Responding to the emerging strategic and financial issues in the Indian hospitality industry

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Abstract

Purpose – This paper aims to summarise and review the key strategic and financial challenges faced by the hospitality industry in India.

Design/methodology/approach – The paper draws from the findings of the theme issue contributors. All the papers in the theme issue have drawn inputs from practitioners in the domain of strategy and finance.

Findings – The paper summarises the key issues in the areas of strategy and finance in the context of the hospitality industry in India. Some of the key areas that have to be addressed are: cost management, land management and policies, risk management, revenue management, branding, growth issues and talent management.

Practical implications – There are a number of implications for practitioners and policy makers that would help the hospitality industry to grow more quickly and contribute meaningfully to India's economic growth.

Originality/value – Practitioners' perspectives are important as they help in framing policies and guidelines to enable the hospitality industry to grow. The outcomes of the theme issue are especially helpful in this context as they yield insights on issues that really matter to the hospitality industry in India.

Keywords Strategy, Financial issues, Hospitality industry, Cost management, Risk management, Revenue management, Hospitality services, India

Paper type General review

Overview

The hospitality industry in India is growing and by 2040 as per OECD estimates, India will be the world's third largest economy. This scenario has implications for investment, travel and consumer spending and as tourism increases so too must the provision of hospitality services. Furthermore, as more of the world's major firms seek to enter India on account of its business potential this development will generate an array of strategic and financial issues that the hospitality industry will need to address.

This theme issue addressed the question: 'What are the strategic and financial issues faced by the hospitality industry in India?' To explore the question, academic researchers partnered with practitioners to blend perspectives and draw on practitioner insights, experience and viewpoints. The key strategic and financial issues are highlighted below, together with the related implications for industry and policy development.

Strategic challenges for growth in the Indian hospitality industry

The hospitality industry faces number of challenges in the years ahead especially for hotel and motel development. Jauhari (2012a) provided the following summary:

Worldwide Hospitality and Tourism Themes
Vol. 4 No. 5, 2012
pp. 478-485

1755-4217
DOI 10.1108/17554211211277905

- *Land prices:* These constitute almost 40-50 per cent of the cost of property in India.
- *Cost of funding projects in India:* The cost of debt is very high for hotel development projects in India.
- *Approval processes in India:* These are very time consuming and complex. Sometimes the delays in land acquisition can significantly increase the costs associated with the project.
- *Human resources challenge:* There are huge challenges associated with the talent management processes. Attracting the right people with the appropriate skill sets is a very critical success factor. There are lot of gaps here and therefore implications for both hospitality firms and the education sector. There are also challenges related to attrition and rising labour costs.
- *Pace of technology:* Online bookings are on the rise. Social media applications and travel blogs are influencing guest decisions on the choice of destinations and choice of brands. Firms need to develop a technology strategy in order to secure the desired business outcomes and investments in this domain.
- *Issues of security and localisation.* With growing global unrest and a digital divide coupled with economic uncertainty, there is likely to be yet more violence and more frequent security threats. Mitigating security related risk is therefore likely to be an important issue as the industry expands.
- *Finding viable locations for business investments.* There is a need to identify viable locations for future business investment. As markets become more crowded, developers will need to identify the cities and other locations that are likely to become next drivers of growth. Investing in overcrowded markets is not a sensible option for the future as it is much more difficult to recover costs and sustain profitability.

Kapur and Sen (2012) identified the following strategic challenges:

- Unavailability of unencumbered/dispute-free land parcels.
- High land cost in comparison with developed countries.

Kapur and Sen also enumerated the challenges associated with developing and operating hotels in India's bureaucratic environment. They observe that it requires 110 licenses to set up a hotel – a very costly and time-consuming task. Further, it takes almost three years to get all these licenses in place. They also observe that the government regulations for FSI (Floor Space Index) are unrealistic, and these regulations complicate matters for smaller budget hotel developers who can only afford a small parcel of land. FSI in the central business districts of most global metropolitan cities ranges between 5 and 15 as compared to 1.0-4.0 in India.

