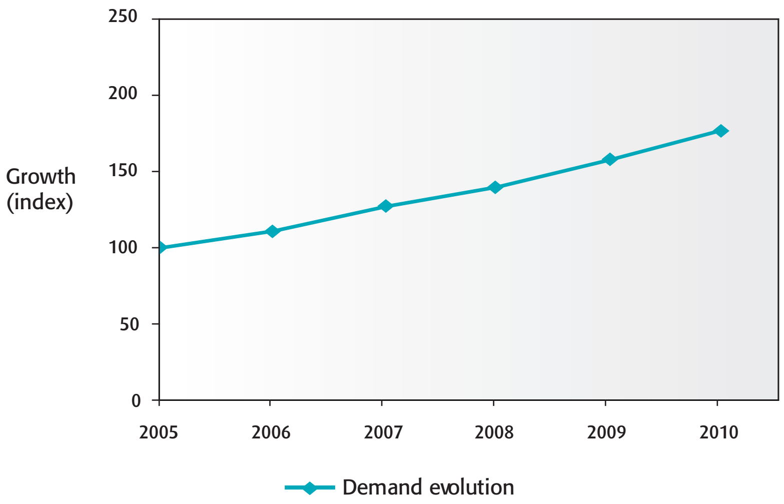
Demand

Hotel demand is mainly driven by two factors: international arrivals and domestic travel in India.

- International arrivals are forecast by the Indian government to increase from 4.4 million in 2006 to 6.4 million in 2007 and 10 million by 2010.
- Domestic passenger numbers are forecast to increase from 30 million in 2006 to 35 million in 2007.
- Looking further ahead, core demand will be boosted by the Commonwealth Games in New Delhi in 2010 and the Cricket World Cup in India in 2011.

The impact of increasing visitors and domestic travelers is naturally reflected in higher demand for hotel rooms. According to Crisil, an India-based rating, research, risk and policy advisory services company, **demand should grow by 15 percent in 2007 and continue at this annual rate up until 2010.** This compares to an already impressive 11 percent increase in 2006.

Demand evolution



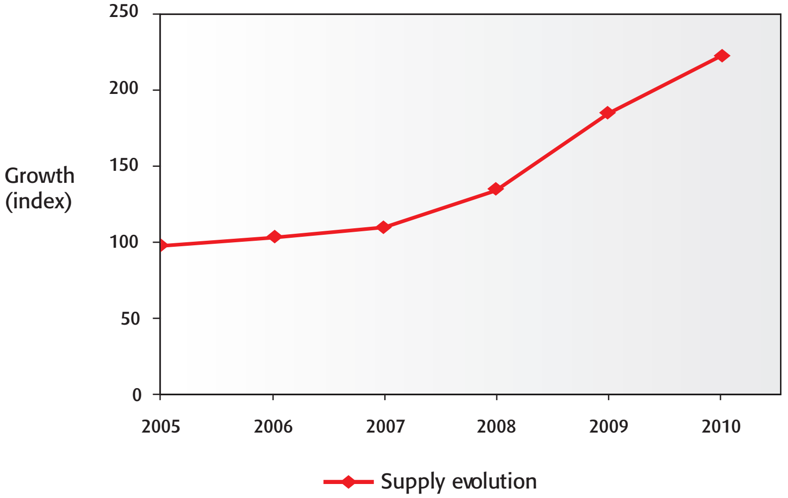
Source: CWT Travel Management Institute, Crisil
Analysis based on 24,000 rooms in 315 hotels across 10 cities

Supply

The historical undersupply of rooms has been a key driver of the Indian hotel market. It is only within the last three years that the main global chains have made significant plans to expand their presence in India.

According to market data from HVS International, a U.S.-based hotel consulting and valuation services company, supply should **grow by 7 percent from 2006 to 2007,** compared to a 4 percent increase from 2005 to 2006. Growth should accelerate sharply, with an annual average rate of up to **26 percent between 2007 and 2010.**

Supply evolution



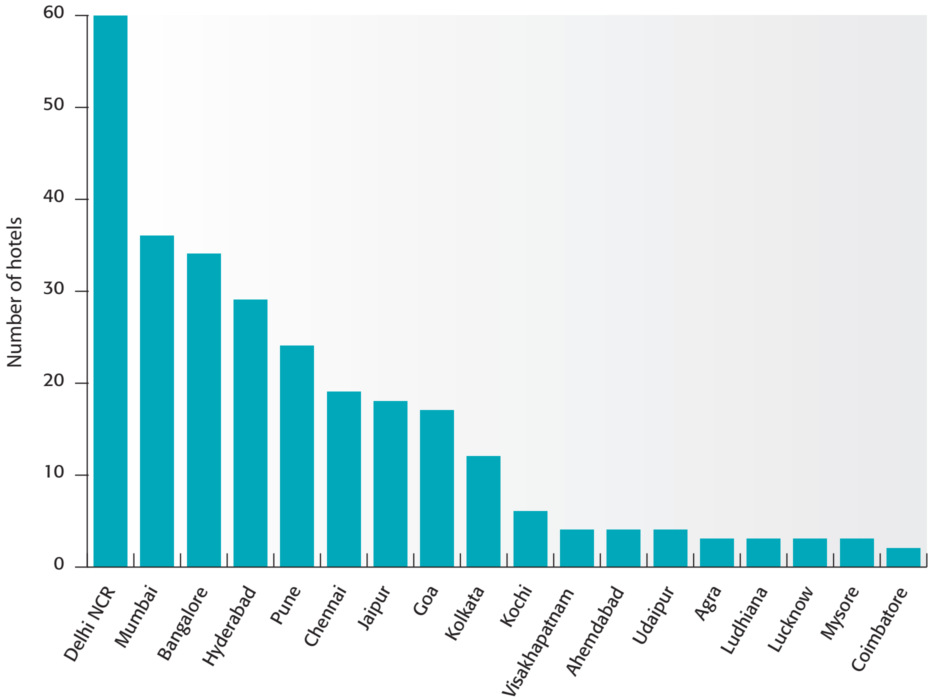
Source: CWT Travel Management Institute, HVS International
Analysis based on 62,055 rooms in 1,151 hotels across 30 cities

