

ANALYSIS OF HOTEL INDUSTRY IN PORTER'S FIVE COMPETITIVE FORCES

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SYNOPSIS

This presentation is going to discuss the strengths and weaknesses of the Hotel Industry on a global basis and to study the viability of a hotel project, taking into account the five competitive forces of Michael Porter's Model. The main competitive forces and factors within those forces will determine the feasibility and potential profitability in a hotel project. The two crucial factors that enable hotels to differentiate themselves are good location for relative target market and quality of service.

INTRODUCTION

- **Industry** can be defined as a group of companies producing products and services that satisfy a need, function and use. Industry can be broadly defined as a group of companies producing products and services that satisfy a need, function and use. It can be narrowly defined as a group of companies producing products and services which are close substitutes for each other. **Business strategy** can be defined as an integrated set of acts aimed at securing a sustainable competitive advantage over competitors. The **Five Competitive Forces** of Industry will influence prices, costs and investment (Porter, 1980). The feasibility and potential profitability of a hotel can be determined by answering the following questions.

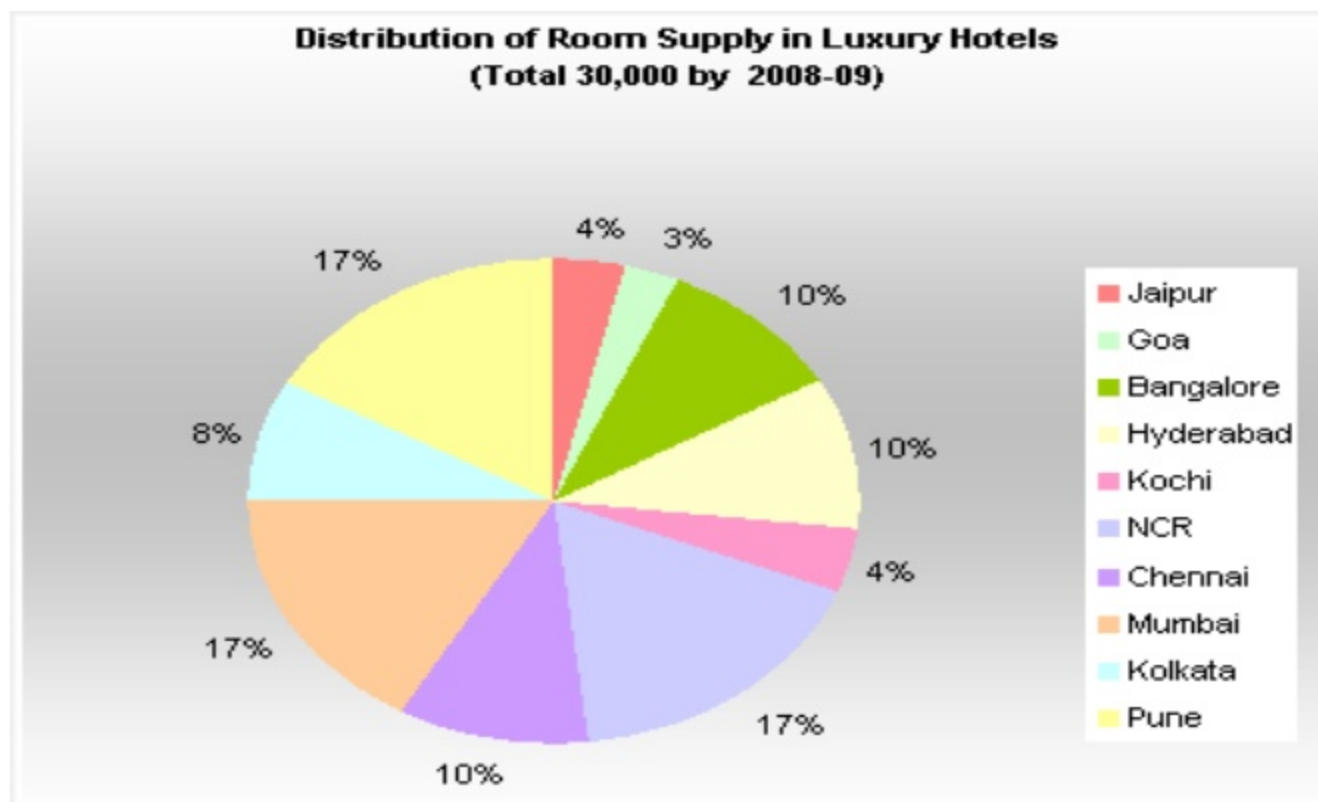
INDUSTRY OVERVIEW

- Tourism in India is the largest service industry, with a contribution of 6.23% to the national GDP and 8.78% of the total employment in India. Visiting foreigners has reached a record 3.92 million and consequently International Tourism receipts have also risen to US \$ 5.7 billion. The World Travel and Tourism Council (WTTC) have named India along with China as one of the fastest growing tourism industries for the next 10 to 15 years. The Indian hospitality sector is expected to show a healthy growth and according to the Ministry of Tourism, the contribution of tourism to India's GDP is 5.9 per cent as compared to worldwide average of 11 percent.