- Leveraging cost: India as compared to other developed countries has a high leveraging cost in the range of 11-16 per cent. This makes debt unsustainable given the industry's cash flow characteristics.
- Promoter profile: In India, investments in hospitality operations are often made by wealthy promoters, who see it as an investment which enhances their

prestige. There is an aspirational value attached to the status of acquiring a hotel. Typically in these cases, projects costs escalate on account of unrealistic investment in grand properties that have been built beyond the brand segment specifications.

Implications for practitioners
Jauhari (2012b) lists the following implications for practitioners:

- Land reforms need to take place. Land acquisition processes should be simplified with clear timelines for completing the various steps.
- The hospitality industry in India should be accorded full industry status. This would help to streamline the planning and policy issues.
- Brands have enormous potential value in mass markets. Value for money is a key proposition in India and by developing brands that deliver a good consumer experience at affordable pricing levels, good profit levels can be achieved and sustained.
- Talent management is one of the key concerns that hospitality educators and practitioners must address. Relevant skills and attitude with engaging work practices can create a big difference in attracting good manpower to the hospitality firms.

Some other implications for practitioners as noted by Kapur and Sen (2012) are:

- Digitising land records: Land records should be digitised as this would help to resolve the contentions of ownership and transfer. The experiment conducted by the Gujarat government is a case-in-point.
- Developing a land use plan: Modifications that would enable developers to acquire and aggregate smaller pieces of land for bigger projects would be helpful. Public private partnership initiatives could also be initiated.
- Fixed project deadlines: This would help in terms of defined procedures and timelines for obtaining the necessary clearances for hotel development projects.
- Attractive funding schemes: These could also be initiated so that project borrowing can happen at attractive market prices. Subsidised loans could be provided from government funded financial institutions.

Key financial issues and implications for the hospitality industry in India
Bharwani and Mathews (2012) analysed the risks faced by the hospitality industry in India and used a number of categories to classify the risks. These are:

- strategic risks;
- commercial risks;
- operating risks; and
- other external risks.

Strategic risks are associated with those threats or opportunities that materially affect the ability of an organisation to survive. The main risks in this category are:

- reputational risk;
- new project viability;
- competition;
- business portfolio revenue contribution mix;
- seasonality of business;
- change in customer preferences and brands;
- management contracts and joint ventures; and
- external reservation demands.

From a practitioner perspective, the area of foreign exchange regulations was deemed to be the most significant risk among the commercial and financial risks cited by local industry professionals. Regulatory compliance is the second most significant risk due to the complexity of the legislation. Legal and taxation risks were deemed to be the most frequently occurring.

Commercial risks are faced by firms in the area of their fund flows and regulatory framework. These risks relate to credit, financing, hedging and property as well as risks related to regulatory and tax compliance and environment laws.

The other key risks cited are those that relate to terrorist activities, pandemic diseases, force majeure, political risks and economic cycles. From a practitioner's perspective, the risks due to fluctuations in economic cycles were rated as the most significant.

Operational risks are associated with carrying out normal business activities in an organisation. They include:

- guest health and safety;
- employee health and safety;
- employee recruitment and retention;
- employee relations;
- fraud and integrity risk;
- information technology and communication security;
- supply chain continuity;
- operating costs;
- automobile liability;
- fire and explosion;
- property upkeep and damage repair;
- security of property; and
- physical assets.

Guest health and security are the operational risks accorded the highest priority by hospitality practitioners who participated in the study.

Overall terrorism, competition, foreign exchange volatility and guest health and safety have emerged as the most significant risks according to industry practitioners.

The implication for practitioners is to adopt appropriate mitigation strategies in order to counter these risks with a proactive, programmed approach.

Food cost management strategies

Munjal and Sharma (2012) discussed food cost-management practices in the context of the budget hospitality segment. The budget sector has been dealing with a 14 to 18 per cent rate of inflation. This has implications for cost management and adopting strategies which deal with the management of portion sizes or alternatively, passing on the cost increase to the end user. The practitioner inputs suggest that there are two broad strategies that have been adopted by budget sector restaurants:

(1) focus on food cost reduction; and

(2) focus on pricing.

Focus on food cost reduction

Some of the strategies adopted here are:

- purchase contract negotiation for economies of scale;
- aggressive yield-management practices;
- menu changes and menu balancing;
- portion size reductions;
- increased focus on buffets rather than a la carte options; and
- menu-engineering focus on high margin menu items.

