

# China's Hospitality Industry—Rooms for Growth

Far from reaching a saturation point, the explosive growth of China's hospitality market will continue unabated over the next decade.



China's hotel industry has experienced meteoric growth, resulting in a \$44 billion business with 2.5 million hotel rooms. Some analysts suggest the market is reaching its saturation point, but when compared with hotel penetration rates in mature markets—the United Kingdom, for example, has 10 hotel rooms per 1,000 capita and the United States 20—China, with just 4 rooms per 1,000 capita, appears low. We believe there is still a lot of room for growth: Over the next 10 years, hospitality will become a \$100 billion industry with 6.3 million rooms and reach 8 rooms per 1,000 capita.

What do hospitality players need to know to capitalize on the growth? There are five trends that could make or break you in China.

## Trend 1: Growth Will Vary Across Segments

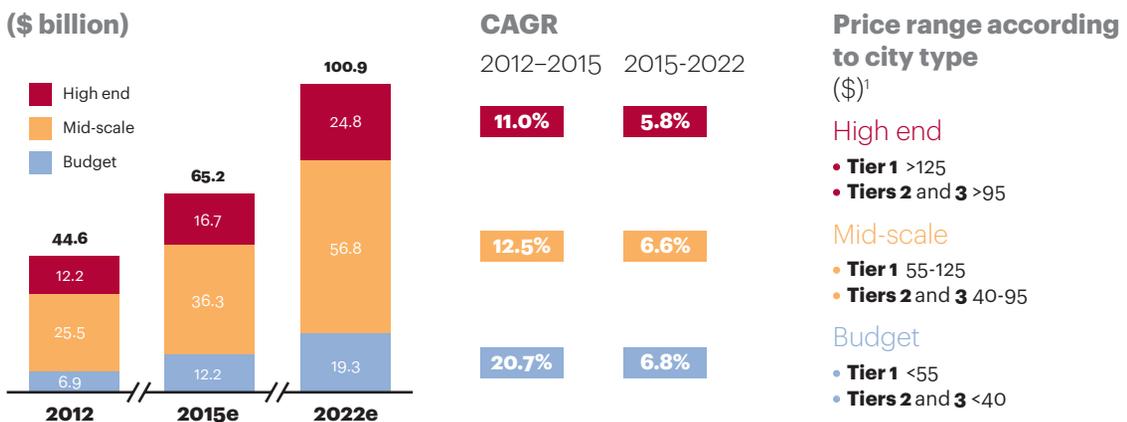
All segments will experience growth in the next decade, but the mid-scale and budget segments will have the biggest growth (see figure 1).<sup>1</sup> The most significant growth areas are likely to be tier 2 and tier 3 cities, due to a continued demand for meetings, incentives, conferences, and exhibitions. The large number of new tourism projects in the pipeline and proliferation of high-tech and industry parks will also drive demand for travel accommodations.

### Key takeaway: There is ample room to grow and new entrants will emerge

China's hospitality market will be among the most important—if not the most important—markets for global operators, as room supply continues to grow and players broaden their portfolios with more brands. A strong China presence is also important as Chinese outbound travelers continue to increase in number and look for familiar brands (see sidebar: China's Outbound Tourism). Marriott, Starwood, InterContinental, and Accor have a combined pipeline of about 400 new hotels in China and are still building. Regional entrants will also emerge to seize opportunities before the market consolidates further.

Figure 1

### Mid-scale and budget hotel segments in China will experience the greatest growth



<sup>1</sup> Price is standard room rate before tax.

Sources: National Bureau of Statistics of China; customer survey; A.T. Kearney analysis

<sup>1</sup> Market size includes targeted five-star, four-star, three-star, and budget segments, and excludes one-star and two-star hotels and unrated guest houses.

## China's Outbound Tourism

With an estimated 80 million overseas travelers in 2012, China has surpassed the United States and Germany to become the world's largest source of outbound travelers and accounts for 30 percent of the growth in international tourism. The top 10 destinations for Chinese vacationers include Hong Kong (more than 20 million), Macau (more than 17 million), and Thailand, Singapore, Malaysia, Japan, the United States, and Vietnam with between 1 and 2 million apiece. This growth is expected to reach an estimated 200 million travelers by 2020,

driven by the growth of the middle class, an increase in the government's approved destinations, and an easing of visa requirements.

