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FINDING ELBOW ROOM

Business is down, but hotel chains are working out new ways to keep growing. By MANU KAUSHIK

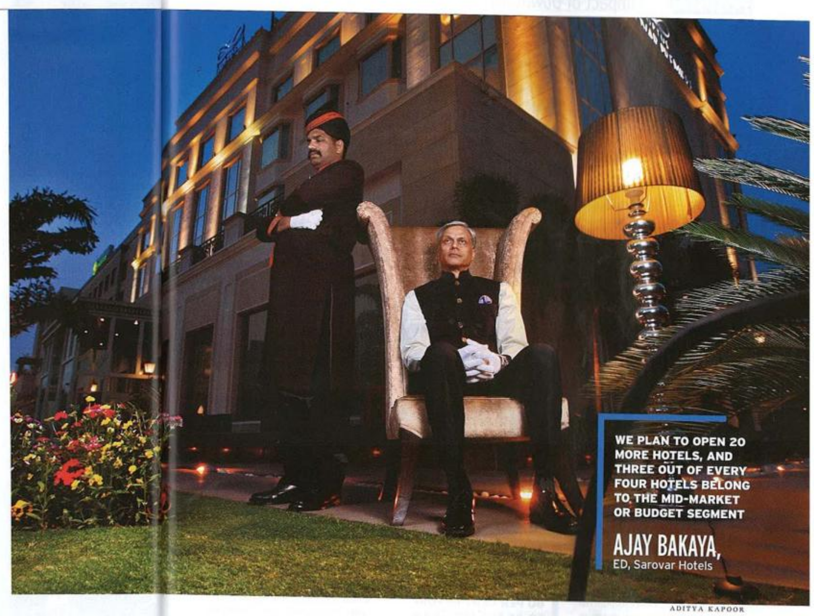
A soothing whiff of lemon greets visitors at the new corporate office of Lemon Tree Hotels in Aerocity, near Delhi's Indira Gandhi International Airport. The office moved here recently from a non-descript building in Okhla Industrial Area, some 20 kilometres away. The snazzy interiors, friendly staff and trademark citrus aroma give no indication of the tough times the hotel chain has been going through.

Aerocity, built as part of an airport modernisation drive, has a Lemon Tree Premier and a Red Fox, both brands of the Lemon Tree chain. The two hotels have a total of 487 rooms. Lemon Tree Chairman and Managing Director, Patu Keswani, has been grappling with airport authorities' objections to the location of these two hotels, among 14 others. "We are waiting for a clearance from authorities," he says. "Till then, the hotels can not be operated. Together, all the hotels have spent over ₹10,000 crore in Aerocity."

Located between Terminal 3 and Terminal 1D of Delhi's international airport, the two Lemon Tree hotels abut an airfield used by heads of state and security agencies. While security agencies take time to figure out a solution, the two hotels lose money daily. But this is not Keswani's only worry – his bigger concerns are falling occupancy, rising expenses and slower income growth. His experience of 11 years in the hospitality sector is of little help in dealing with problems rooted macroeconomic realities. The best he can do is try to fix the other problems.

His thinking reflects a rising trend in a sector struggling with slow demand growth and debt. Hotel industry experts say domestic chains are following in the footsteps of global ones in this regard. "Building hotels is very capital-intensive," says P.R.S. Oberoi, Executive Chairman of EIH Ltd, the flagship company of the Oberoi Group, on e-mail. Hotel chains stay asset-light by signing management contracts with real estate developers. The developer builds the hotel, and the hotel chain runs it for a management fee.

When *Business Today* met Keswani early last year, he was opposed to management contracts, and said it was difficult to get developers in India to build to Lemon Tree's specifications. "In order to build a brand, you need to have consistency in the



ADITYA KAPOOR

EMPTYING OUT

Room occupancy has been declining

	2007/08	2008/09	2009/10	2010/11	2011/12
Room supply	46,982	48,475	61,795	71,531	84,313
Occupancy	68.8%	59.5%	59.5%	60.6%	59.1%

Source: HVS

www.businesstoday.in/hotel-occupancy

"product," he had said. At the time, he had plans to build and manage his own hotels. But in a few months, his opinion changed. In the middle of last year, he formed a joint venture with former Trident Hotels chief Rattan Keswani to manage hotels. "We will add 5,000 rooms under the management contract by 2016/17," says Keswani of Lemon Tree, which currently owns 2,500 rooms on 20 properties.

Except ITC, no Indian hotel company is putting in money, says Kaushik Vardharajan, Managing Director of hospitality consultancy HVS India. "There is enough pressure on their books already." He is referring to the huge pile of debt on hotels' balance sheets. ITC is an exception as its other group businesses generate enough cash. But in the past year, three chains – Hotel Leelaventure, Mumbai-based Kamat Hotels and Gujarat-based Neesa Leisure – have gone for debt restructuring.

Hotel Leelaventure, with ₹4,550 crore of debt, sold its Kovalam luxury hotel in 2011 to Travancore Enterprises for ₹500 crore, and now only manages it. In November last year, it tied up with real estate player Supertech to manage two more hotels, in Noida and Jaipur.

The Oberoi Group has also been signing management contracts rapidly. Until about last year, it had just one managed property, and owned the other 26. Today, it has two managed properties (Trident Gurgaon and Oberoi Gurgaon), and two more in the pipeline (Trident Hyderabad and Oberoi Dubai). EIH's Oberoi says the chain will be signing more management contracts as "the company does not have to invest its own capital in expanding the chain".

