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**Development of the Hotel Industry in China:  
Mega-Events, Opportunities, and Challenges**

The purpose of this study is to explore the challenges to the successful development of the hotel industry in the People Republic of China and to address the opportunities that hosting mega-events provides. In particular, the roles of mega events (Beijing 2008 Olympic Games, World Expo 2010 Shanghai, and Guangzhou Asian Games 2010) in the development of the hotel industry are reviewed. Accordingly, this study, first, briefly reviews the development of the hotel industry prior to the mega events. Second, constraints, challenges, and opportunities for the development of the hotel industry are discussed. Finally, major problems are identified and recommendations for the outlined major problems are provided to the government authorities and to the investors with the goal of enhancing the sustainable improvement of the hotel industry in China.

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Keywords: China, hotel Industry, mega-events, challenges, opportunities

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## **Introduction**

An open door policy after the 1970's has led the Chinese government and private sectors in China to seek foreign hotel investments, management skills, experience, and strategic management from all over the world. After the open door policy; however, there has been a slow growth in investments because of government regulations and restrictions problems that were caused by poor infrastructure (Cook, 1989; Yu, 1992). The Hong Kong Peninsula Group was the first joint venture hotel that invested in China in 1982 (Pine et al., 2000). While multinational hotel groups have invested in China during two decades between 1980 and 2001, the investments were relatively lower than in the previous ten years. Although investments in the hotel industry have relatively decreased due to a recent economic recession, the number of hotels has continued to increase (Gu, Ryan, & Yu, 2012).

China's membership in the World Trade Organization and its ability to win the bids to host the Beijing Olympics 2008, the Shanghai World Expo 2010, and the 16<sup>th</sup> Asian Games Guangzhou 2010 have increased the gross domestic product of China (Li, Blake, & Cooper, 2011). The All China Games, which have 11 years of continuous presence in China, can be considered as another important mega event in China. These mega events contribute substantially to the Chinese economy; taking into account of creation of 40 venues for the games in 2013 in Shenyang (News, 2013), the games contribute indirectly to the hotel industry development. The annual disposable income has doubled between 2001 and 2007 and the mobility of Chinese domestic tourists increased with enhanced transportation infrastructure, which are the major factors that have driven multinational hotel groups' interests to invest in China. These factors have also increased the local hotel investments.

While there are investment challenges both for local and multinational hotel groups, the investments are more challenging for multinational hotel groups. In general, these arise from business, social, political, economic, and cultural differences in China (Pang et al.,

1998; Pine et al., 2000). For example a lot of the hotels are still state owned and the government authorities appoint managers. These hotels constitute approximately 30% of the industry and they do not consider profitability a main purpose of the business (Tang et al., 2006). This mindset might lead to an unfair competition between multinational hotel groups and state owned hotels because state owned hotels apply a strategy of decreasing the prices to a lower degree relative to their competitors. Furthermore, these hotels underperform and thus they decelerate the development of the industry. The managers of these hotels are inexperienced with respect to management of technology, financial systems, and most importantly they are inexperienced in hospitality management (Zhi et al., 1997).

Nonetheless, China has a great tourism potential for the hotel industry with an increasing number of international and domestic tourists (Gross, Gao, & Huang, 2013). It is reported that the number of star rated hotels was 13,583 and number of budget hotel was 1,698 in 2007 (CBRE, 2009) and 13,528 in 2011 (Jiang, Gretzel, & Law, 2014). The rapid growth has been experienced for most of the hotel segments, for instance, budget hotels, upscale hotels, luxury hotels, and MICE hotels (Guillet, Zhang, & Gao, 2011). While multinational hotel groups are mainly interested in upscale hotels, they expand their hotel segments to the mid-range and budget hotels, which is expected to contribute to the budget hotel development given the growth of domestic tourism (Yu, 1998). On the other hand, economic and political systems, hotel ownership, deficiency incapable management human resources, and competition between local investors are the major investment barriers in China for the multinational hotel groups (Pine & Qi, 2004).

