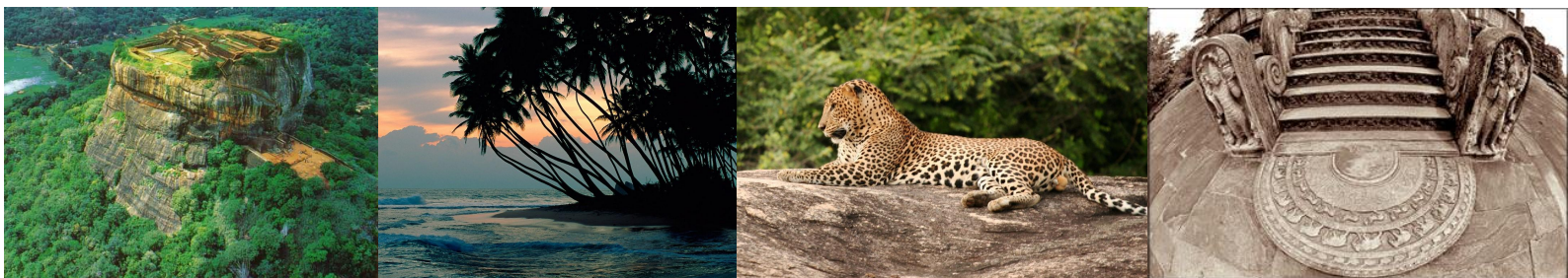




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SRI LANKA TOURISM: POISED FOR GROWTH

Inshita Wij
Senior Associate



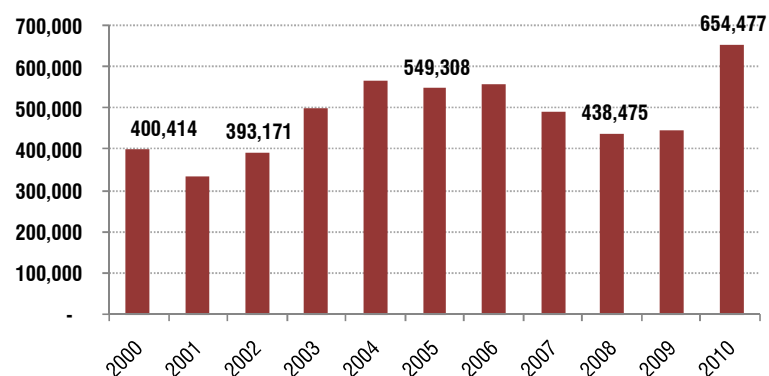
Following the end of a three-decade long civil war in 2009, Sri Lanka has witnessed unprecedented growth. With a real GDP growth rate of 8% in 2010, a jump of 125.2% in the stock market in 2009, and 32% year-on-year growth in tourist arrivals in 2010, Sri Lanka is on its way to becoming a major tourism destination in South Asia.

In the past one year, HVS India has received numerous inquiries about Sri Lanka from hotel operators, investors, and developers. These queries rightly come at a time when the country's total rooms supply needs to be more than doubled in the next five years to meet the tourist arrivals targets. We have, therefore, in this article tried to highlight the current tourism landscape, highlighting the projected shortage of hotel rooms in the next five years and discussed in detail the factors that would help in tourism growth in the long term. We have also highlighted the future trends and challenges in the Sri Lankan hotel industry.

The Current Tourism Landscape

Sri Lanka witnessed a strong upsurge in tourism after the end of the civil war in 2009. Tourism¹, which forms 0.6% of the total GDP of the country, was one of the fastest growing sectors in the economy, growing by 39.8% in 2010 over 2009. Exhibit 1 provides the tourist arrivals from 2000 to 2010, clearly showing the rise in tourist arrivals in 2010 (over the rest of

EXHIBIT 1: TOURIST ARRIVALS: 2000-2010



Source: SLTDA

the decade) with political stability and economic resurgence of the country. With Sri Lanka being ranked at the first position in the “31 Places to go in 2010” published by the New York Times, co-hosting the Cricket World Cup from February to April 2011, and the year 2011 being declared as the “Visit Sri Lanka” year by the government, the country witnessed record levels of tourist arrivals in the early months of 2011; a trend that is expected to continue for the remainder of the year.

