

# China Hospitality Study: Unlocking the Market Potential in China



This detailed study uses primary and secondary channels to create a granular picture of the China hospitality market, including:

- A review of historic sector spend and an analysis of expected spend till 2013 by branded hotel segment
- **Future headroom for each hotel segment** in China over the next 10 years with an analysis of what Asia Now believe to be the **key variables** that will determine upside growth opportunity
- **Profitability** of different hotel segments in China. What really drives overhead costs in China and what does this imply for **future development?**
- **Drill down into 20 key cities with an detailed analysis of each from an operating perspective and an appreciation of local market dynamics**

An analysis of the strategies hotel players should leverage to unlock market potential in China and achieve sustainable growth.

# China Hospitality Study

Unlocking the Market Potential in China

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February 2009

## China Macro Variables

### Economy

China's economy will be larger than Japan and Germany combined by 2018. The stimulus package will help maintain short term growth. China's urban population will be close to one billion by 2025. Development will be concentrated in four key clusters. The number of high income urban households will rise to 41 million by 2025. Consumption patterns will change as incomes rise. The government plans to make significant investments in improving the rail, road and airport infrastructure between now and 2020. The government's vision to 2020 is centered on raising per capita incomes. The high degree of state control poses risks for companies.

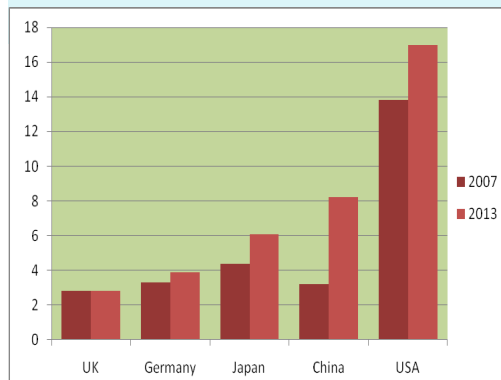
China's economy is the world's fourth largest in nominal US\$ terms and has been growing more rapidly than other large economies. China will be the second largest economy by 2013 in nominal US\$ terms because of rapid growth and the appreciation of the Renminbi. China's economy is

likely to be larger in nominal US\$ terms than Japan and Germany put together by 2018.

Real GDP growth is forecast to slow but is still expected to be in the high single digits over the next five years. Net exports will make a small negative contribution to growth since imports will grow faster than exports. Domestic demand is expected to remain strong – private and government consumption are both expected to grow at around 10% per annum. Gross fixed investment growth will average a respectable 8.5% per annum because the government will raise infrastructure spending to counterbalance the expected fall in corporate capital spending. Industry (49% of GDP) is expected to grow at 8% per annum and services (40% of GDP) at 9.5% per annum. The Chinese government's 4 trillion yuan stimulus package should help maintain growth at 7.5-8% in 2009 and 2010. The key risk to growth is that private consumption spending will slow more than expected

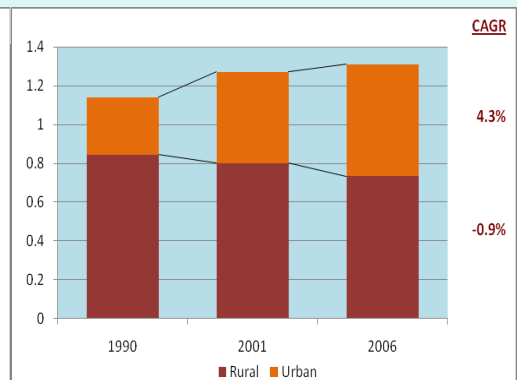
*China's economy is the world's fourth largest in nominal US\$ terms and has been growing more rapidly than other large economies. China's economy is likely to be larger in nominal US\$ terms than Japan and Germany put together by 2018.*

**Chart 1.1. GDP At Market Prices (US\$ Trillion, 2007 and 2013)**



Source: EIU

**Chart 1.2. China's Urbanization Development Between 1990 - 2006**



### Urbanization

The urban population has increased from 296 million to 576 million (from 26% to 44% of the total population) between 1990 and 2006.

China will have an urban population of 926 million by 2025. Mega cities and midsized cities will increase their share of the urban population. China's top cities will be eco-

nomic powerhouses by 2025. Shanghai and Beijing will each be about three times as large as Singapore today. China's economic reform policy has led to the establishment of special economic zones open to the outside world. The Bohai, Yangtze Delta and Pearl River Delta clusters were the first to develop. The Western Key Area is now following the same path. The Bohai cluster is resource rich. The main economic driver for the other three clusters is manufacturing

