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An Analysis of Hotel Financial Management in China

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Tourism development in China continues to experience sustained growth in inbound, domestic and outbound markets as rapid economic growth has been fueling international and domestic travel activities in China. By the end of 2006, China received 125 million inbound tourists, a 3.9% increase over that of 2005 and its domestic travel volume reached 1.4 billion person-trips, an impressive 12.12% jump from the previous year. In addition, the pent-up demand for overseas travel by Chinese citizens generated 34 million Chinese outbound tourists in 2006, a 10% increase over that of 2005. Clearly, all three markets, inbound, domestic and outbound, recorded growth in 2006.

The growing demand for travel in China, particularly the inbound and domestic markets, coupled with the two world mega events scheduled for the next few years: 2008 Beijing Olympics and 2010 World Expo in Shanghai, have attracted many international hotel groups to strategically develop their portfolios in China and stimulated Chinese hotel investors and operators to upgrade facilities and improve performance to embrace international competition. This article discusses the current competitive hospitality landscape in China with a focus on the financial management of hotel operations. Hotel financial performance is reviewed and analyzed among different ownerships and

management organizations. Operation efficiency as identified by the financial analysis is reported and recommendations are presented for improving the financial management and reporting system.

Shrinking SOEs and Growing Private and International Companies

Tourist hotels are administratively classified in China: star-rated tourist hotels and non-star tourist hotels. The star-rated tourist hotels are evaluated and granted star ratings by China National Tourism Administration (CNTA) and CNTA reports the profiles and basic financial performance of star-rated hotels each year. Most of the star-rated hotels cater to inbound tourists and business visitors. The non-star hotels, regulated by the Commerce Bureau of each city or province, primarily cater to domestic tourists and business travelers. No comprehensive data is compiled for the non-star hotels in China, therefore little is known about the market efficiency and financial performance of these non-star hotels. This paper focuses mainly on the star-rated tourist hotels in China. Table 1 describes the hotel ownership in China in 2005. The hotel industry in China has been going through rapid fundamental and structural changes in the last decade and the most salient characteristics include the gradual decline of state-owned enterprises (SOEs) and the ever expanding of private ownership and international management. As Table 1 reveals that the proportion of state-owned star-rated tourists hotels declined from 50.3% in 2004 to 46.7% in 2005. 2005 was the first year when SOEs in China's hotel industry dipped below 50%. The shrinking state-owned star-rated tourist hotels demonstrate the government efforts in reducing its holdings of hotel assets, particularly the non-performing assets (Yu and Gu, 2005). This government's slow retreat from hotel

Table 1. Hotel Distributions by Ownership, 2005.

Ownership	Hotels	% Total 2005	% Total 2004	Rooms	% Total 2005	% Total 2004
State-owned	5,528	46.7%	50.3%	626,712	47.1%	50.1%
Collective	964	8.2	9.5	89,808	6.7	7.9
Shareholding co-operative	309	2.6	2.3	29,538	2.2	2.0
Joint-venture between Chinese enterprises	72	0.6	0.7	8,794	0.7	0.8
Limited liability	1,928	16.3	14.2	231,626	17.4	15.0
Limited liability shares	518	4.3	4.2	66,689	5.0	4.6
Privately owned	1,624	13.7	11.6	126,593	9.5	7.2
Other	315	2.7	2.4	25,889	1.9	2.0
Foreign-invested	256	2.2	1.8	59,036	4.4	3.3
Hong Kong-, Macao-, and Taiwan-invested	314	2.7	3.1	67,398	5.1	6.4
Total	11,828	100%	100%	1,332,083	100%	100%

Source: CNTA. The Yearbook of China Tourism Statistics. *China Travel & Tourism Press*. 2006: pp. 98-99.

ownership was also in response to the mandate of the World Trade Organization to open its hotel market for private and international competition, which created opportunities for the development of both Chinese private and international hotel chains in China. Table 1 reports that both Chinese private and foreign investment in hotels gained market shares between 2004 and 2005. Chinese private investors demonstrated strong interest in hotel investment, typically from real estate development companies and other capital investment firms. Meantime, international hotel companies continued to expand their operations in China and many have penetrated secondary cities. By 2006, international hotel brands were present in all Chinese provinces except for Qinghai and Shanxi.