	Occupancy (%)	change %	ADR (INR)	change %	RevPAR (INR)	change %
India	59.8	-1.0	6,601.44	-0.1	3947.68	-1.2
Bangalore	59.0	-2.9	7,245.20	4.8	4,274.00	1.8
Chennai	65.7	0.6	6,166.80	-1.7	4,051.78	-1.1
Delhi	63.8	-7.4	8,326.15	-3.4	5,309.19	-10.6
Goa	68.6	2.6	6,031.83	5.2	4,140.21	8.0
Hyderabad	57.1	1.5	5,531.55	2.9	3,156.38	4.4
Jaipur	55.5	-4.5	5,507.47	7.6	3,058.94	2.7
Mumbai	63.1	6.2	8,450.84	-0.8	5,333.98	5.3

Source: STR Global

ADR = Average Daily Rate; Rev PAR = Revenue per available room
= Average Daily Rate*Occupancy



THE KEYS TO PROFITABILITY IN THE INDUSTRY

- **What are the main competitive forces and factors within those forces which determine potential profitability in the industry?** The Hotel Industry in most metropolitan cities in the world is characterized by high capital costs and a high proportion of fixed costs to total costs. The high capital costs require that from the outset the project must be managed to achieve the most cost-effective use of resources applied to construction, furnishing and equipment, pre-operational expenses and finance. Hotels also been built to an optimum size, approximately 500 rooms, in order to benefit from the economies of scale. Hotels must also aim to fill their rooms as profitably as possible, both through room occupancy levels and the relative tariffs applied.

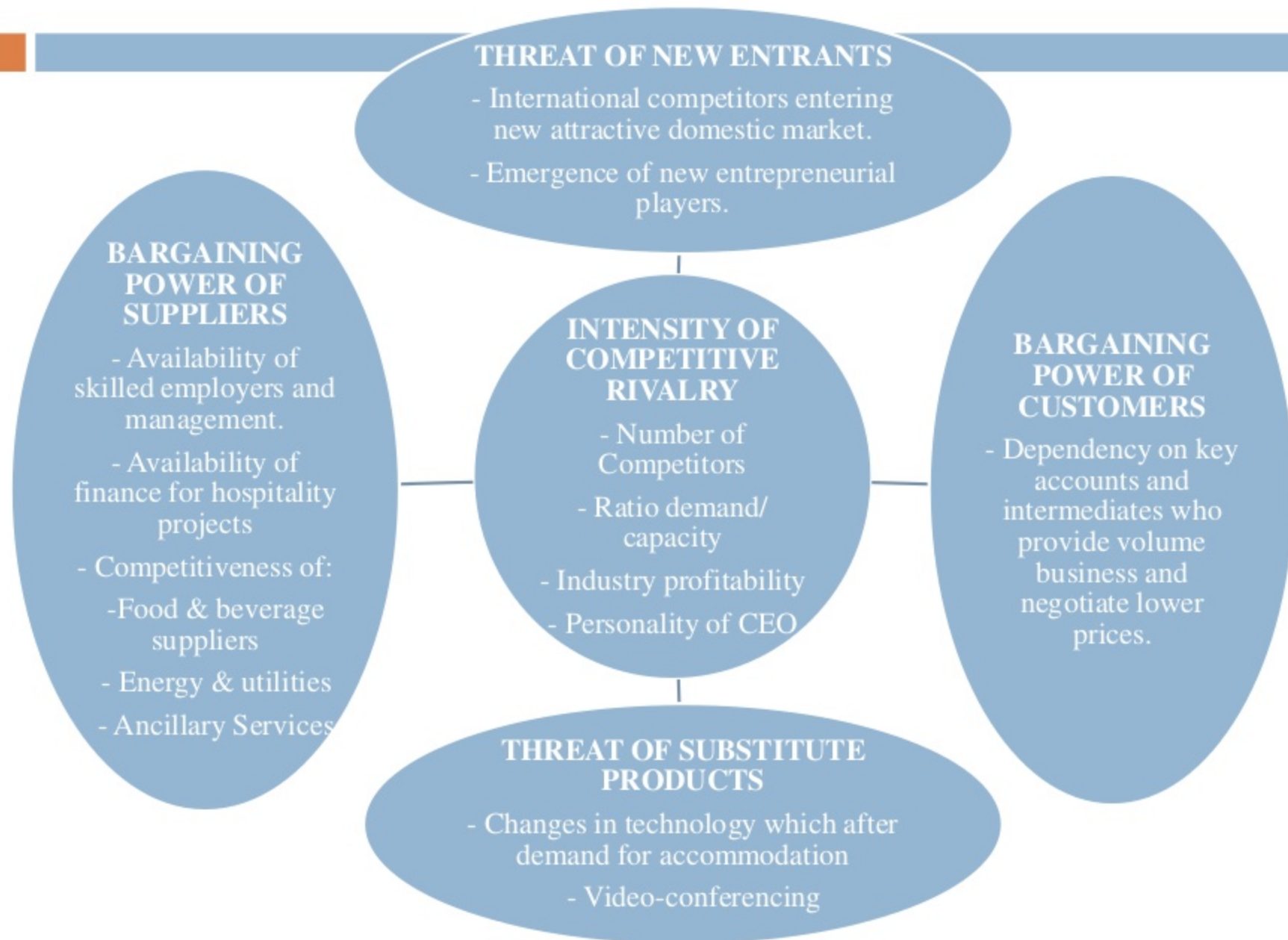
TWO KEY METRICS USED TO ANALYZE THE HOTEL INDUSTRY ARE AS FOLLOWS:

