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Why China? A study of why foreign hotel companies are rushing to develop new luxury hotels in China

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Why China? A study of why foreign hotel companies are rushing to develop new luxury hotels
in China

by

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of the requirements for the

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PART ONE

Introduction

In today's hotel development world it has become commonplace to hear of new internationally branded hotels opening in China. A quick glance at the website of any major multinational hotel company will confirm that China accounts for a large percentage of near-term development. A more in-depth look at any one of those multinational hotel companies will highlight a long-term strategy that is centered on the significant hotel development pipeline in China. A report in Lodging Hospitality published after the 2011 New York University International Hospitality Industry Investment Conference, where over 2,000 industry executives gathered, further supported the bullish stance many hotel companies have taken towards hotel development in China. While the CEOs expressed caution over world events and their effect on the lodging industry, they also cited the overall strength in the world economy as a hopeful sign. Starwood's CEO Frits van Paasschen expects the projected 4.5% growth in global GDP to significantly drive his company's business. The talk of global economics quickly led the executives into their new favorite topic: the seemingly endless opportunities for hotel development, management and franchising in emerging markets, particularly China (Anonymous, 2011, p. 1).

Over the last two decades companies such as Hyatt, Starwood, Hilton, InterContinental Hotels Group, Marriott, Kempinski, and Four Seasons have successfully challenged the long established reign in the Chinese luxury segment previously held by Peninsula and Shangri-la. The success of the aforementioned traditional multinational hotel companies has attracted new players like MGM Resorts International and Caesars Entertainment Inc. to incorporate expansion

into mainland China in their corporate strategies. It appears almost every multinational hotel company is placing an increased emphasis on their expansion efforts in China.

Purpose

The purpose of this professional paper is to identify why China is currently the number one recipient of foreign investment from foreign multinational luxury hotel companies.

Statement of Objective

An exploratory study will be conducted in support of the purpose. With such a lack of available information relating specifically to luxury hotel development in China; published data on the current economic, cultural, and tourism environment in China will be used to support conclusions made in regard to luxury hotel development by multinational hotel companies.

Justification

Deng Xiaoping's introduction of the Open Door Policy in 1978 opened the door to what would become decades of unprecedented economic growth in China's history. Riding along the waves of new found economic liberty and the freedom to partner with foreign investors, China's hotel investment community seized the opportunity to welcome outside investment. The hotel industry in China quickly developed from 137 properties in 1978 to 14,237 properties in 2009. One of the main catalysts of the rapid development seen in the hotel industry has been the expansion of multinational hotel groups into China (Zhang, Guillet, & Gao, 2011).

The outlook for international tourism in China remains extremely positive. In a 2010 study conducted by the World Tourism Organization, China was listed as the fourth most popular international tourism destination (in terms of arrivals) with 133 million visitors. The number of international visitors to China is expected to increase to 137 million by 2020. As

positive as these numbers seems, they are dwarfed in comparison to the 2+ billion people participating in leisure travel within China already.

Currently, there is little information available on what makes China an attractive target for foreign multinational luxury hotel companies. This paper will serve to address the void of information relating to this specific issue.

Constraints

The main constraints that exist in this study are due to the limited availability of information. Development information available from hotel companies is limited to projects that are currently in construction or have been publically announced. Information regarding potential future projects with signed letters of intent, scale of development pipelines with joint venture partners and targets of acquisition, which number in the thousands, are not publically available. A second major constraint is the accuracy of information reported by the Chinese government. Economic statistics can vary depending on the intent of the report. Since economic information is closely censored by the Chinese government, the validity of economic may be questionable.

PART TWO

Introduction

In recent years, China has played host to premier global events like the 2008 Olympics in Beijing and the 2010 World Expo in Shanghai. Interest in traveling to China and doing business with China has been on the rise for the past decade. Few industries, if any, have benefited more from growing interest in all things China than the tourism industry. Tourism in China, both domestic and international, has exploded in recent years and foreign hotel companies are racing to fly their flags in key markets in China and capture a portion of the rapidly growing tourism market. The hospitality industry is one of the forerunners in economic development and privatization in China (Chan & Yeung, 2009). In a recent report published by InterContinental Hotels Group (IHG), the largest hotel company in the world by number of rooms, China is expected to reach 6.1 million hotel rooms by 2025, the same as the United States (Yang, 2011). China is the fourth top international destination country and will be the top international destination country with over 137million international arrivals by the year 2020 according to the World Tourism Organization's forecast (Guillet, Zhang, & Gao, 2012). This literature review will explore which multinational hotel companies are expanding in China as well as the general economic and cultural conditions that will affect future growth in the country.

Current Hotel Market in China

The first joint-venture hotel began in 1982 with the Jianguo Hotel, importing the management of the Hong Kong Peninsula group. Since then, China has experienced rapid growth (Kong, 2009). Table 1 illustrates the latest available figures from the China National Tourism Administration regarding hotel growth in China. The statistics indicate a 13% compound annual growth rate (CAGR) over the last 5 years. In 2010 there were 15,713 hotels

open in China with over 2.2 million rooms generating over 27 trillion Yuan annually. Despite the global economic downturn from 2008-2010, total hotel revenue growth in China advanced 2.7% during the period. The substantial increase in revenue during a period of worldwide economic slowdown clearly indicates a greater demand for and availability of higher end lodging as well as food and beverage in China.

Table 1

Overview of Current Hotel Market in China

Year	2006	2007	2008	2009	2010
Total Hotels	10,269	10,971	14,628	14,498	15,713
Total Hotel Rooms (x10,000)	N/A	N/A	215.5	201.7	224.9
Total Revenue (x100 million Yuan)	1,551	1,804	2,231	2,260	2,797
Revenue from Rooms (x100 million Yuan)	742	851	1064	1041	1309
Revenue from Meals (x100 million Yuan)	607	715	887	931	1143

Note: Yearbooks of China Tourism Statistics (Beijing: China National Tourism Administration, China Travel and Tourism Press, 1990–2011).