Table 2 lists the major Chinese and international hotel development and management companies with estimated portfolios in China. Market segmentation and

Table 2. International and Domestic Hotel Companies in China

Company	Hotels	Headquartered in
Jin Jiang International (Group) Co. Ltd.*	199	Shanghai, China
Inter-Continental Hotels Group Plc**	59	Windsor, Berkshire, UK
Jianguo International Hotels Ltd.*	23	Beijing, China
Marriott International Inc.**	22	Washington, DC, US
Accor**	36	Paris, France
Home Inn Hotel Management Group**	131	Beijing, China
Hong Kong CTS Metropark Hotel Management Group**	20	Hong Kong, China
Shangri-la Hotels & Resorts**	27	Hong Kong, China
Conifer Hotels Management Co. Ltd.**	20	Hong Kong, China
China Travel Service Hotel Corp.**	13	Beijing, China
Starwood Hotels and Resorts Worldwide Inc.**	43	White Plains, NY, US
Wyndham Worldwide	9 32 5	Parsippany, NJ, US
Howard Johnson International Inc.**		
Super 8 Motels Inc.**		
Days Inn Worldwide**		
Teda Hotels Management Co. Ltd.**	15	Beijing, China
New Century International Hotel Management, Co., Ltd**	17	Hangzhou, Zhejiang, China
Gloria International Hotels Ltd.**	13	Hong Kong, China
Best Western International Inc.**	25	Phoenix, AZ, US
Hua Tian International Hotel Group**	13	Changsha, Hunan, China
Hilton Hotels Corp.**	4	Watford, Hertfordshire, UK
Jinling Hotels & Resorts Corporation**	23	Nanjing
Guangdong (International) Hotel Management Holdings**	25	Hong Kong, China
Marco Polo Hotel Group**	3	Hong Kong, China
Shanghai Motel Management Co., Ltd.		Shanghai
Four Seasons Hotels Ltd.**	2	Toronto, Ontario, Canada
Global Hyatt Corp.**	9	Chicago, IL, US
Mandarin Oriental Hotels Group	1	Hong Kong, China

* Corporate 300 Ranking by *Hotels*, July 2006

** Estimated number of hotels in China based on company website.

Note: The properties listed under each brand do not include properties in Hong Kong and Macau, and it also does not include new projects in the pipeline, such as the 12 new Global Hyatt properties which will be completed between 2007 and 2009.

differentiation now offers more development opportunities which include business hotels, conference hotels, resorts, budget hotels, boutique hotels, condotel and timeshares.

Market entry and penetration by international hotel groups have been accelerating in the last decade. Most major international hotel brands are strategically developing their brands in the major provincial capital cities and secondary cities (medium-size cities that are not provincial capitals and that have populations from 500,000 to 1 million). It is

reported that 47 hotel brands by 31 international hotel groups are now present in China. Geographically, only two Chinese provinces, Qinghai and Shanxi do not have any international hotel brands. Table 3 presents the 10 most recognized international hotel brands in China by China Tourist Hotels Association.

Table 3. Most Recognized International Hotel Brand in China.

International Hotel Brand	Headquartered in
Inter-Continental Hotels	UK
Shangri-la Hotels and Resorts	Hong Kong
Howard Johnson International	US
Marriott International Hotels	US
Starwood Hotels and Resorts	US
Accor	France
Best Western International	US
Hilton Hotels International	UK
Conifer Hotels and Resorts	Hong Kong
CTS HK Metropark Hotels Management Co. Ltd	Hong Kong

Source: China Tourist Hotels Association, 2006.

Hotel Financial Performance

Hotel financial reporting and management in China does not follow the *Uniform System Accounts for Hotel* practiced in the U.S. and Europe. Domestic hotels use their own proprietary reporting systems and international chain hotels follow the standards established by the hotel company. At the same time, both domestic and international hotels report operating financial performance to the government for tax purpose and statistical compilation. There is very little information on the non-star hotels under the jurisdiction of the Commerce Bureau in China.

Hotel financial performance in China has been improving in the last few years. In fact, the hotel industry reported a profitable year for the first time in 2005 after losing money consecutively since 1998 (Wei, 2007). The China Hotel Industry Study published by China Tourist Hotels Association and Horwath Asia Pacific in 2007 reported detailed

financial performance of tourist hotels based on a sample of 536 hotels in different market segments: 5-star, 4-star, 3-star and budget hotels, and by three types of management: management by international hotel companies, management by domestic hotel companies, and management by independent hoteliers (non-branded and without any international or domestic chain affiliation). Financial performance data for the sample hotels gives most current glimpse of financial management in the Chinese hotel industry. Tables 4 and 5 illustrate the profiles and basic financial information of the 536 sample hotels by star-rating and ownership in this study.

