

The Federation of Hong Kong Hotel Owners Position Paper on “Tourism Revival” Recommendations

Introduction:

The downturn in the tourism industry at a time of growth and change in the room capacity of the hotel industry has led to very difficult business conditions for Hong Kong hotels. The hotel industry has done its best to improve efficiencies and cut costs, but continues to be plagued by reduced revenues. Although there has been a slight improvement in tourist arrivals, Hong Kong hotels experienced a fall in room yields between the second half of 1997 and 1998. In the first half of 1999, total tourism receipts fell further by 1.7%, totaling HK\$25.2 billion, despite a strong growth in visitor arrivals.

The average length of stay for visitors to Hong Kong has continued to decline. The average length of stay was 3.7 nights in 1996; 3.6 nights in 1997, and 3.4 nights in 1998.

The shorter period of stay has reduced demand for hotel accommodation and seen a corresponding drop in visitor spending and the economic spin-offs into other sectors. Per capita visitor spending fell 17.6%, from \$6,722 in 1997 to \$5,540 in 1998.

A worrying development is the drop in high-yield visitors from North Asia, North America and West Europe. For example, visitors from Japan dropped by 43% in 1997 and by 31% in 1998. Business visitors in 1998 also dropped to the level of 1993, or down 16% from the peak in 1996.

With the fall in high-yield visitor arrivals, a shorter length of stay and declining visitor spending, it was inevitable that tourism receipts have fallen. Hong Kong's total tourism receipts dropped almost 40% from its peak in 1996.

Difficult economic conditions look set to continue for some time. In view of more hotel rooms coming on stream over the next few years, the hotel industry can hardly be optimistic under this business climate. We sincerely urge the Administration to consider the following measures:

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- Create Hong Kong as a "must see" destination;
- Attract more high-yield visitors, both business and leisure, to Hong Kong;
- Encourage visitors to stay longer;
- Entice visitors to spend more; and
- Entice visitors to return again and again

This position paper tries to address matters of immediate concern to the industry and makes recommendations on steps to take to improve the short-term outlook whilst examining medium- to longer-term recommendations on how to enable Hong Kong to take full advantage of the opportunities likely to arise in the future.

Our recommendations are not meant to merely represent the hotel industry's own vested interests but rather are based on our wider concerns that Hong Kong needs to live up to the challenges posed by a more competitive environment in the 21st century and the new Millennium. It is time for us to undertake a bold and decisive revamp of Hong Kong's tourism industry from a broader perspective.

We also suggest some views and ideas to promote Hong Kong as a superb international metropolitan city with its unique Chinese culture coloured by colonial past, a shopping paradise with quality services and full range of choices, and as an international cuisine centre. All these areas are meant to promote Hong Kong and distinguish it from other Asian cities. We believe action must also be taken to relieve the hotel industry from the current difficulties. The following recommendations are divided into four main areas:

- I. Concerns of the Hotel Industry
- II. Favourable Macro-tourism Policies
- III. Hong Kong New Image: World class facilities & Tourist Attractions
- IV. A more Sustainable & Healthy Living Environment

I. Concerns of the Hotel Industry

Hong Kong hotel industry is facing the most difficult time in recent history. There has been keen competition in the region together with cutthroat competition in struggle for survival amongst individual hotels. Revenue contracts drastically even though visitor arrivals increase. The followings illustrate hotel industry's difficulties and offer some recommendations to relieve the industry from this business hardship.

1.1. Change of Visitor Profile

In these past few years, the PRC has become the largest single broad source market. The mainland market share has increased steadily from 19.7% (1996), 22.1% (1997) to 27.1% (1998). PRC visitors' spending and length of stay has been satisfactory. However, they only spend more on shopping but less in hotels as compare to visitors from other source markets. Visitors from long-haul markets spend the most in hotels of about HK\$4,900 or 57% of their total expenditure per head.

With the drop in business visitors in 1998 to the 1993 level, or 16% from the peak in 1996, high-yield visitors from North Asia, North America and West Europe also declined. For example, visitors from Japan in 1998 dropped 31% and 43% in 1997, respectively.

1.2. Hotel Burden: fees and charges

Hotels have been burdened with numerous fees and charges, ranging from government rates, licenses, energy costs, Trade Effluent Surcharges (TES) to copyright license fees, etc. These burdens have become heavier with decreasing revenues and have constrained hotels' competitiveness by increasing our cost structure.

Operation costs keep increasing although hotels have done their best to streamline their operations and tightened management controls. Costs like property maintenance, utilities, and wages and benefits, are difficult to cut. An experienced and skillful workforce is vital if hotels are to maintain their quality services. In fact we feel that the need for cost cutting in order to survive has already adversely affected quality services which if not quickly reverse could cost long-term irreparable harm in the industry as a whole.