TABLE 1: DISTRIBUTION OF ROOMS ACROSS REGIONS IN SRI LANKA: 2009

Region	No. of Rooms	Percentage Share
Colombo City	3,190	22%
Greater Colombo	2,494	17%
South Coast	4,940	34%
East Coast	230	2%
High Country	928	6%
Ancient Cities	2,679	19%
Northern Region	NA	NA
Total	14,461	

Source: HVS, SLTDA

This section highlights the regions where hotels are concentrated and provides a list of the major hospitality companies present in Sri Lanka. It also discusses the potential shortage of rooms in the country, keeping in mind the projected growth in tourism.

According to the Sri Lanka Tourism Development Authority (SLTDA), the country currently has 14,161 registered hotel rooms. The majority of these rooms are concentrated in the Colombo and Greater Colombo Area. Table 1 provides a breakup of the rooms inventory present in the country, according to the region.

¹ Referred to as “Hotels and Restaurants” in the National Accounts documents published by the Department of Census and Statistics, Sri Lanka.

TABLE 2: DISTRIBUTION OF ROOMS ACCORDING TO STAR CATEGORY

Star Category	No. of Rooms	% Share
5 Star	3,080	21%
4 Star	1,582	11%
3 Star	1,079	7%
2 Star	2,517	17%
1 Star	1,005	7%
Unclassified	5,198	36%
Total Rooms	14,461	

Source: HVS, SLTDA

The government classifies the hotels in Sri Lanka in five different star categories, ranging from 1 to 5 Star. Currently, the country has a high concentration of 5 Star rated establishments, followed by the budget 2 Star category. The largest percentage of hotel rooms in the country continues to be Unclassified, with no star rating. These are mostly independently-owned properties with smaller inventories, which offer a less expensive but non-standard product option to the tourists. The unclassified properties have been catering to the demand that cannot be accommodated by the branded establishments either due to a higher rate

or due to sold out rooms, and will continue to form an important part of the hotel industry in the country.

The Sri Lankan hotel space is currently dominated by regional players such as John Keells, Aitken Spence and Jetwing Hotels. Some international brands such as the Hilton, Taj, and Aman are also present in the country. Table 3 lists the brands and major hotel companies present in Sri Lanka, having two or more hotel properties. It is to be noted that although we have tried to include most of the major hospitality players in the country, this list does not include all the brands and hotel companies present in Sri Lanka.

With the promotion of new destinations by the government and the demand-supply imbalance prevalent

TABLE 3: MAJOR HOTEL COMPANIES AND BRANDS EXISTING IN SRI LANKA

S. No	Company	Sub Brands/ Tie Ups	No. of Existing Hotels	Mode of Operation	Inventory
1	John Keells	Cinnamon, Chaaya, Other Independent names	Nine	Own and operate	1,624
2	Aitken Spence	Heritance, Aitken Spence, Adaaran, Ramada	Nine	Own and operate/Own	891
3	Taj Hotels Palaces Resorts	Gateway, Vivanta, Taj	Three	Operators/Managers	575
4	Hilton	Hilton, Hilton Residences	Two	Operate	552
5	Tangerine Hotels	Independent names for each hotel	Four	Own/Own and Operate	503
6	Jetwing	Jetwing	Eleven	Own and operate	497
7	Serendib Leisure	Independent names for each hotel	Three	Own and Operate	317
8	Ramada (Wyndham Group)	Ramada	Three	Franchise/ Manage	240
9	Ceylon Corporation Plc	Independent names for each hotel	Two	Own and Operate	231
10	Aman Resorts	Aman	Two	Own and operate/Manage	44

Source: HVS Research

in the country, several brands are planning to enter the hotel industry in Sri Lanka. Six Senses, Shangri-La and Mövenpick are some of the brands that have announced their entry into the country, either through joint ventures or management contracts. The domestic brands are also planning new hotels, undertaking acquisitions, and renovating existing assets.