Ownership Model Breakdown

Table 2 illustrates the most recent information regarding the breakdown of ownership in the Chinese hotel market. Historically, foreign investment by multinational hotel groups (MHG's) is done through cooperative and joint ownership enterprises. As indicated in Table 2, these hotels account for only 1.7% of all hotels in China in 2010. Hotels characterized as a private enterprise are currently the most numerous in China. The main difficulties in operating any business as a standalone entity, especially a hotel, stem from the lack of recognition from foreign customers and the scarcity of investment money. Lending institutions may require high

interest rates on loans to private enterprises due to their lack of scale and relatively small asset base when compared to corporations. As shown in table 2, After private enterprises, limited liability corporations and state-owned enterprises account for the second and third most common ownership model in the Chinese hotel market.

Table 2

Hotel Ownership Models in China

Year	2010
Private Enterprises	6250
Limited Liability Corporations	3557
State-owned Enterprises	3119
Collective-owned Enterprises	680
Share Holding Corporations Ltd.	537
Other Enterprises	301
Cooperative Enterprises	185
Joint Ownership Enterprises	69

Note: Yearbooks of China Tourism Statistics (Beijing: China National Tourism Administration, China Travel and Tourism Press, 1990–2011).

What Hotel Companies are Growing in China

Prior to recent outside investment from foreign hotel companies, the general condition of the Chinese hotel market was poor. A history of poor planning, uncoordinated development, poor management, and rapid deterioration of hotels in China prior to the year 2000 (Chan & Yeung, 2009, p. 210-223) helped pave the way for foreign companies to expand into China and capture guests who were dissatisfied with the hotel product that was available.

1st Wave of Development: InterContinental Hotels

InterContinental Hotels Group (IHG) entered China in the mid 1980's. They were the first U.S. based MHC to focus on growth in China. It is apparent that IHG is showing no signs of scaling back their fast paced development in the region. IHG opened 8,084 new rooms in China in 2011 alone, bringing their total room count in China count to an astonishing 55,182 rooms. The new IHG hotel openings included four of their flagship luxury InterContinental Hotels and 11 Crowne Plaza Hotels, which cater to the much sought after business travel segment. IHG reported 17.4% RevPAR for the year in 2011, which was a 10.7% increase over the previous year (HMA Staff, 2012).

IHG, hoping to continue their strong financial performance in China, has announced significant upcoming development and plans for strategic alliances over the next few years. IHG currently has 49,768 rooms in the pipeline and of those 70% are already in development. In Macau, IHG partnered with Sands China Ltd. to develop the world's largest Holiday Inn, which opened in April 2012 with 1,224 rooms as part of Sands' \$4.4B Cotai Central project. Interestingly, Sands Cotai Central will also be the site of two of IHG's major competitors in the region – Starwood and Hilton. Directly adjacent to IHG's Holiday Inn Macau there will be a Sheraton (Starwood) and Conrad (Hilton).

IHG, like all foreign hotel companies operating in China, are hoping that the strong financial performance in China and other emerging markets will help offset the effect of the recent economic downturn in the U.S. market. Earlier this year Richard Solomons, Chief Executive Officer of InterContinental Hotels Group, said "Looking ahead, in spite of considerable uncertainty in the Eurozone, IHG is well positioned globally to benefit from

positive long term industry trends and, in particular, growing demand in emerging markets.”(HMA Staff, 2012)

2nd and 3rd Waves of Development

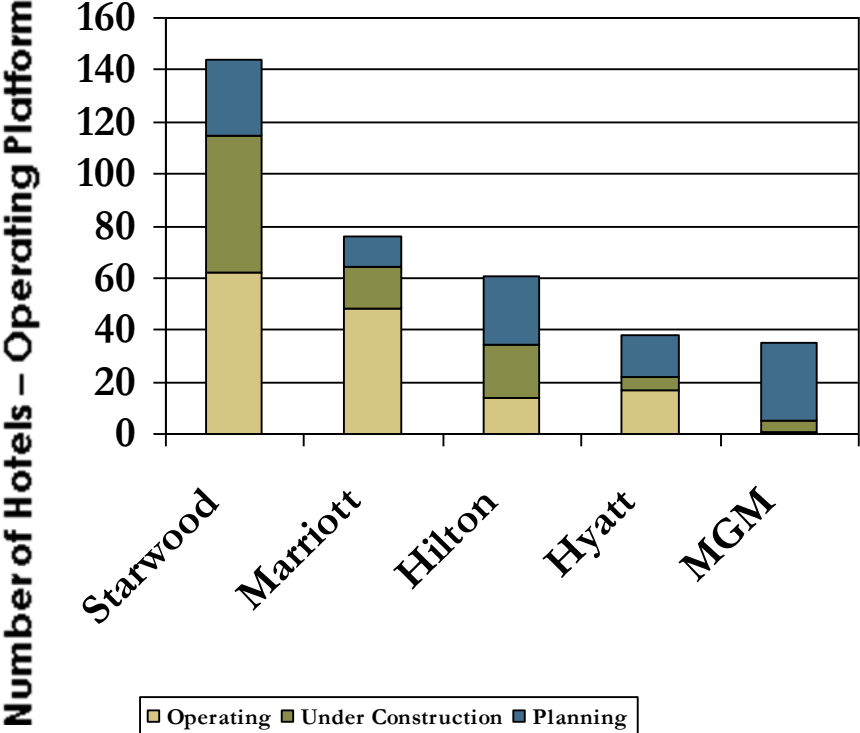
Seeking to mimic the early success of IHG, companies such as Marriott, Hilton and Starwood partnered with private, public and state-owned enterprises to expand their operations to China. These U.S. hotel companies initially entered gateway cities like Beijing, Shanghai and Hong Kong with the intent of establishing their premier legacy global brands. Mark DeCocinis, Ritz-Carlton Regional General Manager for China, supported the IHG CEO’s view on China as the current premier global market. “The Asian hotel market has come back stronger and more quickly than other parts of the world — and China is leading the way.” (Wassener, 2010, p. 1) Ritz-Carlton, which went from having 1 hotel in China in 2007 to 11 hotels in 2011, will be opening another 10 hotels in Asia in the next 5 years. Of those 10 hotels, DeCocinis believes 5 of those will be in second tier Chinese cities like Chengdu and Qingdao (Wassener, 2010).