To capture this market, global hospitality players are tailoring their offering worldwide to provide Chinese guests with familiar comforts. In Hilton's Huanying ("Welcome" in Mandarin) program, guests are greeted at the front desk by a Chinese-speaking team member, guest rooms are outfitted with amenities such as tea kettles and slippers, and breakfast includes traditional Chinese items such as

dim sum, congee, hard-boiled eggs, fried rice, fried noodles, and dough fritters.

Global players are also recognizing the opportunity to build brand loyalty in China. Our consumer research shows that brand is an important criterion for selecting hotels and that Chinese guests choose familiar brands when traveling abroad. This becomes more important as more Chinese travelers book their accommodations online or directly through a hotel rather than through a travel agent or tour operator.

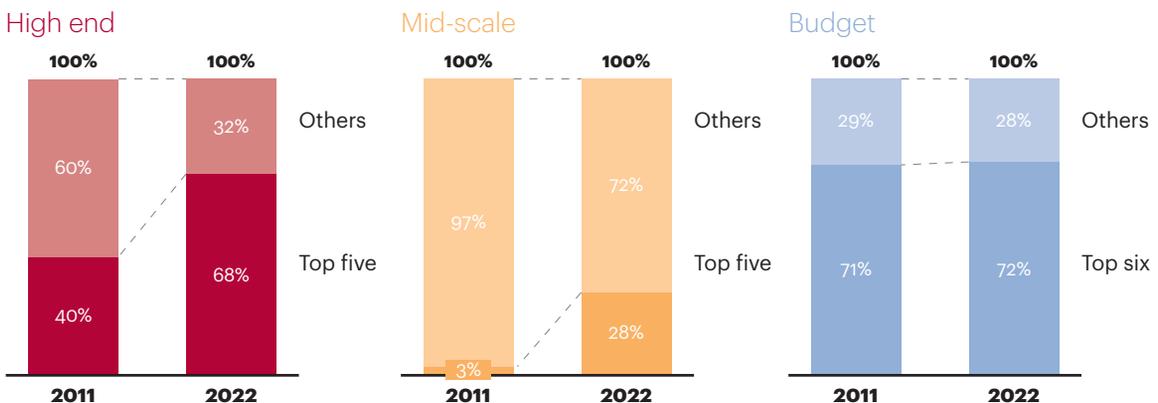
## Trend 2: Consolidation Will Occur in the High-End and Mid-Scale Segments

Significant investment and consolidation has taken place in the past few years, especially in the budget segments—Home Inns' acquisitions of eJia Express, Motel 168, and Top Star Hotels are examples. The high-end and mid-scale segments will likely dominate future consolidation (see figure 2). Of the two segments, the mid-scale is the most fragmented. Consolidation will

Figure 2

### Consolidation in China's hotel industry will occur mainly in the high-end and mid-scale segments

#### Market share of top five and top six players



Sources: National Bureau of Statistics, analyst reports, annual reports of listed hotel companies; A.T. Kearney analysis

occur as large budget operators expand into the mid-scale segment, as exemplified by Hanting's acquisition of the Starway chain in 2012. International operators are also expanding their brands and presence in this segment and looking for the right acquisitions.

**Key takeaway: Capture mid-scale and high-end business now, before further consolidation**

Because the mid-scale segment is underserved, competition will intensify as domestic budget operators extend their presence and international chains invest in it. We expect to see more acquisitions in this segment and new, stronger leaders emerge. As the high-end segment further consolidates, opportunities for new entrants will become increasingly difficult and the next two to three years could be the last window of opportunity for them to make a significant push.

### Trend 3: Travelers are Becoming More Sophisticated

China's burgeoning economy has produced a large middle class looking for services that improve quality of life, which in turn has spawned a growing trend toward more leisure and vacation travel in China. The percentage of travel undertaken for leisure purposes grew from 30 percent in 1999 to 46 percent in 2010, a trend that is expected to continue.