The hotel industry in Sri Lanka currently comprises of a number of hotels that have not been refurbished owing to the decline in tourist arrivals in the past few years. Now that the country has witnessed a revival in tourism, it requires more hotel rooms to sustain the growth. **The government has set a target of receiving 2.5 million tourist arrivals by 2016; HVS projects that the Sri Lankan hotel industry will need an additional 41,000 rooms in the next five years to achieve this target.**

Table 4 illustrates the methodology that HVS has utilised to arrive at the range of additional number of rooms required. We have calculated the ratio of travellers to rooms in 2010 and used this figure to arrive at the number of rooms required, based on the target tourist arrival figures.

TABLE 4: CALCULATING THE ADDITIONAL NUMBER OF ROOMS REQUIRED BY 2016

Total number of tourist arrivals in 2010	654,477
Existing stock of hotel rooms in Sri Lanka	14,461 star-rated and unclassified rooms
Ratio of travellers-to-rooms	45 travellers per room or 45:1
Projected number of travellers in 2016	2,500,000
Keeping the ratio of travellers-to-rooms constant,	
Total number of hotel rooms required by 2016	55,239
Therefore, additional number of hotel rooms required	40,778

Factors that will Support Tourism Growth

We have identified various factors that will support the growth of tourism and help in creating demand for hotel accommodation in the medium to long term. The projected growth of the tourism industry will be supported by these four major factors: Presence of natural and cultural attractions, proximity to and connectivity to major feeder markets, government initiatives to support tourism growth, and focus on infrastructure development by the government.

I. Presence of natural and cultural attractions

Sri Lanka offers a plethora of options for the traveller — beach destinations, heritage and cultural attractions, national parks and wildlife, pilgrimage sites, shopping areas, and casinos. The tourist attractions in Sri Lanka are not restricted to specific geographical areas but span the length and width of the country. The following paragraphs provide more details about these attractions and the upcoming tourism developments in Sri Lanka.

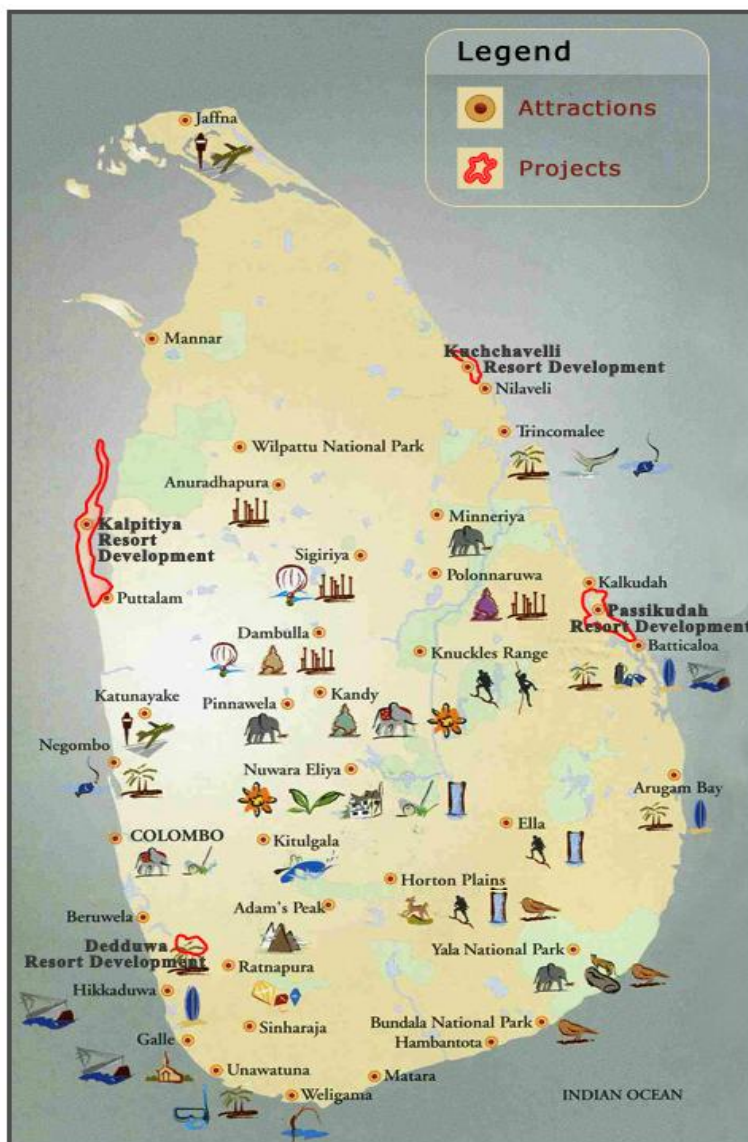
Beach destinations: Sri Lanka offers several natural beaches, dive sites, and surfing destinations. A list of these destinations is provided below.