After a successful launch of their legacy global brands many MHG’s quickly established footholds in gateway cities with their non-flagship brands. For instance, Marriott brought Courtyard and Renaissance to Beijing after they had successfully launched Ritz-Carlton, JW Marriott and Marriott in Beijing. Starwood brought Four Points and aloft to China after they had previously launched the Sheraton, Westin and St. Regis brands. Allowing Chinese customers and global travelers to become acquainted with foreign brands via placement in gateway cities would increase the level of recognition and success rate with expansion to smaller markets in the future.

Figure 1 illustrates the aggressive growth plans of five MHG’s operating in China who are quickly expanding their market share. Figure 1 shows the current number of hotels, those

under development and projects in the pipeline. In China, Starwood is expanding its hotel base by 132%, Marriott by 58%, Hilton by 336% and Hyatt by 124%. Starwood was one of the first foreign hotel companies to pursue domestic tourists within China outside of gateway cities and was also the first mover among foreign hotel companies to build luxury properties in the domestic hub business cities of Xi'an and Chengdu. The company currently has more than 3 times as many properties as Hilton and Hyatt with an equally aggressive growth strategy to ensure their luxury brands are the most widely spread throughout China.

Hotel Development Pipelines of Select MHG's in China



Note: Smith Travel Research, 2011

Figure 1

Key Development Markets

Figure 2 illustrates the development priorities by location for foreign hotel companies who have entered the Chinese market in the past decade. “A markets” are defined as regions

with at least 10 foreign branded luxury hotels in operation and built by multinational hotel groups (MHGs). “B markets” are defined as regions with at least 5 foreign branded luxury hotels in operation or in the development pipeline, which will be operated by foreign MHGs.

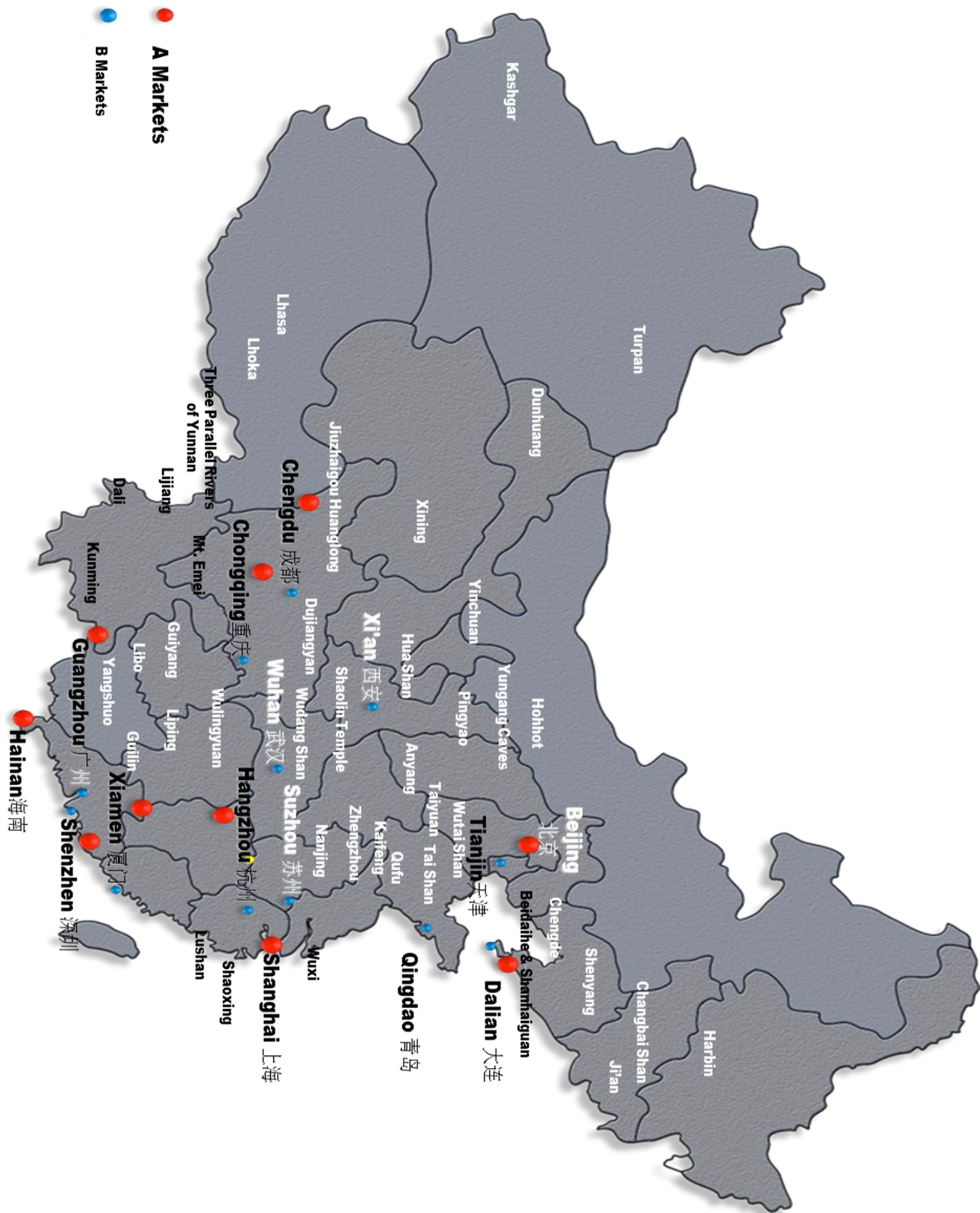


Figure 2

Luxury Focus

It is apparent that most foreign hotel companies are opting to bring their top-end brands to China and build luxury properties rather than mid-range and budget hotels. This is due to the higher margins gained from operating luxury properties in China over other categories. Table 3 (below) illustrates the top twenty hotels in China by revenue in 2009. A quick glance at Table 3 highlights that the majority of the top revenue generating properties are foreign luxury branded hotels. A less obvious aspect of Table 3 is that foreign branded hotels in non-gateway cities like Chongqing and Shenyang are also heavily represented in the ranking.