Table 4. Sample Hotel Profiles and Basic Financial Information by Star-Rating, 2006.

	Budget hotel	3-star hotel	4-star hotel	5-star hotel
Hotels in sample	250	94	205	172
Available rooms/day	18,861	16,910	54,444	61,655
Occupied rooms/day	17,743	11,933	37,953	41,487
Occupancy	87.7%	69.2%	69.4%	66.3%
ADR*	¥152	¥278	¥437	¥792
RevPar	¥133	¥192	¥303	¥525

Source: China Hotel Industry Study 2007, p. 8.

* ADR and RevPar were reported in Chinese currency *yuan*. \$1 was traded for about ¥7.8 in 2006.

Table 5. Sample Hotel Profiles and Basic Financial Information by Management for 5-Star and 4-Star Hotels, 2006.

	Int'l Management for 4-star hotel	Domestic Management for 4-star hotel	Independent Management for 4-star hotel	Int'l Management for 5-star hotel	Domestic Management for 5-star hotel	Independent Management for 5-star hotel
Hotels in sample	46	66	93	97	45	30
Available rooms/day	15,517	17,512	21,415	37,028	13,835	10,793
Occupied rooms/day	11,110	12,228	14,663	25,025	9,614	6,869
Occupancy	71.4%	68.6%	68.7%	66.9%	66.9%	63.6%
ADR	¥578	¥400	¥361	¥940	¥563	¥584
RevPar	¥413	¥274	¥248	¥629	¥377	¥372

Source: China Hotel Industry Study 2007, p. 8.

As Table 4 shows, all market segments generated profitable occupancy levels in 2006, with the strongest capacity utilization in the Budget segment of the hotel industry, at occupancy of 87.7 percent in 2006. Examining financial performance by management as reported in Table 5, it is clear that hotels managed by international companies had slightly higher occupancy rates, but substantially higher ADR and RevPar. This may indicate that international hotel management companies had competitive advantages in sales distributions, marketing efficiency, cost control and yield management in upscale and luxury segments of the hotel markets.

Table 6 further illustrates the departmental revenues and expenses measured as percent of revenue. It is revealing to note that hotels managed by international companies yielded higher room revenues for both 4-star and 5-star hotels in 2006. However, hotels managed by Chinese companies or independently made more sales in food services. International management companies generated higher yield in room revenues and maintained lower costs in operating expenses. Hotels managed by Chinese management companies or independently tended to have higher administrative and general expenses compared to the hotels of the same star-rating status. But the international management companies spent more on marketing and promotions. Finally, the international management companies achieved higher Earnings before interest, taxes, depreciation and amortization (EBITDA): 27.5% for 4-star hotels and 36.7% for 5-star hotels respectively. 4-star and 5-star hotels managed by Chinese hotel companies produced EBITDA of 21.4% and 25.6% respectively while the independently operated hotels had the lowest EBITDA of 13.4% for 4-star hotels and 21.9% for 5-star hotels in

2006. The financial statement based on the survey of the sample hotels clearly reveals the varying operating performances under different management.

Table 6. Sample Hotel Financial Performance by Management for 5-Star & 4-Star Hotels Measured in Percent of Revenue, 2006.