- Arugam Bay: Located to the southeast of the country, Arugam Bay is known for surfing. It houses several lodges and boutique hotels and receives the maximum number of tourists from May to December.
- Bentota: A popular beach destination, it is about an hour to 1-1.5 hours drive from Colombo. The adjoining town of Beruwala is also a beach destination.
- Hikkaduwa: Located along the south coast of Sri Lanka, Hikkaduwa is known for its scuba diving.
- Kosgoda: Located between Bentota to its north and Ahungalla to its south, this small beach destination is known for its turtle hatcheries.
- Mirissa: Located in the south of Sri Lanka, this beach destination is famous for viewing whales and dolphins. The close-by region of Unawatuna is also known for scuba diving.
- Negombo: Located about 40 km north of Colombo, Negombo offers a beach and views of the expansive Negombo lagoon. Negombo's proximity to the airport acts as an advantage for visitors who want to enjoy a short stay near the beach.
- Passikuda and Kalkuda: Located in the east of Sri Lanka, these destinations offer virgin beaches.

- **Tangalle:** Located almost at the southern tip of the island, Tangalle is being promoted as a diving destination. The southernmost point of Sri Lanka, known as Dondra Head, is close to Tangalle.
- **Trincomalee:** Located to the northeast of Sri Lanka, Trincomalee is known for its natural harbour and has two relatively unexplored beaches, Nilaveli and Uppuveli.
- **Wadduwa:** Located approximately 38 km south of Colombo, Wadduwa is a small beach destination in the south-west of the country.

Heritage destinations: Sri Lanka is home to eight UNESCO World Heritage Sites, several Buddhist and Hindu temples, and other ancient monuments that serve as attractions for travellers. Adam's Peak, a mountain in the Central Province with the shape of a footprint on its peak, is considered sacred in a number of religions. The eight UNESCO World Heritage Sites in Sri Lanka include the central highlands area comprising of the Hortons Plains National Park and Knuckles Conservation Forest, the Sinharaja Forest Reserve, the Dutch Fort in Galle, the Golden Temple of Dambulla, the Temple of Tooth in Kandy, and the ancient cities of Polonnaruwa, Anuradhapura, and Sigiriya.

EXHIBIT 2: SRI LANKA: TOURIST ATTRACTIONS AND UPCOMING TOURISM PROJECTS



Source: SLTDA

National Parks and Bird Sanctuaries:

Sri Lanka has nine national parks and seven bird sanctuaries, which house several endangered species. The famous national parks include Kamana National Park, Yala National Park, Uda Walawe National Park, Wilpattu National Park, Horton Plains National Park, Minneriya National Park and Wasgamuwa National Park. Most of these parks are located in the central and southeastern parts of the country.

Sri Lanka also witnesses a significant number of tourist arrivals for **pilgrimage**, especially for Hindu and Buddhist pilgrimage sites located across the country. The famous pilgrimage sites include Adam's Peak, Tooth Temple (Kandy), Kataragama, Bogoda Bridge (Badulla), Buduruwagala (near Wellawaya), Dowa Cave Temple (Bandarawela), Maligawila, Dambegoda, and Muthiyangana. The country's tea estates also serve as tourist attractions.