---

**China's hospitality market** will be among the most important—if not the most important—markets for global operators.

---

How the Chinese vacation is also changing. A recent A.T. Kearney consumer study of China's upper middle class—currently comprising 13 million households and projected to grow to 55 million in 10 years—shows that the Chinese largely prefer self-planned travel over group travel packages.<sup>2</sup> Of the 712 participants we surveyed, 89 percent had experienced self-planned tours while 72 percent had bought a package tour. These vacationers seek relaxation rather than a tight tour schedule, and they want to explore new destinations each time they travel, unlike Western travelers who tend to revisit favorite vacation spots. As one respondent put it, "There is an ancient Chinese [proverb that says] it is better to travel 10,000 miles than to read 10,000 books. I am eager to visit different places."

Chinese travelers are changing not only how they vacation, but also how they plan and book their trips. Our consumer study finds that about 70 percent of travelers use online travel sites for information gathering, with 58 percent booking their accommodations on sites such as Qunar.com or Lvmama.com (see figure 3 on page 5). With China's 500 million-plus Internet users and an ever-increasing demand for individual self-planned tours, online travel sites are important distribution channels for any hotel operator.

---

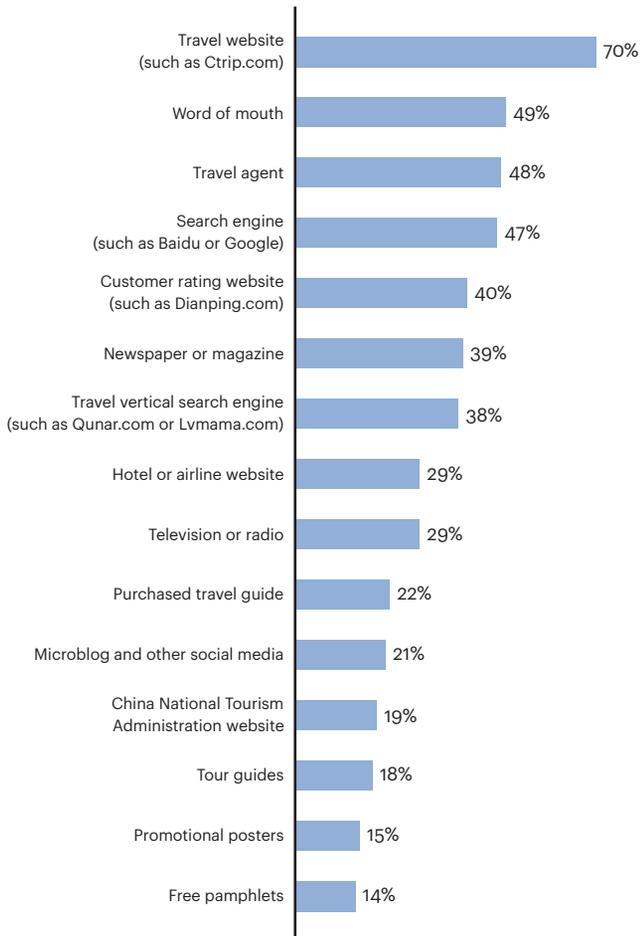
<sup>2</sup> China's upper middle class is defined in this report as having an annual income of more than RMB 300,000 in tier 1 cities and more than RMB 200,000 in tier 2 cities.

Figure 3

**Some 70 percent of Chinese travelers use travel websites for gathering information**

**Source of hotel information**

(% respondents)



**Most frequent channels used to book a hotel**

(% respondents)



Source: A.T. Kearney analysis

**Key takeaway: Adapt your concepts, offerings, and economics to be successful in the Chinese market**

Chinese consumers have specific demands, and some international chains have launched brands and concepts expressly for the Chinese market such as Accor’s Mei Jue instead of the Grand Mercure brand, InterContinental’s Hualuxe, and Mövenpick’s Rui Xiang. The right network of locations, products, services, and amenities is also crucial. The latter two are especially important in China, where F&B (food and beverage) and spas account for more than 50 percent of hotel revenues. Investment in brands, distribution, and a strong local loyalty program is another key to winning visitors—a solid brand and distribution could increase revenues by 20 percent or more. Our consumer study shows that 50 percent of upper middle-class Chinese are influenced by loyalty programs when choosing a hotel. InterContinental Hotels Group (IHG) has the largest active loyalty program in China, with 2 million members.