Table 3

Ranking of Top Twenty Revenue Generating Hotels in China

Rank	Hotel
1	The Ritz-Carlton Beijing, Financial Street
2	The Westin Guangzhou
3	JW Marriott Hotel Shanghai at Tomorrow Square
4	Sunworld Dynasty Hotel
5	The Eton Hotel Shanghai
6	Radegast Hotel Beijing
7	Pullman Beijing West Wanda
8	Hilton Beijing
9	Sunrise International Hotel
10	Grand Millennium Beijing
11	Westin Beijing Financial Street Hotel
12	Sheraton Xi'an Hotel

13	Sheraton Shenyang Lido Hotel
14	The Regent Beijing
15	Chang An Grand Hotel
16	JW Marriott Hotel Chongqing
17	Beijing Chang Fu Gong Hotel
18	Crowne Plaza Park View Wuzhou Beijing
19	Kempinski Hotel Shenyang
20	BaoAn Hotel Shanghai

The significance of having foreign branded non-gateway city hotels included in the list of the top 20 revenue generating hotels in China is magnified when you take into account the number of foreign branded luxury hotels that are currently operating in China. Table 4 illustrates the top ten largest parent companies of five star hotels in China. It is important to note that the star ranking system in China is not affiliated with the AAA and Mobil scale used in western countries. In order to meet international standards, the China National Tourism Administration (CNTA) introduced the star-ranking system in China. It is based on architecture, decoration, facilities, maintenance, management level, service quality, and level of service in the hotel (Chan et al, 2009).

Table 4

Ranking of Top Ten MHG's (by number of hotels) Operating 5 Star Hotels in China

Rank	Company	5 Star Hotels
1	Starwood	62
2	Marriott	48
3	Greater China Hospitality	38
4	Jin Jiang	25
5	Jingling	25
6	Intercontinental	23
7	Hilton	14
8	HNA Hotels	12
9	BTG Jianguo	10
10	New Century Hotels	10

Internal Tourism in China

In the past few years foreign hotel companies have opened many successful hotels in key gateway Chinese cities like Beijing and Shanghai. The successful launch of those hotels and the growing brand appreciation from Chinese customers coupled with the rise in Chinese individual wealth has prompted many foreign companies to focus on expanding further into China. For example, the relatively small scale Fairmont Hotels & Resorts has three new hotels slated to open in China in the next two years. All three Fairmont properties are being built in second tier Chinese cities – Chengdu, Nanjing and Taiyuan (Fairmont Hotels & Resorts, 2012). As previously illustrated in Figure 2, many foreign hotel companies are now setting their sights

away from first tier gateway cities and traditional “A markets.” Table 5 illustrates by percentage the fastest growing hotel markets in China during 2011. Chengdu, which is a major domestic and international hub for Air China, experienced 15% more revenue hotel growth than Beijing and 46% more growth than Shanghai during 2011. Interestingly, Shanghai, which experienced -9% hotel revenue growth, was the only major city in China to have negative revenue growth during 2011(Horwath HTL, 2012). The growth in revenue among second and third tier Chinese cities is likely the result of foreign direct investment in those markets by MHG’s.

Table 5

Fastest Growing Hotel Markets (by percentage) in China During 2011

Market	Growth in 2011 (%)
Chengdu	37
Chongqing	34
Xi’an	31
Xi’amen	30
Sanya	29
Guangzhou	28
Tianjin	26
Qingdao	25
Suzhou	24
Beijing	22
Shenzhen	19
Nanjing	18
Hangzhou	17

Dalian	12
Shanghai	-9

Note: Horwath HTL., & STR Global., 2012

"Today, more than 50 percent of our guests in China are Chinese. The Chinese are beginning to become a major global travel force as well," said Simon Turner, president of global development for Starwood. "When they travel abroad, the Chinese will stay with the hotel brands they know from home, which underscores the significance of our growing footprint of flagship hotels in China and its halo effect on Starwood's hotels around the world," he said (Yang, 2011, p. 1). The rise in foreign hotel brand recognition has forced many domestic Chinese hotel companies to collaborate and develop partnered strategies to strengthen domestic brand power (Anonymous, 2009).

Rise of Personal Wealth is Linked to the Rise in Number of Luxury Hotel Rooms

"By 2012, according to a study published by McKinsey last year, China will have more than four million wealthy households — defined in China's case as having an annual income of more than 250,000 Renminbi, or about \$37,000. Only the United States, Japan and Britain will have more wealthy households by then." (Wassener, 2010, p. 1) Historically, a high percentage of the wealthy Chinese population has congregated to live and work in the Guangdong Province. Guangdong is located in southeast China and contains the economic hub areas of Hong Kong S.A.R. and Guangzhou. With such a high concentration of wealth and business in the region, it comes as no surprise that Guangdong has played a pivotal role as the starting location for many foreign hotel corporations' initial ventures into China. Foreign investment from international hotel companies has been a major focus of the Guangdong provincial government since 2005. The government published "2005 Guangdong Economic Development Blueprint" stated that