Exhibit 2 provides a map of Sri Lanka highlighting the various tourist attractions and the major upcoming tourism projects.

Retail and Casino: The capital city of Colombo, which acts as a gateway to Sri Lanka due to the presence of the international airport, offers various options for shopping and entertainment. The famous retail outlets in Colombo include Odel, Paradise Road, and House of Fashion. Small markets like Pettah and the Fort Market also attract tourists. Colombo has four major Casinos – MGM, Bellagio, Ballys and Stardust – that offer gaming options such as roulette, poker, black jack, and baccarat. However, the names for the casinos have been copied from the ones in Las Vegas and have no link to the original casinos.

The most frequently visited tourism destinations currently are located in the west and centre, and to a small extent to the south of the country, due to limited access to the northern and eastern parts in the war period. Currently, most tours ranging from 3 to 5 days involve visiting Kandy, Sigiriya, Anuradhapura, or Nuwara Eliya for their world heritage sites and temples, and a visit to Bentota as a beach attraction, with entry and exit into the country from Colombo. In addition to the above mentioned destinations, the tours for a longer duration of 10-15 days include a visit to all or some of the following – tea factories in Nuwara Eliya, the beach in Trincomalee, beach in Galle, and a wildlife safari in one of the national parks. All tours currently utilise the Colombo Airport for entering and exiting the country.

Although efforts are underway to preserve and maintain the existing tourist attractions, the government is also promoting the development of **new tourism destinations in Sri Lanka, especially in the north and east of the country**, to encourage economic growth in the area. The major tourism projects that have been announced by the government with the view of developing the country as a major tourism destination in South Asia by 2015 are summarised below².

Dedduwa Lake Resort: Proposed development of resorts over an area of 1,800 hectares, located to the east of Bentota. The project is in its initial planning stages.

Eastern Province Region Development: The government is encouraging the development of areas in the Eastern province, including Passikuda, Arugam Bay, Trincomalee, Waakarai, Verugal and Kalkudah, in order to accelerate economic development in the region. Two notable projects in the region are Kuchchaveli and Passikuda.

- o *Kuchchaveli Resort Development:* An area of approximately 500 acres has been identified for tourism development, near the Nilaveli Beach in Trincomalee. According to the SLTDA, this development is proposed to include more than 3,000 hotel and resort rooms, along with theme parks and water park facilities. A conceptual zoning plan is currently being prepared for the area by the SLTDA with the assistance of the Urban Development Authority (UDA). The government is currently inviting applications from private investors to develop hotels and resorts in the region.
- o *Passikuda Resort Development:* The SLTDA has finalized the conceptual design and is undertaking the economic impact assessment for a resort development on approximately 150 acres of land close to the beach.

Kalpitiya Integrated Resort Development Project: The Kalpitiya Tourism Development Program, as envisioned by the government, will include 17 hotels with a total capacity of 5,000 rooms and 10,000 beds upon completion, along with an amusement park, golf course, race course, and a domestic airport at Uchchamunai. The 13-kilometre-long stretch comprises 14 islands, of which nine belong entirely to the government while the rest are owned partly by the government and partly by private investors. Currently, the project is in the initial stages with the government inviting bids for leasing out the islands. Two islands have been leased out to foreign investors – Vellai Islands for a sum of SLR 3.7 million (approximately USD 34,000) for the first five years to Sun Resort Investment Lanka Private Limited and the Ippantivu Island for SLR 14 million to Qube Lanka Leisure Properties Private Limited.

² HVS Research, Sri Lanka Tourism Development Authority

TABLE 5: TOP TEN SOURCE MARKETS: 2009

Market	Total Arrivals	Percentage Share
India	83,634	19%
UK	81,594	18%
Maldives	31,916	7%
Middle East	23,741	5%
Germany	29,654	7%
Australia	23,239	5%
France	15,886	4%
USA	14,241	3%
Russia	11,834	3%
Netherlands	11,291	3%
Total	327,030	73%

Source: HVS Research, SLTDA

II. Proximity to and connectivity to major feeder markets

Sri Lanka's location in close proximity to India, Middle East, and China, some of the fastest growing markets for tourism, along with frequent flights to these regions helps in increasing the inflow of tourist arrivals. Table 5 lists the top ten source markets for Sri Lanka in 2009, which is the most recent information available. Although India remains the largest feeder market, the Middle East region deserves a special mention in its contribution to Sri Lanka tourism, contributing 23,741 tourist arrivals in 2009, an increase of 42% over 2008. It is expected to be a major source market in the next few years.