Revenue	International Management for 4-star hotel	Domestic Management for 4-star hotel	Independent Management for 4-star hotel	International Management for 5-star hotel	Domestic Management for 5-star hotel	Independent Management for 5-star hotel
Rooms	61.6%	47.4%	49.0%	58.2%	48.7%	46.1%
Food	22.9%	29.3%	28.2%	22.5%	28.7%	32.3%
Beverage	4.2%	5.3%	5.2%	6.0%	6.1%	5.5%
Other F&B	4.2%	5.3%	9.9%	6.1%	5.2%	4.1%
Telephone	0.7%	0.5%	0.5%	0.5%	0.2%	0.3%
Spa & Fitness Center	0.7%	2.2%	2.2%	1.4%	2.6%	1.3%
Minor operating Department	3.7%	4.9%	4.6%	3.7%	3.7%	5.8%
Rental & Other Income	4.4%	5.4%	4.6%	2.4%	3.7%	4.5%
Total Revenue	100%	100%	100%	100%	100%	100%
Expenses						
Rooms	20.1%	23.4%	23.4%	18.8%	19.3%	22.2%
F&B	68.4%	66.2%	75.3%	58.4%	64.6%	66.8%
Telephone	108.6%	178.1%	105.0%	95.0%	163.8%	158.7%
Spa & Fitness Center	60.9%	98.7%	86.5%	56.5%	77.2%	98.5%
Minor operating Department	48.8%	102.8%	88.7%	38.4%	73.0%	77.6%
Rental & Other Income	11.7%	31.3%	15.1%	16.6%	12.9%	14.8%
Total Expenses	36.1%	48.6%	42.6%	33.9%	40.7%	42.3%
Departmental Profit (Loss)						
Rooms	79.9%	76.6%	76.6%	81.2%	80.7%	77.8%
F&B	31.6%	33.8%	24.7%	41.6%	35.4%	33.2%
Telephone	(8.6%)	(78.1%)	(5.0%)	5.0%	(63.8%)	(58.7%)
Spa & Fitness Center	39.1%	1.3%	13.5%	43.5%	22.8%	1.5%
Minor Operating Departments	51.2%	(2.8%)	11.3%	61.6%	27.0%	22.4%
Rental & Other Income	88.3%	68.7%	84.9%	83.4%	87.1%	85.2%
Total	63.9%	57.4%	51.4%	66.1%	59.3%	57.7%
Undistributed Operating Expenses						
Administrative & General	10.4%	12.4%	12.3%	7.3%	10.8%	9.9%
Marketing	4.1%	2.5%	2.6%	4.6%	2.5%	3.4%
Energy	8.3%	8.7%	8.8%	6.8%	7.9%	8.2%
POM	4.3%	4.1%	6.4%	3.2%	3.8%	5.1%
Total	27.4%	26.3%	28.3%	21.6%	23.6%	29.2%
IBFCMF	36.6%	32.2%	24.9%	45.5%	36.8%	29.7%
Management Fee	3.4%	2.8%	5.8%	3.6%	2.3%	3.6%

(Base + Incentive)						
Income before fixed charges	33.2%	29.0%	19.1%	41.9%	34.5%	26.1%
Fixed charges	4.7%	6.0%	4.4%	4.5%	2.7%	2.5%
EBITDA	27.5%	21.4%	13.4%	36.7%	25.6%	21.9%

Source: China Hotel Industry Study 2007, p. 10.

Challenges Facing Hotel Financial Management

Due to the diverse ownership of hotels and two different government regulators overseeing star-rated and non-star tourist hotels in China, there is no uniform system or financial standards for hotel financial reporting and management. Most hotels simply use the general *Accounting System for Enterprises* which does not reflect the characteristics of hotel service operations. Some hotels adopted the commonly used financial statements, such as Income Statement, Balance Sheet, and Statement of Cash Flow. However, these financial statements present only highly generalized line items and do not show the level of details as reported in financial statements following the Uniform System of Accounts for Hotels used in the U.S. and Europe. Furthermore, there is also a lack of standard and consistent instruments for recording, reporting and analyzing financial information at the hotel department level. The absence of standard and consistent financial reporting makes it very difficult to compare financial performances between firms and across geographical boundaries.

It is estimated that there are now about 160 Chinese hotel development and management companies of varying sizes. As these hotel companies grow and are actively involved in development and acquisitions, there is an urgent need for corporate financial management based on established standards of accounting and finance procedures. Corporate financial system enables the management leadership to communicate effectively between the corporate office and unit properties and provides

the executives with timely accurate financial data for investment decisions, hedging potential risks and efficient operations.

In addition, some Chinese hotels companies have strategic goals to raise equity from the global financial markets for future expansions. Home Inn, a budget hotel chain based in Beijing, went public in October 2006 and became the first Chinese hotel company to be listed on NASDAQ. Its IPO was well received in the U.S. financial market because the company had an ambitious development strategy: growing its franchise operations from its current based in 50 Chinese cities to 100 cities with more than 4 million populations. The company raised \$109 million on the first day of trading and allocated \$45 million from the IPO for expansion and renovation and \$7.5 million for debt repayment. However, most Chinese hotel companies do not meet the strict financial reporting and monitoring standards required by the financial markets. Hotel companies interested in raising equity in the financial markets need to learn and set up standards for financial management and reporting to be in compliance with government regulations and market functions.

