Lower tariffs but better returns entice hoteliers to budget segment

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Close to Mumbai's domestic airport, Accor's mid-scale hotel, the Ibis, stands on leased land. Each room in the hotel has been developed at a cost of around ₹32 lakh. The rooms command an average rate of ₹5,000 per night. Not far from the Ibis, the luxury Four Seasons has invested ₹2 crore per room, almost six times the sum spent by Ibis, in order to earn double the average room rate of ₹11,000. When the figures are stacked against each other, it is clear that the smaller, 400-square-feet Ibis rooms offer better returns than the 1,500-square-feet luxury rooms at Four Seasons.

Given such numbers, many companies have suddenly recognised this potential of the budget segment for higher as well as more stable returns. "Across the world budget hotels are giving better returns," avers Kaushik Vardharajan, managing director, HVS India. "The gestation period is lower and break-even is faster." So, more brands than ever are now eyeing the space that they had ignored till a few years ago.

Most budget hotels are scouting for locations in metros and big cities and are ready to bear with the high land cost

There are now offerings from economy brands like Ginger and Formule1 and budget hotels like Holiday Inn Express, Premier Inn, Hampton and Red Fox. There are also the mid-level Ibis and Fairfield by Marriott. In addition, there are other brands that do not yet have a clear categorisation. These projects have attracted institutional investors like Samhi Hotels, Duet Hotels and the Dutch pension fund, APG, among others.

"Who was investing in these smaller hotels 10 years ago?" asks Ashish Jakhanwala, co-founder, Samhi Hotels. He answers the question himself, "It was largely individual families and promoters. They did not want to go beyond their areas of control. A Delhi developer was not comfortable making investment in Bangalore or Chennai. And in budget and economy hotels, you get profitability by scale." Jakhanwala's Samhi Hotels is investing in 15 Formule1 and 15 Fairfield by Marriott hotels across the country. Around 55 per cent of its total investment on hotels of ₹1,400 crore is in the budget and mid-scale segments.

Duet Hotels, which has tied up with the Intercontinental Hotel group, has committed investments of over ₹1,000 crore. The company estimates a future outlay of an additional ₹1,250 to achieve a targeted room count of over 4,000. "We work on a focused brand strategy," says Naveen Jain, president, Duet India Hotels. And while he says it is looking at "multiple synergies related to the development of a consistent product", the aim will be towards the cost efficiencies of a replicable model, procurement benefits from scale and learning from one easily being replicated to another.

With a relatively low cost of development and operations, budget hotels make a lot of economic sense. Two of the biggest cost components — employee salaries and power consumption — are controlled more easily in a budget environment. The absence of frills like room service and bell boy and porter services ensures that the staff-to-room ratio remains low at 0.2 for budget hotels, compared to 1.5 for luxury and up-scale brands. Besides, with no lavish meeting spaces, grand lobby areas and concierge facilities, the electricity bills are also kept to a minimum. This means that even at 30 per cent occupancy, a budget hotel can manage to recover its monthly operating costs. For a premium hotel, on the other hand, even with a 45-50 per cent occupancy level, operating costs are not easily recouped. "Budget hotels are like a fast-growing stock, while a luxury property is a blue-chip investment. Unlike budget, luxury is a long-term play," says HVS India's Vardharajan.

PROFITABLE SEGMENT A LemonTree hotel in the country

What is also attractive to hoteliers is the steady tariff at budget hotels. Even during the period of slow economic activity, the budget hotels have not seen any tariff correction, ostensibly because the price points are already on the lower side. "They are far more stable assets and cash flows are fairly consistent," adds Jakhanwala.

However, while the demand may be much more recession-proof, keeping costs under control while catering to the increasingly demanding consumer is a challenge most companies grapple with. "Customers want a lot of service, which adds to the cost. We do higher occupancies even in a tough market, but since the tariffs are low, the revenue too is not large," says Patu Keswani, chairman, LemonTree Hotels, which has invested ₹400 crore in creating a 1,000-room inventory for its budget brand, Red Fox.

In a departure from strategies followed by budget hotels overseas, several brands have made an exception of adding food and beverage facilities, banquet halls and room service in the budget segment as a concession to highly-demanding clientele. "Internationally, when I say budget, I am aware (that I am) spending less and agreeing to receive less. In India, 'it is how much more I can get at the same price'," discloses Jakhanwala.

Brand positioning, however, is an evolving anxiety. Hotel brands often shy away from associating themselves with the word "budget". Industry experts feel that as more international brands start operations, there will be more clarity on the subject. "We want to redefine the budget hotel segment in India," says Philip Logan, vice-president, Formule1 Hotels, Accor Group. Keeping this rebranding need in mind, Formule1 hotels promise customers a contemporary design and offer speedy services, and a great sleep-and-shower experience.

Various brands are also coming with innovative promises for basic deliveries. At AirAsia's Tune hotel, for instance, for every amenity you ask for, you are billed separately—whether it is 24-hour air conditioning, television, towels or toiletry kit. "When we first started, we thought people wouldn't understand our business model. But it has worked well for us," said Mark Lankester, group chief executive officer, Tune Hotels.

Many have taken lessons from the Tata Nano. When Ratan Tata, chairman emeritus of Tata group, said that positioning the mini car as a "cheap car" was a mistake, the sentiment resonated with some hoteliers. "A budget consumer is also aspirational. He should not be treated like someone going in for a cheaper option. He is moving up the ladder, leaving behind non-branded, unclean Paharganj hotels for an international brand," Jakhanwala adds.

As the learning curve of hotel brands increases, more and more companies are focusing on building properties in bigger cities with high economic activity even if the land cost is high. "In a remote location, there is no transportation available. So all the price benefit gets annulled in the cost of commute," says Keswani. Even with 28 hotels in its portfolio, Ginger hotels learnt about the drawbacks of building budget hotels in smaller cities with low economic activity the hard way. While its Delhi's Rail Yatri Niwas, now branded as Ginger, clocks a very high occupancy rate, its properties in Vadodra, Guwahati and Indore are lagging. The company's strategy now is to park itself in a catchment area like industrial zones in Manesar or Pantnagar, where it had set up a hotel on government's invitation. Ginger also wants to operate a hotel in every metro. "We are looking out for ways to populate the metros though investment costs. Wherever there is a major railway station or airport, we want to reach there," says P K Mohankumar, managing director, Roots Corporation.

Ginger isn't alone. Most budget hotels are scouting for locations in metros and big cities and are ready to bear with the high land cost.