

**HONG KONG HOTELS ROOM RATE STUDY
FOR
THE FEDERATION OF HONG KONG HOTEL OWNERS LIMITED
JANUARY 2003**

1. INTRODUCTION

Horwath Asia Pacific (HAP) was engaged by the Federation of Hong Kong Hotel Owners (the "Federation") and its members to conduct a study on the current low hotel room rates (and hotel profitability) in Hong Kong, despite relatively healthy average occupancies by world standards.

In an effort to improve room rates, we have been engaged to conduct a study which focuses on 2 main areas:

1. Detrimental pricing practices employed by hotel managers and/or owners and possible malpractices employed by travel agents.
2. Analysis of whether current room rates cover operating costs and their impact on investment returns.

These topics are covered in the following sections of the report:

2. EXECUTIVE SUMMARY

The following is a brief summary of our main findings on the causes behind the weak room rate situation in Hong Kong and our recommendations of possible solutions. Please note that this section is a summary only and it should be read in conjunction with the main part of the report for a full and proper understanding of the issues raised.

2.1 MAIN CAUSES BEHIND WEAK ROOM RATES

Growth Of Group Business From China

In the last 5 years low rate guests from China have grown from a minor segment in hotels to up to 33 percent of demand at Medium Tariff hotels while previously high rate business from Europe and Japan has decreased. Average rates for group business from China at Medium Tariff hotels is between HK\$ 250 to 300 – a level which is barely breakeven at occupancies of 70 to 80 percent.

Corporate Account Problems

- **Corporate budget cuts** - Corporate accounts are implementing cost saving efforts such as downgrading hotels, demanding rate decreases from properties and, demanding flat room rate quotes for all room types.
- **Reverse auctions** - In the last 12-24 months, many corporate accounts have also introduced reverse auctions where the hotel with the lowest rate bid wins the account.

Travel Agent Related Problems

- **Power of consolidators** – These firms now control large portions of inventory and are therefore able to force hotels to lower rates with threats of withdrawing all business if the properties do not comply with their demands.
- **Consolidators encroaching on FIT business** – Whereas in the past travel agents were typically quoted two very distinct group and FIT rates, many hotels are now quoting a single rate to consolidators who are then, as a result, taking what are effectively groups rates into the local corporate and FIT markets.
- **Zero based tours** – There has been a proliferation of zero based tours where it is in the operator's absolute interest to squeeze costs including hotel rates as low as possible.
- **Shorter lead times leading to panic** – Agents and consolidators purposely hold back business until as late as possible so that the hotels are faced with imminent low occupancies and are therefore then susceptible to dumping rates to try to win last minute business.

- **Extreme Agent Competition in China** – There has been an enormous growth in agents in China which has led to extreme price competition on packages offered to Hong Kong.

Other Problems

- **Perception of a buyer's market** - From a psychological point of view, it is clearly a buyer's market with travel agents and corporate accounts very confidently going after rate reductions from hotels.
- **Extreme competition from other destinations** – Hong Kong is facing extreme competition from other destinations in Asia . For example, the price of a 7 day tour from China to Thailand can be less expensive than a 4 day tour to Hong Kong.

2.2 POSSIBLE SOLUTIONS

Recommendations For Owners

- **Less of an occupancy focus** – If owners genuinely want to increase room rates, then they need to focus less on occupancy.
- **Renovations** – Many hotels are now aging and, in comparison with international standards, can not realistically expect to drive rate increase without renovation.

Recommendations For Management

- **Having a longer term perspective** - In times of soft demand, management should not drastically cut rates in order to try to gain business as once rates are lowered, it is much harder to raise them again when business begins to improve.
- **Re-instating stricter rate definitions** – Standard industry contract clauses and definitions should be re-developed such as strictly defining groups as at least 8 (or more) people all arriving and departing at the same time with no shortening of stays and also adding restrictions such as extra charges for credit and, amendment and cancellation penalties.
- **Remove Conflicts in Sales Teams** – Hotels need to remove internal competition or conflicts in sales departments where some staff are trying to maximize business with consolidators (which includes possible corporate business) while other staff are focused directly on corporate accounts.
- **Yield management** - Most hotels in the city do not have effective or properly implemented yield management practices or systems. Yield management is an issue that needs to be addressed by most hotels and requires investment in dedicated yield management software and training.
- **Addressing large rate fluctuations** – Huge rate fluctuations on a seasonally and even daily basis are giving Hong Kong an image as being expensive or a "rip-off". This issue requires more skillful management and also better education of the market on the rational behind movements.

Recommendations For Management, Government & the Federation

- ***Developing FIT business from China*** – China business will remain dominant so the key is to accelerate its evolution away from groups to FITs. This will require management to improve Mandarin language capabilities of staff and eradicate rude service; and for government to simplify the permit and visa process which is more difficult than places like Thailand.
- ***Star rating system*** – A proper star rating system driven by the Federation would help hotels with strengths / advantages to demand premiums particularly with the China market (rather than being lumped with lower-tier properties where price is the only factor).

2.3 CONCLUSION

At the end of the day, for room rates to increase, the main issue is for owners to place less emphasis on occupancies and give managers and sales staff more flexibility to implement strategies such as strict group definitions, holding firm against consolidators and implementing yield management. While these actions are likely to cause occupancies to decrease, net operating cash flows should increase in the end as a consequence of the resulting rate increases.

We would also submit that raising room rates is not an issue that can or should be addressed by government unless the industry wants pricing fixing legislation introduced or legislation banning zero based tours which would be difficult to make effective. Rather, in our opinion, all that the government can do to assist with this matter is to continue to make it easier for individual travelers from China to visit the city in terms of visas and permits.