The purpose of this study is to explore the challenges to the successful development of the hotel industry in the People's Republic of China and to address the opportunities that hosting mega-events provides. In particular, the roles of mega events (Beijing 2008 Olympic Games, World Expo 2010 Shanghai, and Guangzhou Asian Games 2010) in the development

of the hotel industry are reviewed. Accordingly, this study, first, briefly reviews the development of the hotel industry prior to the mega events. Second, constraints, challenges, and opportunities for the development of the hotel industry are discussed. Finally, major problems are identified and recommendations for the outlined major problems are provided to government authorities and to investors with the goal of enhancing the sustainable improvement of the hotel industry in China.

### **Literature Review**

Beginning with the open door policy, number of tourists increased extremely and according to World Tourism Organization (WTO), China ranked 3<sup>rd</sup> in arrivals (WTO, 2011). Additionally, hosting the Beijing Olympics in 2008, World Expo held in Shanghai in 2010, and 16<sup>th</sup> Asian Games Guangzhou 2010 have triggered tourism and therefore hotel industry growth in China. As a result, despite the fact that there are major gaps in management, marketing, service quality, and human resources that need to be filled in the hotel industry in China, the industry is growing tremendously. However, Pine and Qi (2004) argue that economic and political system, hotel ownership, deficiency incapable management human resources, and competition between local investors are the major investment barriers in China for the multinational hotel groups. Gullie et al. (2011) put forward that occurrence of mega events, government policies, presence of local hotels, and market potential affect investment decisions of multinational hotel groups in China. It is further argued that while the managers of some major hotel chains involved in the tourism planning and development coordination of Shanghai World Expo 2010, government-authorized tourism agencies have strong autonomy in terms of the decision-making process, such as where the hotelier would build their properties, what would be their segments, and what kind of packages they would offer to the tourists (Lamberti et al., 2011, p. 1478).

Due to the economic and political system in China, hotels had been owned by the state and commonly managed by local governments. State owned hotels have never had clear economic goals, such as financial efficiency and cost effectiveness (Tang et al., 2006). Thus, economically mismanaged hotels cause many problems in the industry. Mwaura et al. (1998) note that there are cultural differences among hotel managers in China. In particular, hotel managers in China have different attitudes and means of conducting business relative to managers of foreign hotel groups, which is considered to be a challenge for the development of the Chinese hotel industry. In addition to cultural differences, state owned hotel managers are inexperienced with regards to strategic marketing and pricing. Keeping prices lower than their competitors, who are mostly foreign investors, is used as a pricing strategy, and the hotel property complex is the main advertisement theme rather than the hospitality of employees (Siu & Fung, 1998). While the competitiveness of the state owned hotels is low against the foreign investors, they are highly competitive in the domestic tourism market, which is growing considerably (Yu, 1998). Nevertheless, most of the state owned hotels do not have a website to attract domestic tourists in local languages and they do not provide information in foreign languages, such as English, to attract international tourists (Hsu et al., 2004). However, the state owned hotels benefit from the emergence of online booking sites and they have somewhat improved their reservation systems (Lu & Zhu, 2006). Besides these very initial important factors, the Chinese hotel industry faces further problems in terms of service quality and skilled human resources. The major problems of the hotel industry in China in the service and human resources context, especially for state owned hotels, are inability to speak English and having poor communication skills (Kong & Cheung, 2009).

One of the main objectives of the Chinese Government in placing the bid for the 2010 World Expo was to develop international and domestic tourism in Shanghai (Lamberti et al., 2011). One of the requirements of hosting an Olympic game is to provide approximately 130,000 hotel rooms with at least 22,300 hotel rooms to be provided in 4 or 5 star hotels

(International Olympic Committee, 2001). However, in 2000, Beijing hotel room capacity was only 85,000. Thus, the city of Beijing needed to provide 45,000 more hotel rooms before the Olympics in 2008 (Zhang et al., 2012). Most of the hotel rooms were still supplied by state owned hotels by 2004 and the RevPAR of state owned hotels was less than that of international hotel chains (CNTA, 2001 in Xiao et al., 2008). These disadvantages have led the Chinese Government to change their strategy by selling the shares to outside investors (Dai, 2003).