- **Average occupancy:** *The average percentage of the times in a year when the room is occupied. This number usually fluctuates as the hotel industry is highly cyclical with high demand for rooms when tourist influx is high.*
- **Average room rate:** *Average rate charged per night per room. This number can also fluctuate with demand.*

FOUR OWNERSHIP MODELS IN THE HOTEL INDUSTRY

- **Full Ownership:** *This type of ownership warrants huge capital allocation and the owner undertakes* higher risk. It also gives the owner full control over pricing, operating expenses and business decisions.
- **Management Contract:** *Under this form, certain individuals called as operators run the hotel and* receive remuneration directly from the owner as a percentage of sales, around 2-3%, and an incentive fee, around 8-9% of operating profit.
- **Franchise:** *In this case, franchisors license their brands, thereby giving the hotel owner to use the* brand and reserve rooms. The franchisees need to comply with certain conditions and standards stipulated by the franchisors and are subjected to checks. Franchisees pay fees in the form of an initial fee plus a royalty.
- **Lease and License:** *Here, the owner of the property leases it for a definite duration. The lease rental* is deducted from the gross revenue and a penalty is imposed if the agreement is not adhered to. Also, the licensor earns revenue in the form of a license fee and the revenue earned is given to the operator.

PORTER'S FIVE FORCES MODEL WITH RESPECT TO HOTEL INDUSTRY



NEW ENTRANTS

- The hotels & motels industry is strongly influenced by travel and tourism trends. It is possible to enter the industry in a relatively low-key way by opening a small, independent hotel or motel as a sole proprietor. However, the industry is capital intensive, and for a large-scale entrance, upfront investment in buildings, décor and furnishings, ICT infrastructure and staff is expensive. To sustain revenue growth in the premium market, operating a chain of hotels is often an important strategy as it reduces dependence on tourism in any particular location. Regulations in terms of real estate and buying abroad need to be taken into consideration and can therefore be restrictive in some countries. The purchase, leasing, and management of property may involve legal and financial complexities, necessitating spending on professional services. Overall, the likelihood of new entrants is moderate.