Finally, an adaptation of standards and economics is vital for profitability and, consequently, for the development pace in China. Hotel chains with strong brand standards will need to be flexible enough to develop hotels with favorable economics. For example, for two- to three-star hotels, sound insulation is not such a big issue in China as in Europe and the United States, offering savings in construction costs.

## Trend 4: New Models and Formats

To capture the growing demands of vacation travelers, major hotel chains such as Starwood and Marriott and boutique operators such as Club Med and Banyan Tree are increasing their vacation-resort footprint across China. This trend is not limited to high-end properties. Domestic budget operators, aware that 63 percent of budget accommodations are for leisure travelers—versus 42 percent of high-end accommodations—are considering opening up budget resorts.

China's vacation-rental market is also taking off, and is expected to double in size annually over the next two years to reach \$1 billion in 2015. Leading players include Tujia, Airizu, YTX, and Mayi. Tujia, with investments from China's leading online travel agency Ctrip and major U.S. vacation-rental firm HomeAway, dominates the high-end market. Tujia caters to travelers seeking hotel-style services in their rental accommodations such as room maintenance, pick-up and delivery, and restaurant-guide assistance.

---

## **For two- to three-star hotels,** sound insulation is not such a big issue in China as in Europe and the United States.

---

The time-share format, although not new in China, is still in its infancy. Domestic players such as HNA's Club Vac, Tianlun Vacations, and Freedom Vacation Club are time-share leaders. While many Chinese still largely view time-shares negatively—58 percent of respondents cited company bankruptcy as the reason for their disapproval and 40 percent complained about inflexibility—attitudes have begun to change as they have become acquainted with the time-share concept in mature markets. The comments of one consumer focus group in our study include the following:

“I like this new concept. With enough of a guarantee, I will try a time-share.”

“This is absolutely my dream vacation. I can't wait to get there.”

“Look at those big rooms and the friendly staff. I am confident of the service quality now.”

“These resorts are really attractive and make me feel at home.”

International hotel operator Anantara is planning to offer time-shares in China, and it won't be long before other major players do the same.

## Key takeaway: Innovate and prepare for new competitive models

Options for consumers will increase, as will the competition. The market will continue to innovate, so it would be wise to look beyond the traditional competitive realm. Consider new models and formats, and leverage synergies and differentiation through a mixture of properties and products. It will be essential to tailor new formats and concepts to the Chinese consumer by, for example, offering butler-type services for vacation rentals and shorter rental terms, and more services in general for time-shares.

## Trend 5: Government Continues to Shape the Market

China's Five-Year Plan identifies tourism as a core growth engine, and many provincial government authorities plan to further promote tourism by encouraging direct investment in tourism real estate and the tourism industry (see figure 4). As these governments develop their plans, they are focusing on differentiation, internationalization, high-end brands, and big impact, welcoming investments, and providing support for major hospitality players such as land-price discounts, cash or tax incentives, and priority approval processes. Others are considering providing support for new formats such as time-shares and vacation rentals as a way to help sell existing properties.