Today, 281 new hotels are under development and due to open over the next 10 years. These projects include the following:

- Hilton hotels will build 75 hotels in 10 years with local partner DLF Ltd.
- Accor Hotels will develop 100 hotels with local partner Emmar MGF over the next 10 years.
- Choice Hotels plans to set up 30 budget hotels in the next five years.
- Ramada Hotels will build at least 10 hotels with a local partner.
- InterContinental Hotels Group will open eight hotels in the next five years.
- Marriott will open eight hotels in the next five years.
- Starwood will open five hotels in the next five years.
- Hyatt Hotels will open four hotels in the next five years.
- Fifty other hotels are due to open in the next 10 years.

New hotels will be concentrated in 18 main cities over the next 10 years, as shown in the following chart.

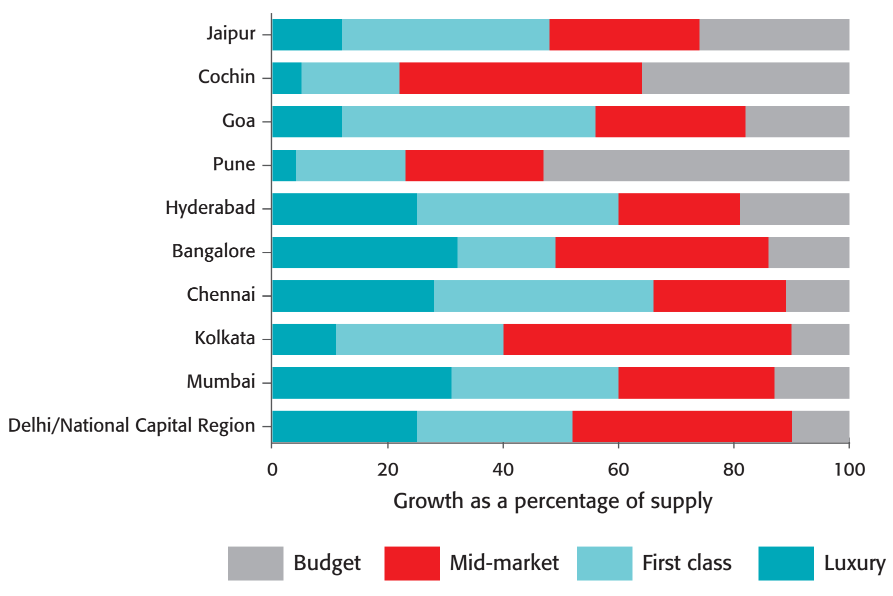
New hotel developments by location



Source: HVS International

Between 2007 and 2010, supply will increase in all categories of hotels, as shown in the chart below.

New hotel developments by location and by category



Source: HVS International

Demand and buying conditions

Based on a combined view of supply and demand, market conditions for corporate room availability, rates and conditions look set to **remain challenging through 2007 and into 2008** when significant supply will start to enter the market.

Static supply, coupled with the forecast increases in demand, will dictate double-digit rate increases in 2007. Lack of available rooms will be an ongoing concern throughout the year.

Negotiations will remain tough in 2007:

- Hotels will carefully consider participating in negotiated corporate hotel programs. Many will choose not to offer negotiated rates in 2007, leading companies to buy at the best available rate on the day of booking.
- Contract terms and conditions will change: last room availability rates and room allotments will remain elusive.

Recommendations

CWT therefore recommends the following strategies and tactics:

- Advance purchasing or booking should be companies' top priority as this improves the likelihood of room availability, while optimizing the chances of obtaining the best possible rates.
- When completing negotiations with hotels, local buyers or resources should be used to leverage relationships and local market knowledge.
- Alternative accommodations, such as guesthouses and apartments, should be considered alongside regular transient hotels.
- Companies should ask hotels to take a longer-term view, by employing multi-year rates and agreements, leveraging the fact that growth in supply is forecast to overtake growth in demand by 2008 to 2009.
- Travelers to higher-demand cities may be required to fly in and out on the same day during high-occupancy and sold-out periods.
- Corporate housing may be leased on 12-month contracts as a stop-gap solution until supply increases.
- Companies should ask for no cancellation or retention charges for all bookings cancelled more than 24 hours before arrival. ■