LIKELY OF NEW ENTRANTS

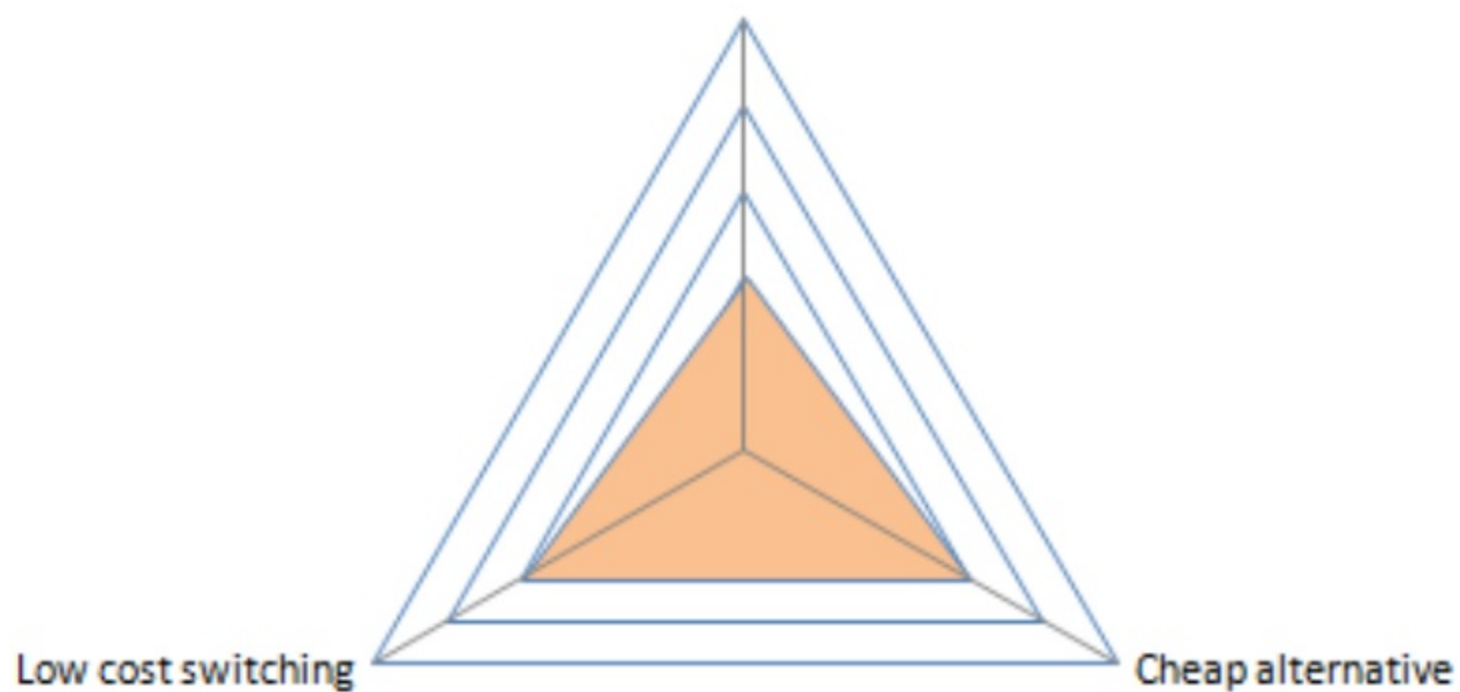


THREAT OF SUBSTITUTES

- Porter indicated that substitute products can be existing or potential products and services which are able to perform the same function. Substitute products can reduce costs, and/or provide better quality performance and better value which very often the result of technological innovation.
- The Hotel Industry in all major cities is not threatened by substitute products except that in times of recession domestic travel might replace international or overseas travel and certain destinations replace more expensive ones on cost grounds.
- A hotel operator in anywhere can compete on a low cost basis in a niche segment. It can also compete on the basis of a modern, comfortable but not luxurious hotel situated in a popular and convenient location.
- There is no major threat of substitute products specific to a hotel's product and service. A hotel will be subject to powerful buyers only if its marketing strategy concentrates on attracting tour groups, provided no oversupply for the hotel's target market develops. A hotel may not appear to be particularly vulnerable to intense rivalry because of the fragmented nature of the competition in its strategic group and the potential growth rate of its target market.