Another challenge concerning hotel financial management can be attributed to the overall hotel management organizational structure. In most Chinese hotels, the general manager is the most powerful chief operating officer and has the unquestionable authority to sign any bills of expenses. On the other hand, in the U.S. or Europe, there are often a checks and balances established between the general manager and the controller. The Chinese general manager has often to respond to the governmental and societal pressures and accommodate and entertain government officials as standard cost of doing business.

The Chinese hotel industry is confronted with many challenges in standardizing its accounting and financial management system. The urgent priority is to develop a uniform system of accounts for both star-rated hotels and non-star hotels under different regulators and ownership. The standardized and consistent accounting, recording and reporting system will enhance management efficiency and benchmark hotel performances by market segments, geographic locations and branded operations. Efforts have been made by China Tourist Hotel Association to conduct annual industry surveys by following instruments similar to the uniform system of accounts. Though the voluntary participation in this study is still low with only 4.5% of the star-rated hotels, the study provides a snapshot of the financial performance of China star-rated hotels.

In April 2007, China Tourist Hotel Association introduced its members to The Bench (global partner of Smith Travel Research), a U.K. based consulting company which publishes daily, weekly and monthly financial reports on its member hotels based on hotel occupancy, ADR and RevPar, similar to the STAR report by STR in the U.S.A. Some Chinese hotels have already signed up for the free subscriptions to the Bench report between April 2007 and February 2008. The participation of Chinese hotels in Bench report will improve financial reporting system in China since the Bench uses the uniform system to collect and analyze financial data.

In addition to standardizing the financial recording and reporting system, there is an urgent need to train competent financial managers in China at both corporate and unit levels. Knowledge in corporate finance, capital markets, asset management, project finance and risk management are basically absent in hospitality management education curriculum. Education and executive training in these financial management areas will

provide competent financial managers to lead the fast-growing Chinese hotel groups and manage publicly traded companies.

The Chinese hotel industry also needs to leverage the financial management system introduced by the international hotel groups. With the increasing market share of the international hotel companies, these international branded hotel companies will exert influence of quality management and service excellence in the Chinese hotel industry. Through professional networks and industry association platform, international hotel companies can influence their Chinese peers to adopt the standard accounting system.

Finally, the China Tourist Hotel Association could play more effective leadership role to bring the star-rated and non-star tourist hotels into one system. The division of the two types of hotels was the product of past political and administrative functions. However, as China's economic activities are highly integrated into the global economic and financial network, it is necessary to classify all lodging facilities into one system by using a uniform accounting standards. Therefore, the true nature, scope and economic impact of the lodging industry in China can be fully measured and understood.

Summary

Strong inbound and domestic tourist markets have been the catalyst for rapid hotel development in China. The Chinese hotel industry has witnessed the gradual shrinkage of state-owned hotels and the increase in private hotel ownership and international hotel management. The decline of the SOEs is the result of the reform by the Chinese government to rid many unprofitable properties and reduce debt ratios of many lending banks. The increase of hotel market shares by Chinese private hotel companies and

international hotel companies intensifies competition, yet stimulates market segmentations and differentiations. The latest hotel financial performance data reveals that hotels managed by international companies achieved better financial goals due to effective marketing, creative yield management and strict cost cutting measures.

Due to the diverse ownership of hotel operations and regulatory policy by two different government regulators, the hotel industry in China does not have a uniform system of accounts for hotel operations. Most hotels simply follow their own accounting practice and their reporting statements vary from one operator to the other. Such variations in recording and reporting hotel income and expenses make it very different to compare and benchmark financial performance among competitions. Therefore, no reliable financial data can be used for strategic management planning and investment decision.

In addition, the emergence of Chinese hotel companies with a portfolio of multi units calls for the establishment of strategic and systematic corporate financial management. The growing interest in raising funds from the global equity markets by the Chinese hotel companies requires advanced and sophisticated knowledge of the capital markets. There is a dire need for competent professionals in corporate finance, capital markets, asset management, revenue management, project finance and risk management. These specific fields of financial management should be considered as new curriculum in hospitality management programs and as training opportunities for industry associations and consulting firms.

Finally, China Tourist Hotel Association should exert a strong leadership in developing and implementing a uniform system of accounts that is comparable to the

system practiced in the U.S. and Europe yet retains certain degree of difference to fit certain mandates by the government regulators. The introduction and adoption of the Bench report is a positive step toward the establishment of a consistent accounting system by its member hotels. Only with a standard, consistent and transparent financial accounting system, China's hotel industry can achieve the high operating efficiency of the international hotel counterparts.

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