### Infrastructure

The government plans to make significant investments in improving the rail, road and airport infrastructure between now and 2020. By 2020, China will have over 120,000 kms of railway lines of which more than 10,000 kms will support high speed railways and most major cities in China will enjoy excellent railway connectivity. Government plans call for the road network to be increased to 2.5 million kms, including 70,000 kms of highways, by 2020. Key hubs for the national road system will include Beijing, Shanghai, Changchun, Shenyang, Dalian, Jinan, Guangzhou, Chengdu and Xian. 97 new airports will be built in China before 2020 to meet increasing demand, as passenger traffic will grow by 11.4% annually to 2020. By 2020 China will have 244 airports dispersed in the Northern, Eastern, Central, Southern and Western regions

### Government

China's 11<sup>th</sup> and 12<sup>th</sup> Five Year Plans and 2020 vision emphasize increasing per capita GDP, developing the four key economic clusters, and putting greater emphasis on innovation

11<sup>th</sup> Plan. Double 2000 per capita GDP by 2010 and develop Western region

12<sup>th</sup> Plan. Further develop four key clusters and emphasize innovation more

2020 Vision. Quadruple 2000 per capita GDP by 2020 and raise R&D spend to 2.5% of GDP

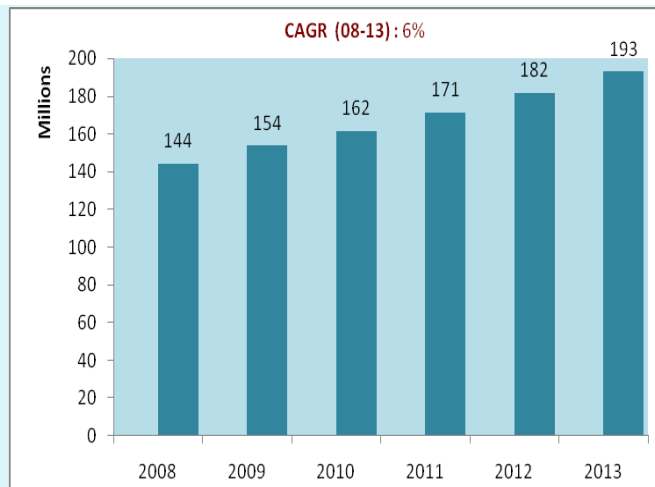
## China Consumer and Travel Flow

### International Travelers

The number of international travelers will increase at 6% per annum, from 144 million in 2008 to 193 million in 2013. 59% of international arrivals are for day trips, with Hong Kong, Macau and Russia accounting for the bulk of these. Non day trippers are mostly from Asia, with Japan, Korea and Taiwan being most important.

China is the most popular destination for Hong Kong outbound travelers and continues to dominate outgoing tourist spending. China also accounts for a large share of outbound trips from Taiwan. China accounts for 22% of outbound travel from Japan and 17% of total spending by outbound travellers. China accounts for over 30% of South Korea's outbound market with travel to China being mainly business related. A detailed look on the profile of these travellers country based on expenditure, method of transport, length and purpose of departure is included in the report.

Chart 1.3  
Forecasts for Total Foreign Arrivals (Millions)



*“The number of international travelers will increase at 6% per annum, from 144 million in 2008 to 193 million in 2013.”*

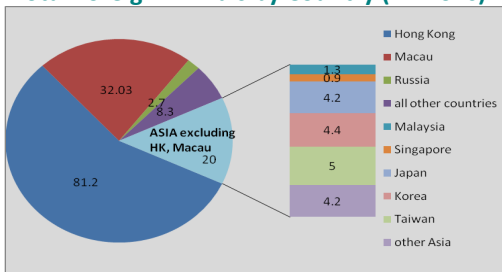
## Domestic Travelers

The number of domestic travelers has been increasing rapidly and is expected to continue to do so. Total spending by domestic travelers is expected to more than double by 2013. Major spending components are shopping, accommodation and food. The most popular destinations for domestic travelers include Guangdong, Beijing, Shanghai, Jiangsu and Zhejiang. Domestic travelers are evenly split by gender and are mostly below 50. Buses and trains are the most important modes of travel, but air travel is growing in importance and will continue to do so. The number of domestic air travelers is growing at about 5% per annum. Changing lifestyles and falling airfares are contributing factor. Cities with the busiest airports and the largest number of relatively affluent inbound travelers include Beijing, Guangzhou, Shanghai, Shenzhen and Chengdu.