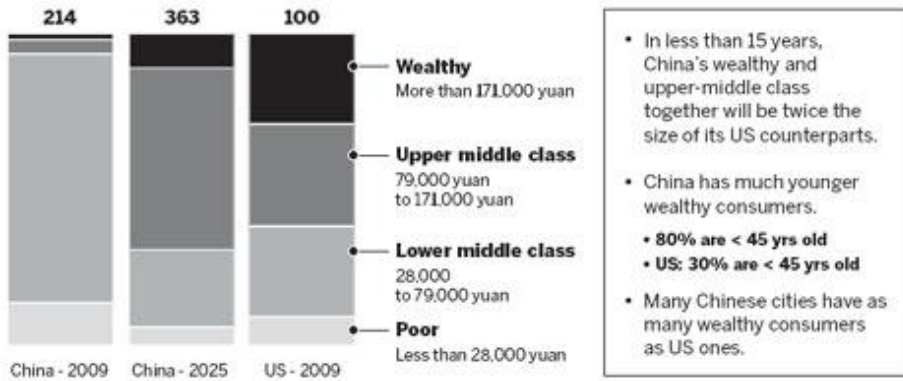
“Many state-owned hotels were not well managed, which is a burden for the province.” (Chan & Yeung, 2009, p. 220) The positive stance from the Guangdong provincial government regarding their lack of faith in state-owned hotels has spread throughout China and regions previously off-limits for development have been opened to foreign MHG’s. A perfect example of this was the Chinese government’s approval for Starwood to develop multiple hotels in the special region of Tibet.

With foreign hotel development now embraced across all regions of China and new luxury segment construction surging, it is important to know if the future Chinese population will be able to support such development. Figure 3 was published by the China Daily in 2010 and combines personal wealth and hotel room supply studies for China and the United States (Yang, 2011).

HOTELS AND POTENTIAL CUSTOMERS

Chinese and US urban households by annual income

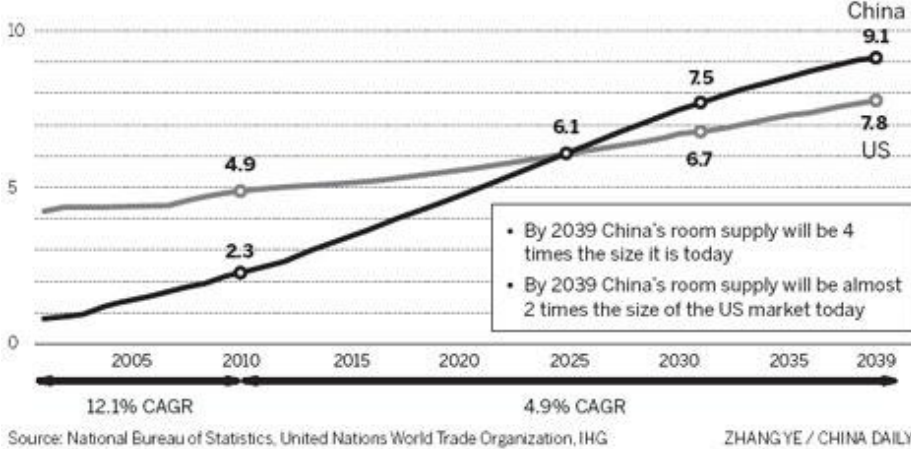
Unit: millions of households



- In less than 15 years, China's wealthy and upper-middle class together will be twice the size of its US counterparts.
- China has much younger wealthy consumers.
 - 80% are < 45 yrs old
 - US: 30% are < 45 yrs old
- Many Chinese cities have as many wealthy consumers as US ones.

Hotel room supply for China and the US (projected)

Unit: million rooms



- By 2039 China's room supply will be 4 times the size it is today
- By 2039 China's room supply will be almost 2 times the size of the US market today

Note: Yang, 2011

Figure 3

Figure 3 illustrates that China's room supply is projected to reach 9.1 million rooms by 2039, which is 1.3 million more rooms than the number of rooms projected to be available in the United States by the same year. During the period from now until 2039, China's wealthy and upper-middle class segments are expected to experience significant growth, signaling support for the growth in the foreign luxury hotel segment in the Chinese market.

Growth by MHGs, most frequently in form of a joint ownership or cooperative enterprises, represents the highest portion of growth in the luxury segment. As illustrated in

Table 3, the top 20 revenue generating hotels in China are all luxury hotels. Figure 4 illustrates the ratio of MHGs to total hotels and the ratio of MHGs to total hotel revenues in China.