III. Government initiatives for tourism growth

The Board of Investments (BOI) in Sri Lanka is offering incentives for development of hotels and other tourism facilities. According to the BOI website, the government currently offers a five-year **tax holiday** on any project with a minimum investment of US\$500,000. To encourage projects in the northern and eastern provinces, the government offers additional incentives, depending on the nature and scale of the project.

It is interesting to note that all countries forming the top ten source markets for Sri Lanka have been provided the option of a **'Visa on Arrival'** by the Sri Lankan government. Currently, approximately 80 nationalities are allowed the option of obtaining a visa on arrival for tourism purposes, which is valid for a period of 30 days. This illustrates the pro-tourism stance of the government.

The government has set a **target of receiving 2.5 million tourist arrivals by the year 2016**. In order to achieve this target, several promotional and developmental activities have been initiated. One such promotional initiative is the declaration of the year 2011 as "Visit Sri Lanka Year", where each month is promoted with a special attraction and festival.

Sri Lanka has also placed a bid for hosting the Commonwealth Games in 2018 in the city of Hambantota, where a new airport and an expansive port facility is currently under development. Sri Lanka is competing with Australia on the bid; the winner will be announced in November 2011. The Commonwealth Games will provide an opportunity for the country to showcase its tourist attractions and build a better infrastructure.

A unique example of the government tourism policy is the introduction of **minimum rates** by the government in the capital city of Colombo. In order to help the hotel industry, which was suffering from very low rates owing to weak demand during the civil war, the government introduced minimum rates for rooms and food and beverage services according to the star classification of the hotels. The hotels in Colombo are now required to charge above or equal to the minimum rates for each type of customer segment, as specified by the government. Although the policy received substantial resistance from travel agents and tour operators in the beginning, it helped bring the rates to sustainable levels. Before the introduction of minimum rates, upscale hotel rooms were being sold in the range of USD 35-45, as a result of which the hotels were not able to generate sufficient revenues to cover their expenses. However, the government has announced two consecutive upward revisions in the minimum rates in a short span of four months, which might affect the demand for hotels in Colombo, at least in the short term.

Table 6 provides the minimum rates for the FIT segment when the policy was introduced in 2009, and highlights the subsequent increases in the rates due to revisions in government policies.

Date of Rate Revision	5 Star	4 Star	3 Star	2 Star	1 Star	Percentage Increase in Each Revision
January 2009	75	60	45	30	20	
January 2011	100	85	70	55	40	33%
April 2011	125	95	75	60	45	25%

IV. Infrastructure development

Along with the development of new tourism destinations, the government is simultaneously placing emphasis on infrastructure development, with the construction of airports, ports, roads, and power plants.

- **Airports:** The country currently has one major international airport, the Bandaranaike International Airport in Colombo, with 20 operating airlines that provide 277 incoming flights per week in the high season. The airport currently has the capacity to handle 7 million passenger movements; it can handle a significant increase in passenger traffic even without expansion. However, keeping in mind the projected increase in tourist arrivals in the coming years, an expansion and modernization of the airport is planned. A new passenger terminal building with segregated departure and arrival areas, new parking aprons, and additional area with duty free retail are proposed to be added in Phase II of the airport development, which would increase the airport capacity to 12 million passengers. The work on Phase II is proposed to start in 2012. A second airport is also being planned in Hambantota, in the south of Colombo. The construction of the airport is underway, and it is expected to be completed by 2013. In the first phase, the airport is expected to have a capacity to handle 1 million passengers.
- **Ports:** Work is also underway for the expansion of the existing Colombo port, under the Colombo South Port Project. Another large port facility is being developed at Hambantota, with considerable Chinese investment.
- **Roads:** Several road development and expansion projects such as the Southern Highway Project, Colombo - Katunayake Expressway, National Highway Sector Project and Road Sector Assistance Project are underway to improve the road connectivity to various cities.
- **Power:** The government is working towards the goal of being self sufficient in terms of power generation. . The first phase of the Norochcholai Coal Fired Power Plant was declared operational in 2011; work is also underway on the Upper Kotmale power plant, Trincomalee Coal Fired Power Plant, and the Kerawalapitiya power plant.