There are four major business models in hotel investment in China, and these models are the management contract, franchise, lease and operate, and owner-operated (CBRE, 2009; (Gross, Gao, & Huang, 2013; Pine, 2002). The management contract model is the most commonly used model in upscale hotels, while the franchise model is considered a risky investment by the franchisor due to franchisees' inability to comply with the quality and other requirements of the brands. However, contrary to this argument, Xiao, O'Neill, and Wang (2008) put forwards that franchising is becoming an effective model of investment for both investors and domestic hotel operators in China. Also, the lease and operate model is the most common in budget hotels, and the owner-operated model is the dominant business model in China. The owner-operated model was also acquired during the time when China was a closed economy and it is still the model for the state owned hotels; however, this model loses popularity due to the high degree of competition amongst hotel chain companies. Xiao et al. (2008) show that the domestic hotel managers' preferences on franchising are affected by education level and work experience, and brand of the franchisor, franchising and royalty fees, reservation systems, and high RevPAR are important factors on hotel operation preferences.

In general, the upscale and luxury hotel industry in China is dominated by international brands, while economy and budget hotels are dominated by local brands

(CBRE, 2009). The major international hotel brands that invest in China are Accor, Hilton, Hyatt, IHG, Marriott, Starwood, and Wyndham. All these brands have investments in upscale and mid-range or budget hotels in China. According to the CBRE Special Report (2009), international hotel investors operate more than 60% of upscale hotels and they have higher profit margins than local investors in China and hence the luxury and upscale hotel investments have increased tremendously in the past ten years (Pine and Phillips, 2005). Although rapid growth has been experienced for most of the hotel segments, for instance, budget hotels, upscale hotels, luxury hotels, and MICE hotels (Guillet, Zhang, & Gao, 2011), the primary business model for international investors is upscale hotel investment with management contracts (Pine, 2002) and full service hotels are more popular than limited service hotels in China (Xiao et al., 2008).

However, global hotel chains' interests in upscale hotel investment have caused saturation in this segment. Thus, potential international investors started to look for other hotel segments including mid-range and budget hotels (Wang, 2002 in Xiao et al., 2008). Although multinational hotel groups preferred to invest in upscale hotel segment, they have expanded their investment into mid-range and budget hotel segments in addition to expansion of the upscale hotel segment after the realization of the market potential in these segments (Guillet et al., 2011). The budget hotel segment along with other hotel segments increased unprecedentedly in China targeting domestic tourists mostly. The China Hotel Association and Department of Commerce reported, "Jin Jiang Inn, Home Inn, and Motel are the major budget hotel brands, and currently, budget hotels account for approximately 10% of the all star-graded hotels and 1% of all shares in the hotel market in China" (Hua, Chen, & Mao, 2009, p. 61). For example, "Beijing needed to renovate more than 200 no-star or low-class hotels before the end of 2007 to accommodate more than half million domestic tourists during the 2008 Olympics, according to Mr. Changjiang Yu, director of Beijing Tourism Bureau" (as cited in Hua et al., 2009, p. 60). "Budget hotel chains generally have higher

market share by number of hotels in the eastern cost, particularly in Shanghai (55%), Tianjin (36%), and Beijing (29%)” (CBRE, 2009, p. 7). However, in their study Hua et al. (2009), from the industry professional, government authority, and hotel investor point of view, show that safety and security, comfort, hygiene, location, service quality, and brand affiliation are the critical success factors for budget hotels. They also show from the customer point of view that security, provision of all kinds of amenities, responsiveness to customer demands, operational flexibility, and speed of service are the most important critical success factors for budget hotels. Chen (2007) examines the effects of macro-economic and social factors on Chinese hotel stock returns and finds that the announcement of the Beijing Olympics 2008, in 2001 had a negative effect on hotel stock returns in China. Chen (2007) suggests that while literature on mega events announcements has inconclusive results, in the case of the Beijing Olympics it had a negative effect because this event did not find support from some of the communities. Tibet regretted China being awarded hosting the Olympics in 2008 because Tibetans argue that hosting the Olympics would legitimize the ruling Chinese authorities, who are blamed for human rights abuses and repression of the government over people and democracy. Lamberti et al. (2011) investigate drivers of the community participation to mega-events for the case of the Shanghai World Expo 2010. One of their interviewees stated that “there has been a decrease in the number of one star hotels with a reduction of some 60% in the total number of beds in these hotels, whereas hotels in higher categories have increased in number by two or three times in response to the higher standards required by domestic tourists and the growing international demand. Nowadays the city has an estimated 21,000 four Star and five Star beds, and about 2 million international visitors and 10 million domestic visitors a year” (Lamberti et al., 2011, p. 1478). Although the occupancy rate dropped to the average occupancy rate of 32% after the games, average occupancy rate in Beijing during the Olympic Games reached the 76% level, up from a 32% average occupancy rate prior to the summer Olympics (ETOA Report, 2010).



