CHINA’S HOTEL INDUSTRY TAKES A NEW DIRECTION
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Tourism

KEY CITIES/REGIONS

China has masses of tourist attractions, focusing on its history, culture and natural landscapes. However, only a limited number are considered to be of a standard acceptable to international tourists. The government has devised a rating system, where attractions are ranked from A (the lowest) to AAAAA (the highest). The number of tourist attractions deemed acceptable for international visitors are around 3,320.

There are 127 AAAAA attractions, such as the Forbidden City, the Stone Palace and the Great Wall of China. The Great Wall of China is a UNESCO World Heritage Site – one of 43 UNESCO-designated locations in China (including Macau and Hong Kong). Other UNESCO sites include the Summer Palace (Beijing), the Museum of the Terracotta Warriors (Xi’an) and the Lushan National Park.

Most first time visitors tend to visit the key cities and attractions and do not tend to venture elsewhere.

Beijing: China’s capital city and main commercial centre and home to over 200 multinational companies. The city is home to some of China’s leading attractions – the Forbidden City, Tiananmen Square and the Imperial Gardens and Mausoleums.

Over the past ten years or so, the city has been regenerating many of its rundown areas. One of the main drivers for this was in preparation for the Beijing Olympics in 2008.

Beijing hopes to attract 10mn visitors by 2016, doubling the amount of visitors in 2010.

Guangdong: previously known as Canton. The city is a major shopping centre, located within easy travelling distance from Hong Kong. It tourist attractions include cruising on the Pearl River, the Sun Yat-Sen Memorial Hall and the Ancestral Hall of the Chen family.

Hainan: the island of Hainan lies at the southern tip of China and is a popular seaside destination for both domestic and international tourists. Its main resort is Sanya. Hainan offers water sports, swimming, yachting and duty free shopping. China’s State Council has decreed that the island should become a ‘world class international tourist resort destination by 2020.

Forty five-star hotels are due to be completed in the next five years in a 19km stretch of Haitang Bay, almost doubling the number of hotels in the city and giving Sanya a greater density of high-end hotels than any other city in China, including Beijing and Shanghai.

A report by WTTC suggests that Hainan is on track to become one of the world’s leading tourist resort destinations by 2021. The report found that 2021 tourism expenditure in Hainan will be roughly the equivalent to that of Singapore today, and the industry will support as many jobs as in Malaysia and Italy currently.

Shanghai: the city which is on the Huangpu River, is China’s largest port. Its main attraction is the Bund, a promenade along the river which is lined with Art Deco buildings from 1920s/30s. In 2010, the Bund was regenerated, with larger areas for pedestrians and a tunnel to reroute traffic under the road.

Shanghai is the second most visited city after Beijing and ahead of Xian, Guilin, Hangzhou and Sanya. The city successfully took advantage of being host to the World Expo in 2010, attracting 73 million visitors (of which 5.8% were from abroad). Thanks to the economic windfall from the event, Shanghai set a goal to become a global tourist destination and to increase sector-related revenues by 70%. This figure was already CNY305bn in 2010. While the domestic market already represented 260 million visitors in 2013, an increase of 3.6% on the previous year, 7.9 million tourists visited the city in 2014, up 4% over 2013. The visitors were primarily from Japan, Korea, the Philippines and Singapore.

TOURISM RECEIPTS

UNWTO provides data on tourism receipts, and as shown below, tourism receipts reached USD57bn in 2014.

ECONOMIC IMPACT OF TOURISM

According to WTTC’s Travel & Tourism Economic Impact 2015 on China, The direct contribution of Travel & Tourism to GDP in 2014 was CNY1,620.3bn (2.6% of GDP). This is forecast to rise by 6.7% to CNY1,729.6bn in 2015. This primarily reflects the economic activity generated by industries such as hotels, travel agencies, airlines and other passenger transportation services (excluding commuter services). But it also includes, for example the activities of the restaurant and leisure industries directly supported by tourists.

The direct contribution of Travel & Tourism to GDP is expected to grow by 6.0% pa to CNY3,100bn (2.8% of GDP) by 2025.

Travel & Tourism generated 23,160,000 jobs directly in 2014 (3.0% of total employment) and this is forecast to grow by 1.2% in 2015 to 23,428,500 (3.0% of total employment). This includes employment by hotels, travel agencies, airlines and other passenger transportation services (excluding commuter services). It also includes, for example, the activities of the restaurant and leisure industries directly supported by tourists.