THREAT OF SUBSTITUTES

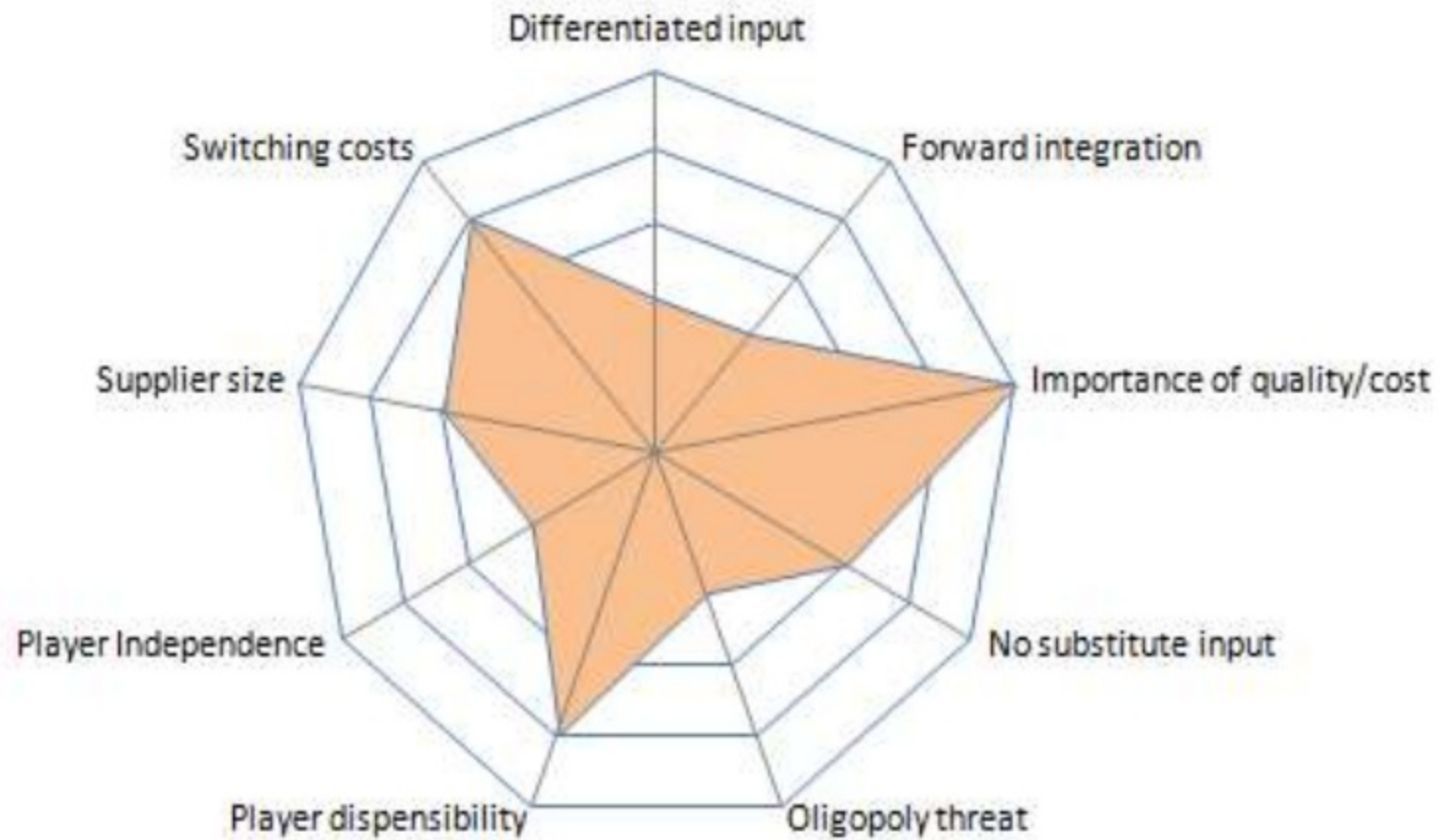
Beneficial alternative



SUPPLIER POWER

- Suppliers in this industry are defined as property owners, developers and real estate companies, interior design and furnishing companies, architects, management and training service providers, marketing companies, industry consultants, and information and computer technology (ICT) manufacturers. Real estate companies are often much smaller companies than hotel and motel operators and rather than being globalized, they are usually local to the property they develop, which reduces their financial muscle and ability to negotiate favorable contracts. Furthermore, hotels can integrate backwards and operate their own real estate business. The quality and availability of supplier services and equipment is essential to the hotel and motel industry. The industry is also labor intensive. Staff costs are significant as success in the hotel industry is strongly influenced by the quality of the service provided. Supplier power is assessed as moderate overall.

SUPPLIER POWER



BUYER POWER

- Unlike its international counterparts, the Indian industry was not affected by a decline recently and so may emerge from the global recession period stronger. Within the hotels and motels industry, where switching costs are rather negligible and competing on price alone is no longer a key to success, brand recognition and innovation helps to attract first-time customers and also repeat business. Due to a high reliance on sophisticated technology and systems and the growing importance of mobile communication channels, some suppliers may exert strong supplier power.

BUYER POWER



RIVALRY

- There are also a large number of independent players present in the industry apart from the existing houses. Larger number of players means increased competition. Many larger operators have diversified to some extent and own additional businesses, such as casinos, restaurants and shops. To attract and sustain more business, operators try to offer more and more complex packages and value-added services, such as free breakfast and parking, free third night, etc. A recent trend among major hotel chains is lifestyle hotels which cater to the conscientious traveler's demands for eco-friendly practices, social responsibility, and affordable style. The largest hotel and motel operators are fairly well insulated from unpredictable market conditions by geographical diversification. However, others are based largely or exclusively in one country.

DEGREE OF RIVALRY