In general, market demand and market size, GDP per capita, local policies, and mega events are the main factors that affect multinational hotel groups' decisions on investment locations in China (Zhang et al., 2012). "All hotel groups signify the influence of the Olympic Games in Beijing, the 2010 World Expo in Shanghai, and the 2010 Guangzhou Asian Games on their development and expansion plans in China" (Guillet et al., 2011, p. 230). Zhang et al. (2012) analyze the effect of mega events, namely Beijing Olympics 2008, Shanghai World Expo 2010, and Guangzhou Asian Games 2010, and they find that these mega events have positive impacts on multinational hotel groups' location trends. Only from 2006 to 2010, the number of hotels has increased dramatically from approximately 10,000 to over 15,000. Most of these hotels are local and approximately 3,500 of them are state owned whereas only 1.7% of the hotels are owned or co-owned by multinational hotel groups. Namely, Starwood, Marriott, Hilton, and Hyatt are the major multinational hotel groups in China (Hardingham, 2012). The number of multinational hotel groups in China grew to 560 in 2008 from 300 in 1989. Most of the multinational hotel groups are located in the eastern region provinces such as Beijing, Tianjin, and Shanghai; however, there are shifts toward western and central region provinces with the encouragement of Chinese Government and the saturation of the hotel investments in the eastern region (Zhang et al., 2012). Furthermore, it is shown that the number of five star hotels doubled from 12 to 24 prior to the opening ceremony of the 16<sup>th</sup> Asian Games Guangzhou in 2010. The new hotel investments include brands of multinational hotel groups such as Marriott and Sheraton, and Starwood hotel groups. These new hotels increased number of hotel rooms to 12,792 from 8,117 hotel rooms in Guangzhou (HVS, 2010).

## **Discussion**

There are major gaps in management, marketing, service quality, and human resources that need to be filled in the China hotel industry. The local hotels are inefficient with regards to marketing, pricing, advertising and basic technology such as websites. They do not have a target market to focus on and to develop strategies for. They also have unsatisfactory service quality and, in general, it is very difficult for both multinational and local hotels to find skilled human resources. Scarcity of skilled human resources makes it problematic for both local and multinational hotel investors to reach the desired service and management quality. Qu and Tsang (1998) note that especially the managers of state owned hotels do not know the expectation of the guests and that makes it harder for them to increase the service quality. Employees in state owned hotels generally have poor English-speaking skills and communication skills. It may not be a problem for domestic tourists but certainly is a problem for international visitors who have lots of Western hotel experiences. As Zhou et al. (2001) put forward that international tourists compare the service quality to the Western hotels and they have a solid quality measurement of Western hotels but these are certainly not comparable to the state owned hotels in China. After realizing losses and inefficient management in state owned hotels, the government of China started to sell the state owned hotels to outside investors. Particularly with the multinational hotel groups' increased investments in the market after the announcement that China will host the Beijing Olympics in 2008 and the World Expo in 2010, the government started to privatize state owned hotels. It is also shown that mega events are positively related to multinational hotel groups' choice of location. These choices signify the importance of mega events on hotel development in China and how they facilitate hotel development in China; especially investments by foreign companies.

In addition to the upscale hotel segment, the budget hotel segment has increased dramatically in recent years, generally serving low-income domestic tourists. However, the service quality is not satisfactory (Hua et al., 2009), neither in upscale nor in budget hotel segments. Nonetheless, after investments of multinational hotel groups, the service and management quality have increased (Gu, Ryan, & Yu, 2012).

