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PolyU Study Finds Overcapacity Problem Looming for Hong Kong Hotels

Hong Kong hotels are facing a serious problem of overcapacity that is likely to become more severe over the coming years, according to Dr Henry Tsai of the School of Hotel and Tourism Management (SHTM) and a co-researcher. In a recently published research paper the pair note that although there is consistently high demand for hotels in the city, demand forecasts indicate a significant shortfall in likely booking when compared to the rooms available. The failure to implement strategies to improve this situation, they suggest, will decrease the profitability of Hong Kong's hotels, and significantly increase their operational risks.

Hong Kong's hotels are renowned for providing high-quality services to both business travellers and tourists, but they currently face a number of challenges and opportunities. The researchers point to "the rapid growth of counterparts both in Macau and Guangdong province" as one of the challenges currently facing the Hong Kong hotel industry. For example, the number of star-rated hotels in Guangdong has increased at a rate of 15.2% per year over the past decade, presenting increasingly fierce competition for Hong Kong.

At the same time, however, policies such as the introduction of the Individual Visitor Scheme for mainland Chinese tourists in 2003 and the anticipated completion of the Hong Kong-Zhuhai-Macau Bridge in 2015-16 should increase the number of visitors from mainland China. This, the researchers note, will "help facilitate economic activity and tourism development in Hong Kong."

To support this promising growth and overcome the challenges from neighbouring regions, the researchers argue that "a healthy Hong Kong hotel industry, in terms of room capacity, is immensely important". A situation of either under- or over-supply of hotel rooms is detrimental to hotel owners. Although hotels could lose out if they have insufficient rooms, "a blind expansion of hotels could result in wasted resources" and financial hardship for hotel owners.

As the researchers warn, the over-construction of hotels in the United States during the 1980s led to serious overcapacity, and two thirds of the hotels built subsequently went bankrupt.

To avoid such a situation in Hong Kong, the hotel industry "needs to plan its capacity carefully based on demand". It is predicted that Hong Kong will have almost 70,000 hotel rooms by 2013, an increase of more than 17% over four years. Yet despite that increase, the researchers note that the occupancy rate "has not shown a similar promising upward trend" and has remained relatively steady at around 85% over the past decade. Hence, it is important to determine whether Hong Kong is likely to face the problems of over- or under-capacity in the coming years.

As future hotel developments and marketing strategies should be based on accurate information about potential demand, the researchers "examine hotel guestroom supply and demand and project optimal capacity". They argue that the availability of such information should be useful in informing stakeholders' decisions about existing and future development plans.

To achieve this aim, the researchers forecast the optimal supply of guestrooms for all hotels, excluding tourist guesthouses, in Hong Kong between 2010 and 2013. They estimate that the annual optimal room capacity for Hong Kong hotels will increase from the 46,577 that it was in 2010 to 50,584 in 2013. Comparing these figures with the actual numbers of rooms available, the researchers conclude that "the industry will experience serious overcapacity" because the discrepancy between the actual number of rooms available and the optimal number of rooms peaked at 40.7% in 2012 and will still be 38.8% now in 2013.

This serious overcapacity should alert hotel industry stakeholders and "prompt them to carefully re-examine existing and future development plans", argue the researchers. They warn that "blindly adding hotel guestrooms" will exacerbate the problem and result in "significant capacity waste and financial burden". For instance, low occupancy causes considerable overstaffing in hotels, even as labour costs remain one of their largest expense items. Put in a slightly different way, it is extremely costly for hotels to retain more employees than they need.

The researchers estimate the waste from each unoccupied hotel room above the optimal capacity to be HK$722 a night, amounting to an overall loss of HK$5.28 billion in 2012 alone. They argue that these losses could have been reduced and the "capital put to better use if proper capacity planning were in place".

As overcapacity "appears to be unavoidable at the moment and in the foreseeable future", hoteliers need to work hard to increase future demand, such as by working with the central government to allow more mainland Chinese visitors to enter the city and by catering to the different needs of all types of visitors. They also advise that rather than "engaging in cutthroat price wars", hotels should seek to maximise the revenue available per room. Hoteliers may also want to consider following the example of some Hong Kong hotels by turning their guestrooms into serviced apartments. As the researchers note, such a transformation appeals to the needs of "many businessmen and short-term visitors alike" and provides a steady revenue source by increasing room occupancy rates.

Because advertising is viewed as an important intangible asset that can promote brand awareness and increase profitability, the researchers also determine the "optimal level of advertising expenditure with the goal of maximising profits". They estimate the optimal annual advertising expenditure to be 3.8% of a hotel's total revenue. This compares with actual expenditure of around 4.02 to 4.71% between 2000 and 2009, suggesting that Hong Kong hotels are slightly overspending on advertising.

The researchers suggest that “hotels ought to spend their advertising budget more wisely” and “direct the money in more desirable directions”. They point to the increasing use of social media and mobile marketing, and suggest that hoteliers use such strategies to increase their return on advertising budgets. In response to the anticipated increase in tourists from the Chinese mainland, hotels should consider tailoring their strategies to attract visitors from this market.

Noting that there is some disagreement over whether spending on advertising should be increased or decreased during challenging economic times, the researchers advise that hoteliers should “carefully examine their methods and goals for advertising” to avoid the “inefficient deployment of previously scheduled advertising budgets”. The “bottom line”, they argue, is “to spend money smartly, whether in favourable or unfavourable economic times”.

The researchers hope that their findings will prompt hotel industry stakeholders into carefully re-examining their development plans, both now and in the future. They advise hotel developers and planning officials to carefully monitor hotel occupancy levels and tourist arrivals and maintain a “sustainable operating environment for the Hong Kong hotel industry”. Revising future building plans, combined with strategies such as increasing capacity by targeting emerging markets and marketing via social media, could save the Hong Kong hotel from considerable financial losses in the coming years.

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