Ratio of MHG's to Total Hotel Numbers and Total Hotel Revenues

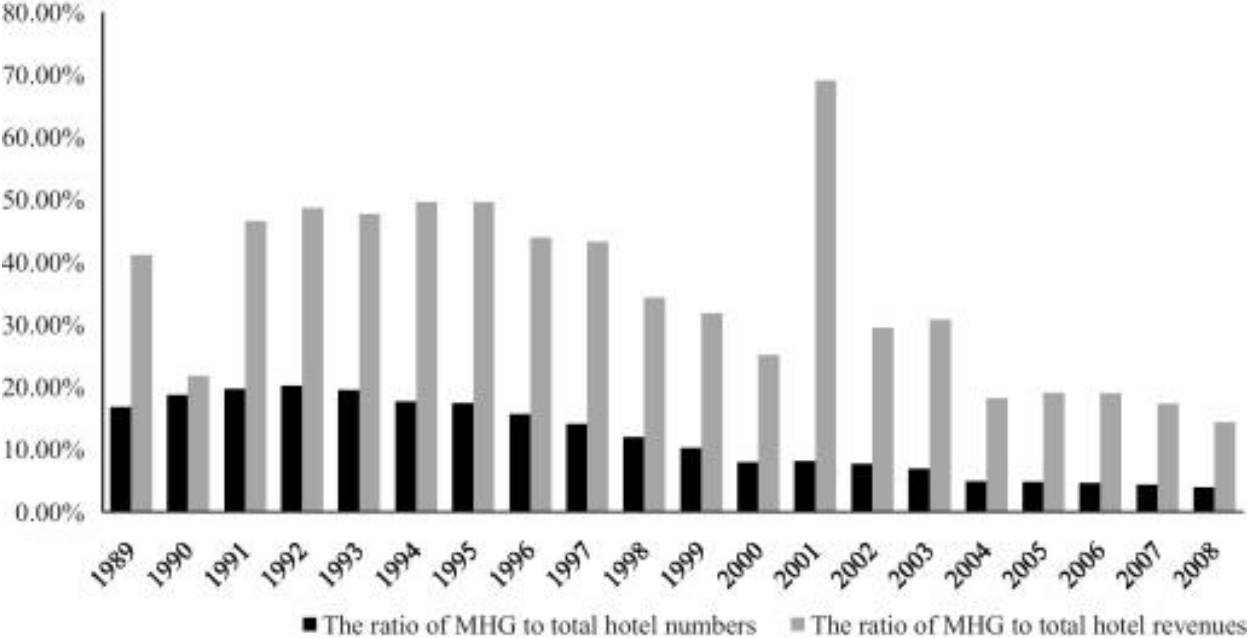


Figure 4

China Set to Rise in Global GDP Ranking

Figure 5 illustrates data from the International Monetary Fund's (IMF) forecasted GDP growth for the top ten nations during decade of 2010 to 2020. China is expected to overtake the United States and jump from the number two positions to the number one position by 2020.

2010 Top Ten GDP Ranking (by country) and 2020 Top Ten GDP Estimates (by country)

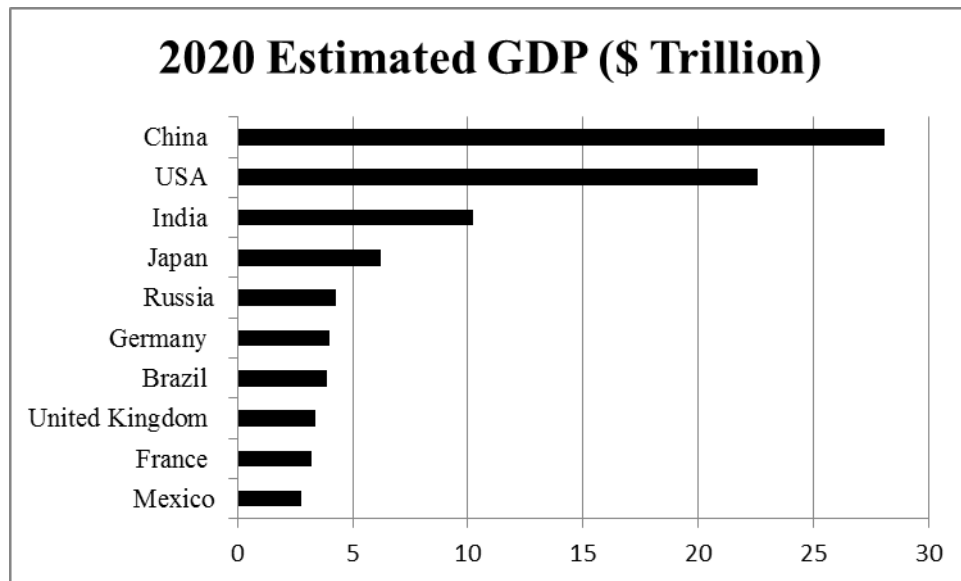
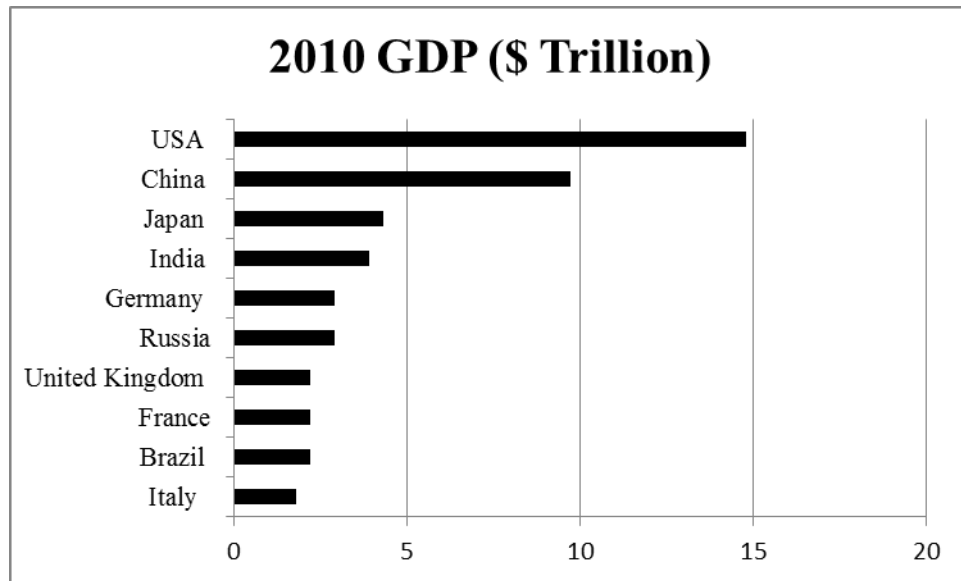


Figure 5

Las Vegas Operators Set Sights on Mainland China

With the decline of gaming revenues and new growth markets in the United States, multiple Las Vegas based hotel & casino companies have turned to mainland China to spur

revenue growth. Although MGM Resorts, Wynn Resorts, Las Vegas Sands and Caesars Entertainment already had substantial hotel & casino projects and real estate holdings in the special administrative region of Macau, where gaming is legal, none had properties in mainland China. In the past few years MGM Resorts launched MGM Hospitality and Caesars Entertainment launched Caesars Global Life, both groups are focused on building non-gaming luxury hotels throughout the world.

As of the third quarter of 2011, MGM Hospitality had announced over 30 signed deals, with five of those hotels in development in China and one completed – the MGM Grand Sanya. Caesars Global Life announced only one deal during the same period - Caesars Palace Long Mu Bay, which will also be built in Sanya. Construction on Caesars Palace Long Mu Bay began in 2011 and the hotel is scheduled to open in 2014.