Recommendations for practitioners

The key recommendations emanating from the study of food cost management is that technology can be deployed to manage food production, storage and consumption costs. An effective management information system needs to be in-built so as to ensure that data is recorded and measured accurately. Further, research and development efforts should be initiated to develop new recipes and cooking methods that enhance the yield.

Revenue management: implications for practitioners

Revenue management can have an impact on the efficiency and profitability of the hospitality industry. Varini *et al.* (2012) examined the rapid deployment strategies for revenue management in the context of the hospitality industry in India. Their study puts forth specific recommendations for practitioners, including the following:

- *Align yield management with other commercial strategies.* A behaviour that contributes towards raising or maintaining the firm's long-term profitability should be rewarded. The service firm should identify how to use yield management to enhance purchase related experiences. The functions of sales, marketing, pricing and revenue management can be clustered under one umbrella in order to facilitate defining a common mission that can be respected by all parties involved. There should be a person who oversees the alignment of social media, revenue management and pricing activities to ensure seamless communication between departments.

- *Growing businesses in local markets.* Smaller firms can set up partnerships with destination management organisations so that smaller businesses can grow their brands. They can form alliances or partner with multinationals to ensure penetration of knowledge.
- *Partnerships to develop infrastructure.* Public-private partnerships can be explored for developing hospitality industry-related infrastructure. Hospitality firms could partner with infrastructure companies for this purpose.
- *Niche marketing.* Certain sectors such as weddings can attract a different kind of tourism. Specialist sectors such as wedding tourism and medical tourism appear to offer huge growth opportunities for the future.
- *Political stability.* Attaining and securing political stability is a big challenge in India. However, tax benefits are available in special economic zones and they can be leveraged to help establish new hospitality businesses.

Factors affecting cost structures in India

The hotel sector in India is characterised by a relatively higher proportion of fixed costs than almost any other country in the world. Research has pointed out that not much innovation has occurred in cost and management-accounting techniques. The study conducted by Vij (2012) in the Indian hotel industry points out that 95 per cent of the respondents agreed that long-term strategic plans are important for controlling fixed costs. Research has found that few hospitality firms apply a strictly cost-focused or quality-focused strategy, and the cost of labour is the biggest expense in the hotel sector. A strong link exists between good management and cost-accounting practices and financial success. Activity-based costing (ABC) is accepted as one of the most important innovations in the field of accounting. The survey conducted in India shows that the reasons why firms choose ABC is because it enables them to oversee customer profitability analysis, budgeting and cost reductions. The other reasons in ranked order are performance evaluation, service pricing and cost modelling.

Implications for practitioners

Some of the factors mentioned by the respondents in the study conducted by Vij (2012) are:

- restructuring logistics operations in a cost effective manner;
- adoption of activity based costing in an aggressive manner;
- suggestions from employees on how to reduce wastage;
- encouraging environment friendly practices and embracing sustainability through both developmental and operational strategies;
- in-house production of some of the products purchased from outside earlier;
- offer off-season discounts and bulk booking;
- waste water recovery systems;
- collaboration with tour operators;
- adoption of energy saving technologies; and
- following the lean technology with just adequate staff numbers.

Firms should deploy sustainable cost management systems and outsourcing for contract labour is an option that could be explored to reduce labour costs. The development of long-term strategic plans might also assist in terms of managing fixed and variable costs. It is clear that the most important action that hotel operators should take during recession, is to restructure its costs.

Summary

There are several notable strategy and finance challenges facing the hospitality industry in India. In tough economic times, it is pertinent for firms to develop a strategy that will enable them to be competitive and profitable. A long-term strategic approach that helps mitigate risk and that facilitates effective cost management can help to ensuring profitability. Additionally, the Indian hospitality industry faces challenges relating to talent management, skill shortages, leadership, land reforms and deploying technology effectively for enhanced revenue management. Furthermore, cost, revenue and risk management are now ever-present themes. Public private partnerships, strategic alliances, deploying innovations for effective cost management are initiatives that hospitality firms in India and similar economies must initiate. There are a lot of suggestions that have implications for the government. These include: Land reforms, doing away with the bureaucratic hurdles of licensing and according "industry status" to hospitality firms in India. These steps would greatly assist the development and future profitability of the hospitality industry in India.

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Further reading

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