Future Trends and Challenges

Infrastructure growth to fuel tourism growth. To ensure rapid growth of tourism in the future, tourism projects will need to be complemented with infrastructure development. We expect that with improvements in road infrastructure and development of the new airport in Hambantota, various new destinations will emerge in the country, especially to the north and the east, as these areas have abundant natural beauty to attract tourists but currently suffer from poor connectivity. We expect more airlines to operate in the country as the second airport develops. Airlines such as Etihad have recently started operating flights to Sri Lanka; an increase in frequency of current operational airlines and charter movements in the winter months from Europe and Russia is also expected.

Source markets in Asia and Middle East to drive demand. Sri Lanka's proximity to source markets such as India and its connectivity to the Middle East and China will help in sustaining tourism growth. The rise in per capita income and therefore consumer spending in these source markets will aid the growth in tourism.

Growth of MICE segment. As new hotels with large inventories and meeting spaces enter the market, we anticipate Sri Lanka to become a lucrative MICE destination, especially for companies located in India.

Greater competition will facilitate growth. We also expect greater competition with the introduction of new hotels in popular destinations such as Colombo, Kandy, Bentota, and Sigiriya, and Galle. We expect the existing hotels to undertake phased renovations to effectively compete with the upcoming hotels. Also, with the increase in income from hotels over the past few years, we expect an increase in the number of hospitality related transactions and mergers and acquisitions.

Challenge of attrition to other destinations. Currently, the hotel industry witnesses significant employee attrition to countries in the Middle East and to the Maldives and India. However, with a more stable political environment and improvement in quality of living in Sri Lanka, we expect the attrition to gradually decline. We also expect the hotel companies, especially the domestic companies located in the country to undertake long and medium term hospitality training programs and regularly undertake competition benchmarking for compensation to retain the talent.

Shortage of skilled labor. As new players enter the market, the projected growth in tourism will be accompanied by shortage of skilled labour. We anticipate the need for relevant hospitality education institutions as the contribution of the tourism sector to the overall economy increases.

Closing Thoughts

The long-awaited growth trajectory for the country is just at the starting point and we anticipate Sri Lanka to emerge as a unique and successful tourism destination in the near future. We anticipate strong demand growth in the country with the expansion of the economy, influx of foreign investments, and development of infrastructure and tourism destinations. In the short term, the growth in demand is expected to outpace the growth in supply, a situation that will be beneficial for existing hotels. In the long term, with the entrance of more international brands and maturing of the tourism industry, we anticipate a change in perception for Sri Lanka from a 'budget' destination to a more exotic one offering a variety of experiences to a diverse segment of travellers.



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For further information please contact iwij@hvs.com or kvardharajan@hvs.com

About the Author



Inshita Wij is a Senior Associate with HVS's New Delhi office, specializing in hotel valuations and consultancy. She joined HVS in 2009 after completing a BSc. at Cornell School of Hotel Administration, Ithaca. She also holds a Diploma in Hotel Management from Les Roches School of Hotel Management, Switzerland.

During her stay in Switzerland, she worked for the Hotel Novotel, Geneva and the Best Western Hotel Astoria, Geneva where she gained knowledge of hotel operations. In India, Inshita started her career with the Starwood corporate office in New Delhi as an intern in the Training and Development division. She then moved to HVS New Delhi after completing her studies at Cornell. At HVS, she has performed several feasibility studies, valuations, and market studies in India, Sri Lanka, and the Maldives.