Obstacles to Foreign Hotel Growth in China

Even with mostly positive news coming out of China in regard to hotel development, there are still firms who advise taking a cautious approach to ensure sustainability in the market. Damien Little Director of Horwath HTL China said “The growth numbers we have seen are truly impressive and indicative of an emerging market in a significant growth phase. However, as many of us are aware, this has not necessarily translated into improved performance at the individual hotel level. The issues of wage inflation, supply concerns are all significant challenges to overcome, but having a strong top line performance will give confidence that these can be addressed.” (Horwath HTL, 2012, p. 1) A study by Pine and Qi (2004) also pointed out four barriers to hotel chain development in China, which are economic and political systems, hotel ownership, management capability and resources, and competition between local and foreign chains (Chan & Yeung, 2009). Additional hurdles MHG’s may encounter when developing in

China are: establishing a successful loyalty program, navigating the unpredictable government environment, understating the role of guanxi, finding skilled labor and dealing with high pollution levels.

Development of Loyalty Programs Unique to China

In order for a customer to join a loyalty program, they must see some sort of value in joining the program. Some MHG's who expanded into China had to radically change the structure of their long established loyalty programs to align the programs reward structure with the interests of Chinese customers. InterContinental found that their immensely successful Priority Club Rewards program, which had been extremely effective in western culture for decades, would not create sufficient value for a Chinese guest to join. In order to create value for Chinese guests, InterContinental introduced a paid membership program called Priority Privilege, which was exclusive to China. "Priority Privilege is offered alongside IHG's global loyalty program Priority Club Rewards, which is the world's largest hotel loyalty program with over 33 million members worldwide and 600,000 members in China. Priority Privilege will help create brand preference for IHG hotels among consumers throughout China," said Dexter Chia, vice president, sales and marketing, IHG Greater China (China Retail News Editor, 2007, p. 1).

Unpredictable Government Policy

An additional hurdle foreign hotel companies face when expanding operations in China is the uncertainty of the Chinese government in regard to legal policy establishment and enforcement. Government policies have exerted a tremendous amount of influence over the expansion strategies of foreign hotel companies. Private sectors have not been mature enough to regulate the hotel industry by itself, thus forcing the government to play an influential role in hotel development. A recent example of the Chinese government's role in business development

has been their tightening of lending practices in the foreign debt market (Guillet et al, 2011).

The Role of Guanxi

Having a high level of cultural awareness and sensitivity is vital to conducting success business ventures in China. As mentioned earlier, the vast majority of foreign hotel companies enter the Chinese hotel market via joint ownership and cooperative enterprises. Western business professionals must understand “Guanxi” to conduct business in China. Loosely translated, guanxi is all about relationships whether to an individual or a group. Developing and nurturing guanxi is a serious business in itself and observing the right guanxi, or “who you know up there”, can make all the difference between success and failure (Wai, 2004).

Availability of Skilled Employees

The scarcity of skilled workers also creates a tremendous challenge for any hotel company seeking to grow in China. This problem is magnified for foreign hotel companies who are primarily building luxury hotels, which require higher service levels and an increased employee to guest ratio compared to non-luxury hotels. In China, less than 30% of those college students who graduated with degrees in hospitality are still working in the hospitality industry. There exists a public stigma in Chinese culture about serving other people where manual work is perceived as a blow to an individual’s personal ego and self-image. Among college graduates, working in the hospitality industry holds even less appeal as personal ego, pride and prejudice play even more of an important role. The idea of entering any industry and working multiple years before reaching a management level position coupled with long working hours and low pay is unacceptable for most college graduates in China (Chan et al, 2009).

Pollution

The presence of high pollution levels in many Chinese cities may significantly impact the future of tourism in China (Chan & Yeung, 2009). The pollution levels in Beijing became a popular international topic for discussion leading up to the 2008 Olympics in Beijing. Foreign tourists, who account for a significant portion of all foreign hotel companies' guests in gateway cities, may be more easily turned off by pollution than Chinese citizens who have grown accustomed to the high pollution levels.

Conclusion to Literature Review

As we have seen there appears to be no slowdown to the rush of foreign hotel companies to develop new hotels in China. China's rising GDP, growing wealthy and upper-middle classes, and increasing familiarity with foreign brands have all contributed to a steady gain in room revenues across foreign branded luxury hotels in China. Still, many consulting firms warn of saturation in the market by increasing the room supply base too quickly. Foreign hotel companies who appear to validate the concern of bearish analysts look to expand further into China and capture new markets. Moving from first tier gateway cities like Beijing and Shanghai to second tier cities like Chengdu and Xi'an has proved to be a successful strategy. Fortunately, in a country such as China where a third or fourth tier city can still have a population over 5,000,000 people, a shortage of customers seems like an improbable scenario.

PART THREE

Introduction

Carefully examining the factors that have led to successful hotel development by multinational hotel groups in the luxury segment serves as a basis to predict future performance. Since the mid 1980's China has been a development focus for an increasing number of MHG's seeking to build the international destination portfolio of their premier brands. Companies such as InterContinental Hotels Group and Starwood have been able to positively impact total revenue by continually building new hotels in China and increasing their exposure to the region. The success of traditional MHG's has urged long-time gaming companies such as MGM Resorts International and Caesars Entertainment Inc. to make substantial investments in creating new off-shore operating companies within their organizations with the intent of capturing a share of the strong revenue growth in the luxury segment in China.

Part Two of this study presented published statistics relating to the past, present and future of hotel development in China. Projections based on those statistics have had a significant impact on luxury hotel development in China and the long-term strategies of MHG's operating in China. With many MHG's frequently raising their development objectives in China, Part Three of this paper will serve to explain how the figures presented in Part Two affect luxury hotel development and why China will remain a top development priority for decades to come.