Cities with the busiest airports and the largest number of relatively affluent inbound travelers include Beijing, Guangzhou, Shanghai, Shenzhen and Chengdu. (report contains the a ranking on China's busiest airports based on the total arrivals)

Chart 1.4

### Total Foreign Arrivals by Country (Millions)



Source: PATA Report

**Domestic Travelers Statistics, Demographics and Preferences.** Our source, BDRC report which provides a comprehensive research on China's domestic business travelers profile and ranking of top branded hotels shows that business domestic travelers are mostly male and below the age of 44. Most domestic business travelers travel 6-10 nights a year and have been traveling for 5 years or less. Do-

mestic business travelers have a tight budget. A significant proportion of them influence the choice of the hotel they stay in comfortable bedrooms, good security and excellent service are key attributes that Chinese business travellers look for in hotels. Intercontinental, Ramada and Shangri-La perform well on the top attributes in choosing a hotel. Shangri-La, Hilton and Holiday Inn are ranked highest among hotel brands in China by business travellers in China. They are also the best known brands. Chinese travellers are most likely to recommend Marriott, Sheraton, Jin Jiang and Shangri-La to fellow travellers

## China's Hotel Landscape

This section describes the likely evolution of the hotel industry in China over the next five years. We have focused on the branded room supply since this is not. The main sources of information used are the Northstar database, and external reports from providers such as Horwath, Euromonitor and Mintel. These sources have been used to build an understanding of the current hotel landscape and the pipeline. We have also built a proprietary model that has been used to project changes in supply, demand, occupancy rates, ADRs and RevPar rates over the next five years.

Room supply is projected to grow 8.4% per annum under the base case, with total rooms increasing from 285,000 in 2008 to 427,000 in 2013. The upper upscale and upscale segments will grow faster than the market and will increase their share of total room supply. A marginal increase in the share of tier 2 and 3 cities, as well as tier 1 cities with the exception of Beijing and Shanghai is likely. Overall room rates will increase, but supply additions will keep the increases to below the rate of inflation. Overall occupancy will fall marginally. Upper upscale and upscale occupancy will fall while midscale and budget occupancy will rise.

A detailed picture of each segment's ADR and Revpar, competitors current supply, occupancy rates and total headroom for 2013 is included in this chapter.





### Longstay

Serviced apartments are evenly split between branded properties run by international operators and locally owned properties. Almost half of rooms are in properties with 150-299 rooms. Properties with less than 150 rooms also have a large share. Shanghai, Beijing and Guangzhou account for most of China's serviced apartments. Other markets are beginning to develop. Serviced apartments have lower room rates and higher occupancy rates than hotels in Beijing and Shanghai reflecting their long stay focus. International operators with a significant presence include Ascott, Shangri-La, Starwood and Oakwood. International groups that plan to expand include Fraser, Ascott, Somerset and Oakwood. We have included a profile of each of these longstay players that gives details on the brands they own, announced strategies, current presence and pipeline.

### International Hotel Management Companies in China

We also included a profile of each of these biggest players which gives a detailed look on the brands they own, announced strategies, current presence and pipeline. Brands in this chapter include Starwood, Accor, Hilton, Hyatt, Marriott, Wyndham, Shangri-La, Kempinski, Best Western, Intercontinental and Carlson. Also included are huge domestic companies such as JinJiang, Home Inn and Motel 168. Our findings include Starwood is expanding rapidly in China. It plans to double its portfolio there by 2011 and introduce all of its 9 brands to this market, Hilton has a small presence but plans to expand across market segments and price points, with special focus on the upper end of the market.

**“Starwood is expanding rapidly in China. It plans to double its portfolio there by 2011 and introduce all of its 9 brands to this market.”**

“Long term prospects in China remain very positive, with economic growth, inbound international travel and domestic travel all set to

## Hotel Ownerships in China

SOEs and the domestic private sector each had a share of almost 50% in hotel ownership in 2005. The SOE share has probably fallen marginally since then.

Large SOEs outside the hospitality sector are divesting their hotel portfolios. China Post, which is probably the largest hotel owner among SOEs, is in the process of divesting its hotel assets. Owners in China typically own 1 hotel and are private sector organizations.

Table 1.1  
Hotels in China by Ownership Profile, 2006

<b>State-owned</b>	<b>5528</b>
Collective	x.x
Partnerships	x.x
Limited Liability Corporation	2000
Private enterprise	x.x
Domestic others	x.x
<b>other Domestic-owned</b>	<b>5730</b>
HongKong and Taiwan	x.x
Foreign investors	x.x
<b>Foreign-owned</b>	<b>570</b>

Source: Mintel

## Issues and Opportunities

Long term prospects in China remain very positive, with economic growth, inbound international travel and domestic travel all set to rise. The risk associated with smaller second and third tier cities is high since the market takes longer to adjust to additions in supply. There will continue to be an imbalance between total room supply in Upper Upscale and Upscale and their share of total demand. Room rates are likely to fall in real terms since they are likely to increase at less than the inflation rate over the next five years. More competition will lead to lower occupancy rates and low ADR and RevPar increases, making it difficult to maintain GOP and CTP levels. Maintaining profitability will be challenging, especially in some cities - including Guangzhou and Chengdu - which face a supply overhang. Older hotels may find themselves competing with local 5 star hotels since they may find it hard to compete with new international hotels.

“Maintaining profitability will be challenging, especially in some cities - including Guangzhou and Chengdu – which face a supply overhang.”

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