Figure 4  
**How Chinese cities plan to develop tourism**

City	Tourism development plan
<b>Weihai</b>	<ul style="list-style-type: none"><li>• Concentrate on multiple interests including sightseeing and recreation</li><li>• Create new options and develop high-end facilities and services</li><li>• Focus on domestic and international tourists</li><li>• Improve service quality and infrastructure</li></ul>
<b>Kunming</b>	<ul style="list-style-type: none"><li>• Accelerate tourism through transformation and upgrade of hotel industry</li><li>• Pinpoint large-scale projects and tourism activities</li><li>• Capture more international tourists and investments</li></ul>
<b>Yangzhou</b>	<ul style="list-style-type: none"><li>• Promote city's ancient and modern culture</li><li>• Undertake bigger projects (with significant investment and well-known brands for high impact)</li><li>• Improve city image through brand differentiation and upgrade</li></ul>
<b>Lijiang</b>	<ul style="list-style-type: none"><li>• Capitalize on reputation as landscaped garden city</li><li>• Increase brand awareness through high-end, unique folk culture, and ecological and special interest vacations</li><li>• Bolster national and international cooperation</li></ul>
<b>Sanya</b>	<ul style="list-style-type: none"><li>• Vigorously attract international tourists and investments</li><li>• Carefully nurture scenic spots brand</li><li>• Prudently develop differentiating activities such as golf and submarine sightseeing</li></ul>
<b>Yangshuo</b>	<ul style="list-style-type: none"><li>• Strengthen tourism industry</li><li>• Grow all segments from low end to high end</li><li>• Center on sightseeing, culture, leisure, ecology, folk culture, and exploration</li></ul>

Source: A.T. Kearney interviews with government investment bureaus and regional tourism administrations

---

**Key takeaway: Develop a clear government-relations strategy**

Invest in government relationships, either by building your own team or developing relationships with leading local developers. Many developers that overbuilt during the previous property boom are looking for partners to help market and manage their properties. Others, such as Vanke, that traditionally focused on residential projects will be looking for new sectors to grow. For example, IHG has built strategic partnerships with key developers ETG, Shimao, HNA, and Poly Real Estate, while Starwood has done the same with Wanda, Greentown, and Powerlong.

---

## Invest in government relationships, either by building your own team or developing relationships with leading local developers.

---

If you're considering time-shares and vacation rentals, developing government relationships will be even more important as regulations are underdeveloped in these sectors. A multi-pronged effort, focusing on both the central government, such as the National Tourism Administration, and various local and provincial governments, will be the best approach.

## Changing Rooms

Change is occurring in China's hospitality industry and the next five years will be crucial as the market consolidates and new players emerge. Implementing a comprehensive plan that responds to these trends will position players for success, not just now but well into the future.

---

### Authors



**Mui-Fong Goh**, partner, Beijing  
mui-fong.goh@atkearney.com



**Chee Wee Gan**, principal, Shanghai  
chee.wee.gan@atkearney.com



**Dale Kim**, principal, Shanghai  
dale.kim@atkearney.com

---

A.T. Kearney is a global team of forward-thinking partners that delivers immediate impact and growing advantage for its clients. We are passionate problem solvers who excel in collaborating across borders to co-create and realize elegantly simple, practical, and sustainable results. Since 1926, we have been trusted advisors on the most mission-critical issues to the world's leading organizations across all major industries and service sectors. A.T. Kearney has 59 offices located in major business centers across 39 countries.

---

<b>Americas</b>	Atlanta	Detroit	San Francisco
	Calgary	Houston	São Paulo
	Chicago	Mexico City	Toronto
	Dallas	New York	Washington, D.C.

---

<b>Europe</b>	Amsterdam	Istanbul	Oslo
	Berlin	Kiev	Paris
	Brussels	Lisbon	Prague
	Bucharest	Ljubljana	Rome
	Budapest	London	Stockholm
	Copenhagen	Madrid	Stuttgart
	Düsseldorf	Milan	Vienna
	Frankfurt	Moscow	Warsaw
	Helsinki	Munich	Zurich

---

<b>Asia Pacific</b>	Bangkok	Melbourne	Singapore
	Beijing	Mumbai	Sydney
	Hong Kong	New Delhi	Tokyo
	Jakarta	Seoul	
	Kuala Lumpur	Shanghai	

---

<b>Middle East and Africa</b>	Abu Dhabi	Johannesburg	Riyadh
	Dubai	Manama	

---

For more information, permission to reprint or translate this work, and all other correspondence, please email: [insight@atkearney.com](mailto:insight@atkearney.com).

A.T. Kearney Korea LLC is a separate and independent legal entity operating under the A.T. Kearney name in Korea.

© 2013, A.T. Kearney, Inc. All rights reserved.

---

The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring "essential rightness" in all that we do.

---