Results

Luxury Revenue Share

Growth in China, especially in the luxury segment, will remain a focus of foreign hotel companies as long as the relatively small luxury segment is able to capture a large proportion of total hotel revenue. Total room revenue in China continues to rise in a manner that is favorable

to the luxury hotel segment. During 2008-2010 (the latest available period from the Chinese government), total room revenue grew by ~23% while total room supply grew by ~11%. This statistic indicates that RevPAR across China rose by 12% in just three years. The willingness of hotel guests in China to pay an increased rate for a hotel room is highly desirable in the luxury segment where room rates will be priced the highest in the market.

An additional positive factor for MHG's operating luxury hotels is that total revenue generated from hotel meals grew by ~28% during the same three year period. Luxury hotels generally have multiple restaurants and bars on property, which tend to operate with higher profit margins than restaurants located at budget and mid-range hotels. With revenue from meals representing ~40% of total revenue across China, luxury hotels with popular restaurants are in a position to significantly raise total revenue as long as they can keep their restaurants busy.

Rise in GDP and Personal Wealth

China is projected to become the world leader in terms of GDP by 2020. The IMF predicts that China will hold a 27% lead over the second place United States and a 54% advantage over the third place India by 2020. A continually increasing GDP in China will drive sustained infrastructure development and world trade in the coming decades.

China will play an increasing important role in global economics and as its cities grow in economic importance they will receive increasing levels of residents and visitors. In general, growing populations require an increased number of hotels when compared to cities with populations that remain level or are shrinking. With China's cities also growing in worldwide importance, business travel will increase and the demand for luxury hotels will increase proportionally. In 2012 China had four airports make the list of the top twenty airports in the world in terms of passenger volume (Anonymous, 2012). The four airports that made the list

were Beijing, Hong Kong, Guangzhou and Shanghai, which are all international business cities. Those cities were heavily represented as the location of many of the top revenue producing hotels in China. As China's GDP rises and the effects of large-scale investment in infrastructure are realized, luxury hotels will be in demand to fulfill the needs of business travelers in new global gateway cities across China.

The rise in personal wealth and the growing upper-middle class in China will mean more Chinese citizens will be able to afford an increased frequency of travel and luxury hotel stays. A major focus of MHG's will be aligning development pipelines with growth rates in interior cities to capitalize on the rise of internal tourism. As discussed in Part Two, Fairmont with only one property in each Shanghai and Beijing is turning their focus to development in non-gateway cities and B markets. The rising upper-middle class will account for significant traffic throughout mainland China and MHG's will continue to establish brand awareness in growing domestic business and tourist markets.

Non-traditional MHG's Enter Mainland China

The lure of China's favorable RevPAR, GDP and personal wealth forecast has attracted non-traditional hotel companies to re-think their corporate strategies in pursuit of increasing revenues. With the recent downward trend in gaming profits, gaming companies like MGM Resorts International and Caesars Entertainment Inc. have sought out new ways to offset declining revenues in the US. Aside from positive long-term revenue projections in many Chinese cities, MGM and Caesars may have a few additional reasons for building non-gaming hotels in China.

Although neither company would risk the negative publicity in China of admitting they're expecting gaming to be legalized in mainland China in the future, both companies are

likely seeking to gain a foothold in Chinese markets where they believe gaming will be legalized in the future. Their intent is likely to raise brand awareness in mainland China with the goal of channeling those guests to their gaming properties in Macau, the U.S. and future gaming properties in mainland China and other parts of Asia.

The parent companies of MGM Hospitality and Caesars Global Life, MGM Resorts International and Caesars Entertainment Inc. respectively, both utilize a sophisticated customer tracking system integrated into their loyalty programs to target and customize marketing to potentially valuable customers. In China, loyalty programs are much less common than in the U.S. and the overwhelming majority of the Chinese population remains disconnected from existing loyalty programs. MGM and Caesars will try to capture information about Chinese customers and in-turn steer those customers they deem valuable to their various gaming locations throughout the world.

Conclusions

In summary, this study concludes that investments from foreign MHG's in the luxury segment in China will continue to rise. The near and long-term economic and tourism projections are positive and extremely favorable to investment in the luxury segment. The current 1.3+ billion population of China is experiencing a period of new found wealth and power in the world economy. The rising upper middle-class and wealthy populations in China will be the focal point for any foreign MHG seeking to expand in China. Developing and implementing successful loyalty programs in China will play an increasing important role in identifying and marketing to those target guest segments. Statistically, there appears to be no end in sight for profits generated in China by foreign MHG's operating in the luxury segment but there are unpredictable factors that may hinder future growth.

Foreign MHG's may fail to understand the role *guanxi* plays in business, the affect rising pollution levels will have on tourism, the willingness of skilled laborers to work in hospitality, and the role the Chinese government will play in foreign investment policies in the future. These factors all play a significant role in the success of future growth in China. With each new hotel foreign MHG's build in China they are allocating greater company resources to China. Having such a large percentage of company assets tied to China means unfavorable events in the country will play an increasing role in the foreign based MHG's financials. Conversely, positive events could help off-set lower performance in other regions. As long as the demand for luxury hotels in China remains high, foreign MHG's will continue their fast development in the country.

Recommendations for Future Research

This study presents a starting point and lays the groundwork for why foreign MHG's are rushing to China to develop new luxury hotels. Future research will need to be conducted for the information to remain current. The information in this study is based primarily on information from 2007-2012, which was a period of unprecedented growth in China. The most recent period may not accurately serve as a prediction for events and shifts in China's economy that will affect growth in the luxury hotel segment in the future. The world has never seen a population and economy as large as China's and therefore projecting an accurate economic future may prove to be more difficult than in countries with smaller economies.

Additionally, it is not unlikely that some MHG's will merge, declare bankruptcy or become private enterprises in the future. Each scenario may drastically change the strategy of these companies and growth in China may be affected. For this study to remain accurate it will require updates at least every couple of years.

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