By 2025, Travel & Tourism will account for 26,710,000 jobs directly, an increase of 1.3% pa over the next ten years.

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8 Hotel Analyst Emerging Markets Volume 1, issue 5
9 Hotels; China’s Hainan set for tourism boom: WTTC; September 2012
10 WTTC: Travel & Tourism Economic Impact 2015 on China

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**Hotel market**

**SUPPLY**

China’s hotel industry has recorded meteoric growth, resulting in some 2.5 million hotel rooms. Some analysts suggest that the market is reaching saturation point, but actually when compared to hotel penetration rates in mature markets, for example the UK has 10 hotel rooms per 1,000 capita and the US 20 hotel rooms per 1,000 capita – China, with just 4 hotel rooms per 1,000 capita, appears low.

Figures from the National Bureau of Statistics in China and the UNWTO indicate that China will move alongside the US to become one of the two largest hotel markets in the world by 2025, when China is expected to have 6.1 million hotel rooms, the same number the US is to have by that time[^25]. Research by AT Kearney estimates that over the next ten years, China’s room supply will grow to 6.3 million rooms, some 8 rooms per 1,000 capita. By 2039 it is forecast that China will have 9.1 million rooms, implying that 3 new 150-plus room hotels will open in China every day for the next 25 years[^26].

The leading economy brands include Vienna Hotel, Starway Hotel, Nanyuan Inn, Holiday Inn Express and JI Hotel.

**Midscale sector:** Estimates suggest that the branded midscale market (approx. 20,000 hotels) only makes just 4% of total midscale market. In a China Lodging presentation, the company estimates that while the branded economy hotels are set to grow by CAGR of 20% between 2011 and 2016, the midscale hotel market is expected to grow by CAGR of 50-60% over the same time period.

The leading midscale brands include Vienna Hotel, Starway Hotel, Nanyuan Inn, Holiday Inn Express and JI Hotel.

**Upscale and luxury sector:** Oversupply in the upscale and luxury hotel market is a major issue in the Chinese hospitality market. Both Beijing and Shanghai has a large share of luxury hotels. The high-end hotels have also been hit by the economic slowdown and government austerity measures.

China currently has about 110,000 luxury hotel rooms and another 50,000 are in the pipeline, according to STR Global. Many of these new rooms will be in cities such as Tianjin and Sanya that are not a draw for international tourists, making shrinking domestic demand a worry.

**KEY MARKETS**

**BEIJING**

During the Olympics, there was a huge development boom for hotels in Beijing. There are now approximately 800 star-rated hotels in the city totalling upwards of 200,000 rooms built in accordance with international and national standards. This hotel supply accounts for approximately 42% of the country’s total hotel supply[^27].

Policies encouraging industry infrastructure growth have led to an oversupply of luxury and upscale accommodation, due to the low costs of upgrading property in the city. Beijing’s hotel oversupply, particularly in the four and five-star category, predictably has its roots in the 2008 Beijing Olympics.

The event was both a blessing and a curse, as it stimulated tourism and investment, but it also left the city with falling room rates afterwards.

**SHANGHAI**

Shanghai is one of the most important hotel markets in China. The city has strengthened this position after strong growth in its hotel supply for World Expo 2010, which saturated the market for the years after the event. The surplus supply has since been absorbed by demand which has continued to grow in recent years, and the market has regained a balance, according to data published by the tourism authorities of Shanghai for the past year. The city’s hotel industry was able to improve its indexes thanks to growth in demand, especially within a country where the demographic advantage is undeniable. Hoteliers, whose business was previously affected by the economic crisis, are more confident now with regard to their outlook, particularly with the forthcoming opening of Shanghai Disney Resort and the completion of the city’s other tourist projects[^28].

While growth on the economy and midscale segments are mostly in the hands of local groups, there are opportunities in the upscale and luxury segments. Shanghai’s market is growing significantly on these segments. Starwood plans to establish its brand W in the city with the W Shanghai, scheduled to open in January 2017. Before that, the group will unveil its Sheraton Jiading Hotel (345 rooms) in June 2015, the sixth hotel by the brand in the city. Meanwhile, although Accor has entrusted the development of its economy brands in China to its new partner Huazhu, it has also announced the opening of a new Sofitel in Shanghai for the year 2016. Sofitel Shanghai Jing’an Huamin with 503 rooms and 77 suites.