The hospitality sector's problems began four years ago, when demand started slowing down. Given the two-year time lag in the business, hotel chains continued with expansion plans for a while before the slowdown became apparent. By 2012, the total branded available rooms across the country exceeded demand by a huge margin. Average occupancy rates for branded hotels stood at a dismal 59.1 per cent in 2011/12. In 2012/13, HVS India expects occupancy to have been around 60 per cent.

SHEKHAR GHOSH

OUR PROFITABILITY IS DOWN FROM 60 PER CENT IN 2010 TO 40 PER CENT NOW DUE TO INCREASE IN OPERATING COSTS

PATU KESWANI
CMD, Lemon Tree Hotels

Demand has slowed because of the current economic downturn. When conditions improve, experts say, demand will exceed supply by a huge margin. Seen in global perspective, India is still an underserved market. Shanghai city alone had more hotel rooms than all of India in 2011. This is why hotel chains are still expanding, albeit slowly.

But slower growth in demand and debt repayment issues have made banks cautious about lending to the sector. "Five years ago, banks did not really understand the sector well," says HVS's Vardharajan. "Now a lot more due diligence happens before money is lent. Not just becoming more conservative – from lending some 70 per cent of the total project cost four years ago to less than 50 per cent now – the focus has entirely shifted away from promoters' background to project fundamentals."

Trying New Models

As the market becomes shaky, several realty developers and hotel chains are looking at models such as mixed-use development and double-brand strategy.

Mixed-use or integrated development refers to large-scale projects that include residential, retail, hospitality, corporate office and entertainment in one large complex. The model is not new, but the last three years have seen the rise of some big mixed-use projects in metros, such as a Sheraton hotel that is part of the World Trade Centre in Bangalore, a Westin that is part of Mumbai's Oberoi Garden City, and ITC Grand Chola, Chennai's largest hotel.

Oberoi Garden City, for example has three residential blocks, a 32-storey office building, 550,000 square feet of retail space, a hotel and an international school, spread over 80 acres. "The model allows developers to spread the risk across different formats," says Dilip Puri, Managing Director (India) of Starwood Hotels and Resorts, which manages the Westin there. "For hotels, it gives them a captive catchment, which translates into better footfall and revenue."

Puri says Sheraton Bangalore, which was launched in 2011, has a 20 per cent higher RevPAR than other upscale hotels in the city. RevPAR (revenue per available room) is a commonly used performance indicator calculated by multiplying a hotel's average daily room tariff by its occupancy rate.

Oberoi Realty, builder of Oberoi Garden City, is finalising a hotel operator for another mixed-use project in Worli in central Mumbai. Another developer, Logix Group, has tied up with Hilton Worldwide for a six-acre integrated project in Noida, near Delhi.

Hilton has pioneered double-brand development. Its Hilton and DoubleTree hotels stand side by side in Mayur Vihar in East Delhi. "Both are catering to different markets," says Rajesh Punjabi, Vice President (Development) at Hilton Hotels. "Our Hilton brand is a notch higher than DoubleTree in terms of price. The idea is to attract two customer segments in the same locality."

Others have followed, including Lemon Tree, with its Lemon Tree Premier and Red Fox hotels in Aerocity. The InterContinental Hotels Group (IHG) is close to signing a similar deal with a land developer, where it will have Crowne Plaza and Holiday Inn Express in the same complex. Douglas Martell, IHG's Vice President (Operations), South West Asia, says that building two brands in close proximity helps save up to 35 per cent on costs, because of shared services.

With land costs rising and latent demand for value-for-money hotels, the sector is moving away from luxury to mid-market and budget hotels. According to HVS India, over 55 per cent of the pipeline consists of budget and mid-market hotels.

IHG, for example, has four brands in India. It has plans to open 47 new hotels by 2017, out of which 40 will be mid-market brands such as Holiday Inn and Holiday Inn Express, and the rest will be upscale and luxury brands such as Crowne Plaza and InterContinental.

Home-grown chain Sarovar Hotels & Resorts, too, is looking at this segment. "We plan to open 20 more hotels, and three out of every four hotels belong to the mid-market or budget segment," says Ajay Bakaya, Executive Director. Not only is the capital cost relatively low, he says, but the segment also suffers the least when the market is down.

At a time when everything in the sector has registered negative growth, two most important cost components – staff salaries and utility costs – have gone through the roof. "In the past two years, inflation has grown faster than the average room rates, which has eroded profit margins of hotel chains," says Subrata Ray, Senior Group Vice President at ratings agency ICRA.

Lemon Tree's Keswani says: "Our profitability is down from 60 per cent in 2010 to 40 per cent now, due to increase in operating costs." His company, which has opened six hotels in the past 18 months, has been smart, though. Its hotels are designed so that entire floors can be shut down if demand drops. "Unlike other hotels, the air-conditioning and water lines are horizontal in Lemon Tree," he says. "Also, I don't put in carpets. If there are carpets, the moment air-conditioning is off, the carpets stink." These things help him control staff and energy costs.

Global hotel chain Accor, too, strictly controls energy expenses through dedicated implementation of preventive maintenance plans, and by cracking down on energy leakages. "We have been able to save some five per cent on energy costs on account of these initiatives," Jean-Michel Cassé, Senior Vice-President, Operations, Accor India.

Another innovation to minimise expenses is kitchen placement. All IHG hotels in India have kitchens on different floors, but its Holiday Inn in Aerocity will have all the kitchens on a single floor. Now that is an innovative cost-cutting recipe. ◆

THE PROBLEM

With the downturn, occupancy remains low

Operating costs have risen 20 to 40 per cent in the last three years

Land prices are up, stymieing expansion plans

THE WAY OUT

Invest in the mid-market and budget categories, where reaching break-even point is relatively quick

Try new business models such as mixed-use development, or build two hotels catering to different categories in the same complex

Cut down on costs through better design and better utilisation of manpower

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