1.3. Hotel Cash Constraints

The downturn in the tourism industry has been longer than expected. Visitor arrivals have increased. However, room rates have driven down to historical low level. Hotels struggle to but just manage to operation break even. Some hotels operate at a loss and others have been driven to offer room rates at \$200 per night.

When the Hong Kong Tourist Association released its latest figures, it stated: “hotel occupancy now averages 77% from 72% a year ago. However, this increase has been achieved on the back of a more that 40% cut in average daily room rate — a massive contraction — a return to rates of a decade ago”. Hotel bills currently account for 24.7% only of visitors’ expenditure, which is the lowest on record.

The average achieved hotel room rate for the past 12 months has continued to drop drastically. For High Tariff A hotels, room rates dropped 21% to HK\$1,113 in the first half of 1999. High Tariff B hotels’ room rate also dropped 23% to HK\$508. Medium Tariff hotels, the most hard-hit category, dropped 27% to HK\$340. If considering the percentage dropped by 1998 to 1997, the contraction of average room rate would be even more drastic.

1.4 Recommendations to boost the hotel industry

We sincerely urge the Administration to support the industry by considering the following:

Reduce hotel industry tax and regulatory costs through:

- Abolishing hotel accommodation tax;
- Providing 50% relief on property rates currently payable by hotels;
- Introducing a tax incentives e.g. tax credit, for capital expenditure; and
- Temporarily waiving or freezing government fees and charges, e.g. TES, hotel licenses and some other associated rent;

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Increase Hong Kong's attraction to visitors through:

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EXECUTIVE SUMMARY

In August 1997, the Federation of Hong Kong Hotel Owners Limited commissioned Jones Lang Wootton Limited to carry out a study on the future of the hotel industry in association with JLW Transact, the specialist hotel and leisure company of JLW.

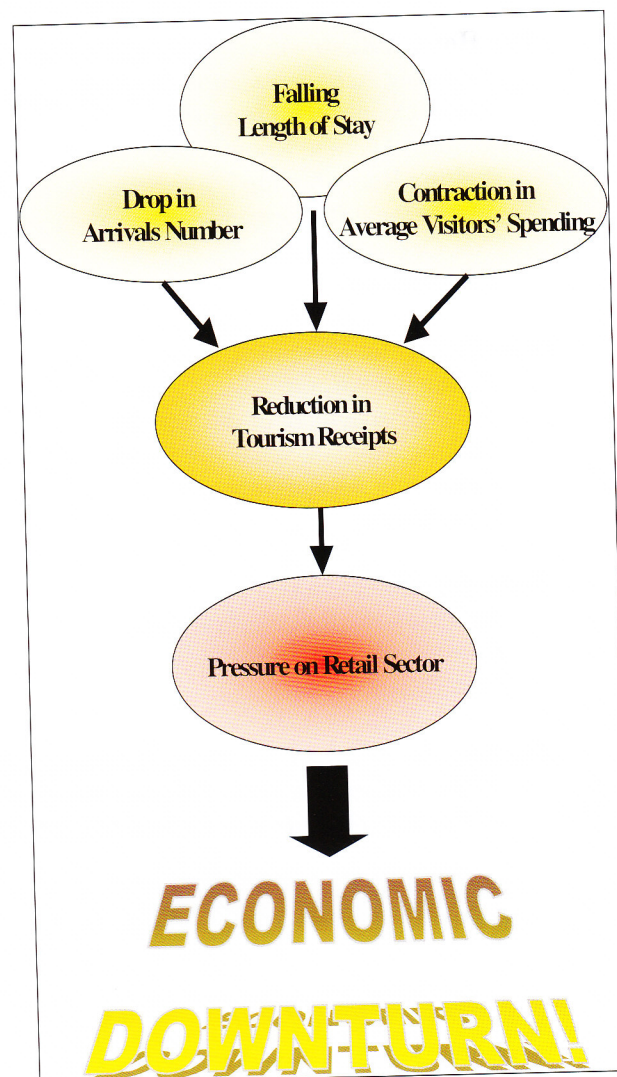
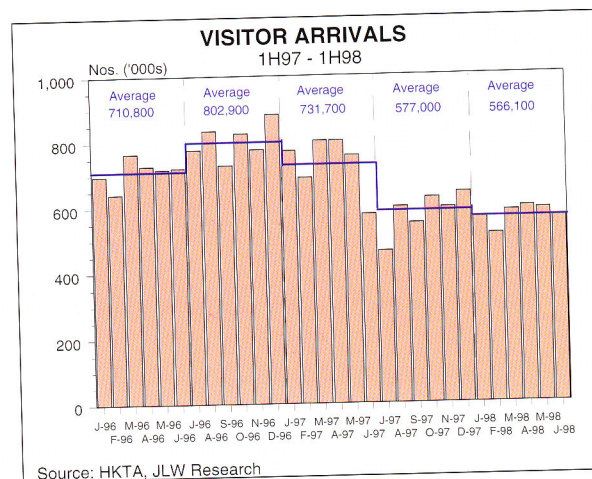
Since the start of the study, economic conditions in Hong Kong and many of its source markets have changed dramatically. The economies of Hong Kong and a number of other countries throughout the region have entered recession. In order to be in a position to take advantage of the long-term potential of Hong Kong tourism it is necessary for the private and public sector to work together in a flexible, pro-active way. This will help to mitigate the immediate negative impact of the regional economic turmoil and local economic recession on the tourism and hotel industries.