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[^27]: MKG Consulting – Hospitality On: Beijing – How to become a World City, 2013
The global hotel industry has been focussed for years on what is going into Mainland China as the big brands jostle to expand there. Now it may also need to pay attention to what is coming out of there.

Mainland Chinese conglomerates are investing in Western hotel companies, and developers are investing in hotel properties worldwide. At the same time, Mainland Chinese domestic brands are popping up overseas.

“Given the size of China, over the next 10 years we expect to see a significant share of hotels in international gateway cities under Chinese ownership that will likely be partially proportionate to the level of visitation by the Chinese,” says Daniel Voellm, managing director, HVS Hong Kong.

Financing deals is not a challenge for these Chinese companies as they typically have strong balance sheets and are able to draw on domestic and local debt to fund their expansion.

Like the Japanese 25 years ago, Mainland Chinese investors are pumping billions into foreign real estate investments despite challenging capital flow restrictions on outbound investment. Chinese companies are investing in mixed-use developments that include a hotel component, a trend likely to continue in the near future.

An example of this is the USD 1bn investment announced in June 2013 by the privately held Dalian Wanda Group to develop and brand a 160-room 5-star hotel in London with Green Property.

Analysts say these investments are likely to be more long-term than that of private equity companies as the goal of the Chinese developers is to diversify their holdings in more mature markets so their portfolios are less susceptible to price or rate movements.

The investments in Western hotel companies are coming from both large state-controlled and privately held companies.

Shanghai Jin Jiang International was an early example of this, with its joint venture investment in 2010 with Thayer Lodging to acquire Interstate Hotels & Resorts.

April 2013 saw HNA Group purchase a 20% stake in NH Hotels with a USD 307m capital increase. It then increased this to 29.5% in 2014.

The privately held Fosun International along with AXA Private Equity in May 2013 gave Club Med a buy-out offer estimated at USD 719m.

Jin Jiang’s acquisition of Louvre Hotels Group in 2014/15

International real estate advisor Savills, predicts Chinese investors will increase their share of global cross border hotel acquisitions from the current level of 4% to 10% by 2017. The firm believes that the Asia-Pacific regions and the UK, namely London, are set to benefit the most from this growing investment in line with the expansion of overseas Chinese tourism.

According to statistics from Real Capital Analytics (RCA), Chinese investors have spent approximately GBP 1.6 billion outside of their domestic market over the last five years. Savills predicts there may be further Chinese investment in the form of corporate acquisition as it represents an attractive channel into the UK and European markets. Direct investment into individual hotel assets will increase as the momentum of wider real estate and infrastructure investment continues into the UK and is supported by visitor growth. The firm also states that it has seen a growing number of Hong Kong and Chinese Hotel groups looking to establish their own brands in the UK in order to capitalise on the growth in Chinese visitors.

Savills reports that Hong Kong and mainland Chinese purchasers have acquired approximately 18 hotels and hotel development sites in the UK over the last five years spending close to GBP 450m. The firm estimates that over the next three years activity by this group could more than double with annual average volumes in excess of GBP 200m.

According to JonesLangLaSalle, Over H2 2014, Chinese insurance companies continued to broaden their investment scope after the relaxation of outbound investment rules that came into effect on 6 October 2014. Previously, any overseas investment project worth more than $100 million required approval from China’s Ministry of Commerce.

It had been somewhat difficult for local institutional investors to compete in ‘on market’ processes, as the time frame required for internal and external approvals often exceeded the sales campaign.

According to the China Insurance Regulatory Commission, domestic insurance companies currently have around 1% of funds invested in real estate assets abroad, against the regulatory ceiling of 15%, suggesting the significant potential for the growth in outbound capital in years to come.

Once traditionally the investment playground for Chinese investors, the drawing out of capital within the Asia region and into new markets previously noted at relatively lower values-per-key is taking place.

Chinese investors with a mandate focused on hospitality have also turned their attention to acquiring management companies. More recently, Shanghai’s Jin Jiang acquired France’s Louvre Hotels Group and the iconic Club Méd was eventually purchased by Fosun International Ltd.

China’s policy change enables investors to more readily compete in international bidding processes. This will have a mixed implication for China domestically. On one hand, less capital circling the country might temper the development pipeline in markets where supply is too high. On the other hand, China faces a risk that local investors won’t focus their attention towards existing assets within China.