Increased competition and declining occupancy rates after mega events in China make it difficult for existing international and domestic investors to expand their investments, and it also makes it hard for new entries to the market. However, existing investors and potential investors might consider investing in second tier and third tier cities of China to expand their business. More importantly, government officials in China need to develop better strategies on the venues that are built for the mega events either for international events such as the Olympics or national events such as the National Games. In the near future, as China is ranked number one in tourist arrivals, the occupancy rate will increase parallel to the demand from both international and domestic tourists. However, the major problem seems to be twofold. First, international tourists have some concerns on traveling to China. This is because potential tourists, who are generally considered to be tourists from western countries by Chinese government officials, have a different culture, social life, and political environment in their own countries and in most of the other destinations they travelled to or they would travel to in the world such as Italy, France, Brazil, and so on. Thus, investments of international hotel brands in China either via franchise, management contract, or joint venture might make western tourists feel more comfortable in China. It will be a win-win strategy for China, for its Government and for the private sector, to engage with the international brands and make it easier for such multinational companies to invest in China. Second, the government of China should develop policies and strategies to decrease the investment risk of the country by increasing the business freedom and financial freedom, and it should privatize all the hotels that are state owned or help them act with a business mindset.

Privatizing the hotels they own will be beneficial to the government because they are not efficiently operated and they do not have economic purposes. For example, one of the major tools of competition and profitability of the hotel operation is pricing, but state owned hotels decrease prices to the level lower than their competitors in the market as a strategy, which not only causes losses to the state owned hotel but it also causes unfair competition in the market. The government might subsidize the losses of the state owned hotels; however, the losses of the private hotels especially international brands will have worse effects in return. If the multinational hotel companies have such problems, this will affect future investments in China. Thus, the government should take serious steps towards privatizing the state owned hotels and adopt free market laws to increase efficiency, service quality, and competitiveness in the hotel industry.

## **Conclusion**

China has received more than 1.1 billion tourists in 2014 and it ranked 1<sup>st</sup> in tourist arrivals in the world (WTO, 2015). China has great opportunities in the future for its own economy, local businesses and foreign investors within the hotel industry (Tsang & Hsu, 2011). After announcements of China hosting the Beijing Olympics in 2008 and following other mega events, the number of hotels both local and multinational doubled and the number of star-rated hotels in China has reached over 15,000 in 2011 (Jiang, Gretzel, & Law, 2014) along with 1,698 budget hotels (CBRE Research Report, 2009).

Therefore, cooperation of the local hotel investors, both existing and potential hotel investors, with the multinational hotel investors would create opportunity to both sides. Considering investment expenses in the hotel industry and payback periods, multinational companies refrain from tying up large amounts of investment in foreign joint ventures. In addition to payback period and amount of investment, joint venture has much more risk than franchising and management contracts. However, multinational companies have much more

experience than Chinese hotel companies. On the other hand, the financing can be provided by local investors, who have less experience in operating a hotel to maximize the profits, while multinational hotel companies increase the service quality and other important features of the hotel management that would fulfill valuable customer expectations. Multinational hotel groups have valuable knowledge on hotel operations, profit maximization, human resources, and customer satisfaction relative to local hotel operators. Thus, the cooperation will be beneficial for both multinational investors and local investors in a sense that it will create a synergy between them. Local companies and government could also invest in training and capacity building to close the gap between Chinese and multinational hotels and make the Chinese hotel industry less dependent on foreign investment.

In a nutshell, mega events in China could be considered as a promotion strategy of Chinese Government to show the world their growing economy, capacity, opportunities to the multinational companies to undertake investments in China, and to increase popularity among the world to attract more tourists (Yu & Huimin, 2005). Mega events contributed to the enhancement of the hotel industry, but they might not be sustainable. Hosting mega events in Chinese cities is one of the largest marketing strategies of Chinese Government to enhance the economic development to catch up with the developed countries in the world.

### **Limitations and Future Research**

There are major limitations of this study. First, relevant statistics to help prove the points are limited and not necessarily always trustworthy. Therefore, his study is an exploratory study in its nature that relies on a limited range of literature. However, it has important implications for future research. An extended study is needed to empirically investigate significance and importance of the mega events effects on hotel development in China. If data can be collected, more reliable results can be obtained on the effect of mega events on hotel development. Therefore, future studies should consider collecting and

analyzing statistical data to find the impact of the mega events on hotel development. Considering the impact of the government on investment policy, the political side of mega event impacts and hotel development in China could be another important study for future research.

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