We have prepared two reports, which are published separately. In the first, we address matters of immediate concern to the industry and make recommendations on steps to improve the short-term outlook. In the second we examine the long-term prospects for the industry and the changing nature of the industry. We provide recommendations on steps to enable Hong Kong to take full advantage of the many opportunities likely to arise. The reports are titled:

- Turning the Tide; and
- Catching the Wave.

Tourism Industry in the HKSAR'S First Year

In very difficult economic conditions the performance of the tourism industry in the first year of the HKSAR was markedly down on the previous year. Visitor arrivals, length of stay, visitor spending, retail spending and tourism receipts all declined sharply between the first half and second half of the year. This has had a major impact on the Hong Kong economy. It requires urgent action to "turn the tide".



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EXECUTIVE SUMMARY

PKF Consulting Limited (PKFCL) and Lintel Hospitality Consultants (HK) Limited (Lintel) were engaged by The Federation of Hong Kong Hotel Owners Limited (FHKHOL) to review the operating practices of travel agencies in Hong Kong, specifically as they relate to hotels. It is believed that through an assessment of the key areas of the hotel-travel agent relationship, a more equitable system can be established that will better meet the needs of the travel agency and hotel industries in Hong Kong. Ultimately, the report would be used as a platform for negotiating terms and conditions between hotels and travel agents with respect to room inventory control and pricing.

Based on the results of our research and subsequent analyses, the consultants offer the following principal findings and conclusions.

- IIB.1 The downturn for the hotel industry after the 1997 Handover and the Asian economic crisis made the hotel industry to realise the negative impact of the problematic areas in the structural relationship and operating system between hotels and travel agencies in relation to the selling of hotel rooms.
- IIB.2 The continual increase of visitor arrivals from China demanding low-priced hotel accommodation aggravated the situation after the downturn. In 1998, visitor arrivals from China represented 27 percent of total visitor arrivals, and they spent an average of approximately HK\$219 per person per day on hotel accommodation.

Contrary to the foregoing, each visitor from China spent an average of HK\$3,547 on shopping during their stay in Hong Kong in 1998. The high spending power of visitors from China on shopping acted as a great incentive to travel agencies to promote tours to Hong Kong in order to earn commissions from retail shops. Such promotions would have been done at the expense of promoting tours from other markets which have higher spending on hotel accommodation such as North America and Europe.

- IIB.3 In order to survive in this unfavourable operating environment, hotels and travel agencies resorted to cutting rates in order to compete for customers.
- IIB.4 In face of the economic downturn and competitive operating environment, the sources of business of hotels had also changed.

The percentage of business received from corporate accounts decreased in 1998 when compared to 1997. In 1997, sample hotels received approximately 32 percent of its bookings from corporate accounts. In 1998, this percentage decreased to approximately 27 percent.

The percentage of business received from leisure independent travellers booking through travel agents has increased in 1998 when compared to 1997. In 1997, sample hotels received approximately 25 percent of its bookings from travel agents – LIT. In 1998, this percentage increased to approximately 31 percent.

The percentage of business received from tour groups has increased for some hotels in 1998 when compared to 1997. In 1997, sample hotels received approximately 23 percent of its bookings from travel agents – Group. In 1998, this percentage increased to approximately 27 percent.

In general, hotels' dependence on travel agencies has increased in 1998 when compared to 1997. The total amount of bookings received from travel agencies of sample hotels increased from approximately 48 percent in 1997 to 57 percent in 1998.

IIB.5 The hotel booking business in Hong Kong has become so competitive that representatives in the hotel and travel agency industries describe their relationship as that of a vendor and buyer.

IIB.6 Due to the highly competitive operating environment, travel agencies showed that the amount of gross profit they make on one room night can be as low as HK\$20. Some land operators expressed that they have been subsidising the hotel bills of their clients by using revenue earned from other areas, such as commissions received from retail shops.

IIB.7 In order to obtain more business, travel agencies were reported to have the following operating practices which were not welcomed by hotels:

- undercut hotels' corporate accounts which resulted in hotels' corporate accounts not booking through the hotels;
- used one hotel to undercut another hotel and usually ended up getting the rate they desire;
- exploited the use of special contract rates by selling these rates to other markets;
- used too many levels of sub-agencies with layers of markups; as a result, hotels sold their rooms at low prices but did not benefit final users;
- marketed hotel room rates indiscriminately using handout flyers and multi-fax, this made companies, which may be hotels' corporate clients, to become well aware of the low prices that travel agencies can offer; and,
- demanded better credit terms which procrastinated hotels' collection of payments and increased their risk of having bad debts; this poor payment practice of travel agencies also gave hotels a feeling that they were offering interest free and "discounted" financing to travel agencies.

IIB.8 On the other hand, hotels were reported to have the following operating practices which are not welcomed by travel agencies:

- abandoned travel agencies during the high season and give little flexibility on payment terms, order confirmation lead time and procedures;
- changed rates too frequently leading to confusions for overseas travel agencies which in return promoted other destinations to their customers;
- set their rates too high when times were good such as the period before the 1997 Handover which turned away customers;
- sales representatives exercised personal favouritism when selling rooms to particular travel agencies;
- sales staff of hotels were reported to have vested interests in travel agency business; and,

- hotels charged different rates for different markets which made it difficult for travel agencies to explain to their customers.

IIB.9 In order to be more proactive to the situation in the market, both hotels and travel agencies preferred not to adhere to the terms stated in their contracts and prefer ad-hoc terms and negotiations.

IIB.10 When comparing the situation in Hong Kong to that in the other major travel markets, the following major differences were found:

- the gap between hotels' contract rates and rack rates in Hong Kong was much wider than that in the other travel markets; the contract rates' discount off rack rates for hotels in Hong Kong ranged from 50 to 85 percent, whereas it was 10 to 55 percent in London, Sydney and Vancouver;
- hotels in Hong Kong tended to use contract rates with travel agencies, while hotels in the other travel markets including London, Sydney and Vancouver would also use commissionable rates;
- while most surveyed hotels and travel agencies in Hong Kong objected the use of a fee-based system where customers pay service fees to travel agencies for their services; there was a trend in other major travel markets including London, Sydney and Singapore that travel agencies used a fee-based system;
- the contract rates of hotels in Hong Kong varied a great deal between the high and low seasons that the variation ranged from 45 percent to 70 percent, whereas the variation in other travel markets such as London and Sydney was lower and ranged from 10 percent to 40 percent;
- travel agencies in Hong Kong and other travel markets tended to undercut hotels' corporate accounts but it seems that the situation was more serious in Hong Kong;
- hotels and travel agencies in Hong Kong tended to rely on ad-hoc terms more than those in the other travel markets; and,
- the use of the Internet in room reservations is less common and effective in Hong Kong than other travel markets such as the United States and Australia.

IIB.11 Representatives from the tourism industry in Hong Kong have the following suggestions for improvements:

- Statutory regulations be formed to enforce the official licensing of all inbound travel agencies;
- a statutory regulatory body to be founded to regulate travel agencies;
- a fee-based system to be introduced;
- hotels be officially classified and a range of rate be set;
- minimum rates should be established for different classes of hotels;
- hotels should reduce the gap between corporate rates and travel agency rates;
- hotels should be self-regulated;

- travel agencies should be self-regulated;
- communication and co-operation among hotels should be improve; and,
- hotels should form their own travel agencies.

IIB.12 The following short-term and intermediate-term options for improvements may help to revive the hotel industry:

- freeze rates for one year;
- narrow rate spread between corporate accounts and travel agencies;
- publish realistic rack rates;
- reduce focus on occupancy rates;
- step up their vigilance in protecting and rewarding corporate accounts;
- use one rate system for corporate accounts and travel agencies;
- use loyalty rewards for high yield corporate accounts and travel agencies to foster long-term relationship;
- require sales staff to disclose annually that they do not have vested interests in travel agency business; and,
- hold daily rate meeting to approve price variations.

IIB.13 The following long-term options for improvements may help to revive the hotel industry:

- hotels be star-rated for rate differentiation;
- professionalism of the travel agencies be improved; and,
- fixed commissionable rate be used for all bona-fide travel agencies.