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# SRI LANKA TOURISM: A STEP FORWARD IN THE GROWTH STORY

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## Introduction

*HVS published an article in June 2011, providing an overview of the tourism landscape in Sri Lanka and the various factors that could lead to robust tourism growth in the country after the war ended in 2009. The article also included the tourism vision for the country and its objective of achieving 2.5 million tourist arrivals by 2016. This article seeks to highlight how that vision of tourism growth has been translating into a reality in the past two years with improvements in infrastructure, tourist arrivals and tourism earnings, and hotel market performances. Having followed the Sri Lanka market closely since the last two years, performing market studies, feasibilities, and valuations in different parts of the country including Colombo and other emerging destinations, HVS believes that the growth story continues for Sri Lanka. In this article, we have analyzed the Colombo hotel market and the Southwest Coast resort market to evaluate the impact of the growth in the economy and tourist arrivals on hotel performances in these regions.*

## Economic Overview

The Sri Lankan economy has witnessed tremendous growth in the past three years. The GDP growth in 2011 was recorded at 8.3%, the highest annual rate of expansion since the country gained independence in 1948. The inflation rate in the country remained controlled at 6.7%, and the unemployment rate declined to 4.2% in 2011 from 5.8% in 2009. The Economist Intelligence Unit forecasts that the country will grow at an average rate of 7.4% from 2013 to 2016<sup>1</sup>. Going forward, private consumption and rising incomes will contribute to economic growth, coupled with investment in infrastructure, businesses, and property investments. The following section illustrates the developments in infrastructure that have taken place recently, which will enable both economic and tourism growth.

## Infrastructure Developments

The Sri Lankan government is ensuring that the building blocks for economic growth are being developed simultaneously as tourist arrivals to the country increase. The following major projects have recently been completed or are under active development, supporting the vision for tourism growth.

- **Highways and Expressways:** Sri Lanka's first ever access-controlled 96-kilometer-long expressway from Colombo to Galle, built at a cost of approximately US\$700 million, opened in November 2011. This made the city of Galle more accessible for both locals and tourists with the travel time between Colombo and Galle reduced to two-and-a-half hours from five hours. The hotels and resorts located on the Southwest Coast of the country witnessed an improvement in their performance due to the opening of the expressway. The remaining stretch of the highway until Matara is expected to be completed by 2013.

The construction of the Colombo-Katunayake Expressway connecting the international airport in Katunayake to Colombo city is in progress, and is expected to be completed by the second half of 2013. This is expected to reduce the travel time to Colombo from the airport to approximately 40 minutes from the current one to one-and-a-half hours. Highways from Katunayake to Anuradhapura (153 km), Colombo to Kandy (98 km), and Anuradhapura to Jaffna at the northern

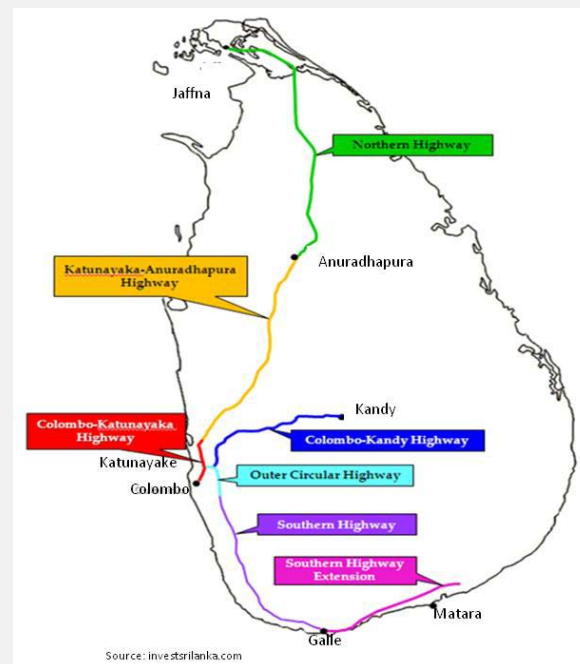
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<sup>1</sup>GDP growth at post-independence high', *Economist Intelligence Unit* (4/6/2012)

tip of the country are currently in the planning stage. Figure 1 illustrates the major highways in Sri Lanka, both planned and under development, including the recently opened Southern Expressway.

- **Airports:** To provide an alternate to the only existing international airport in Colombo, and to enhance accessibility to other parts of the country, Sri Lanka is building its second international airport at Mattala in the southern Hambantota district. The construction is underway for the first phase of the airport, which will include one runway and one taxiway to enable a passenger handling capacity of 1 million. The project is expected to be completed in the last quarter of 2012. The government's plan is to increase the total passenger handling capacity from 6 million in 2011 to 12 million in 2016. To meet this goal, the expansion of the existing airport in Katunayake is also planned, with the addition of another passenger terminal and expanded cargo handling facilities<sup>2</sup>. Several airlines have expressed interest in starting flights to Sri Lanka in the past two years, and airlines such as Jet Airways and China Eastern Airlines have almost doubled the frequency of their flights into the country. Emirates, Air Arabia, Spice Jet, and Gulf Air are other airlines that have increased their frequency in 2011 to cater to the rising demand from tourists and Sri Lankans residing in other countries. The past year also saw Sri Lankan Airlines commence their seaplane operations. The seaplane services currently connect Colombo to 12 destinations within the country while another six routes are being planned. The seaplane services are utilized by tourists and locals and are a step forward in making different tourist destinations across the country more accessible.

**FIGURE 1: MAJOR HIGHWAYS IN SRI LANKA (PLANNED AND UNDER DEVELOPMENT)**



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- **Port Projects:** The Hambantota Port, located to the south of the country, opened for international shipping in June 2012. The estimated cost for building the port was US\$800 million<sup>2</sup>. The port is ideally located to serve the main East-West shipping lane connecting Europe and the Middle East with South East Asia. The expansion of the Colombo South Port is also underway; the project involves the addition of another 600 hectares of land with three terminals and berthing facilities. The enhanced port facilities will enable Sri Lanka to become an important logistics hub.

Along with improvements in basic infrastructure, the country has also experienced important changes in tourism infrastructure, which will facilitate its growth as an important tourism destination in South Asia.

<sup>2</sup> Board of Investment, Sri Lanka from investsrilanka.com

## Tourism Infrastructure

In 2011, the Sri Lanka Tourism Development Authority (SLDTA) started the **One Stop Shop** for tourism projects to fast track the approvals required for hotel and resort projects and encourage investment in tourism. The One Stop Shop provides information to potential investors regarding tourism projects and acts as a liaison in obtaining all approvals required for a project from various ministries and agencies and obtaining incentives such as tax breaks and exemption from import duties for the project.

Despite the apprehensions of several hotel and travel and tour operators, Sri Lanka introduced the **Electronic Travel Authorization (ETA)** system on 1 January 2012 to grant visas to foreign nationals from 78 countries, with the exception of Maldives and Singapore. Before the introduction of this new system, the visa was granted on arrival and was free of charge. The introduction of this system does not seem to have had a negative effect on the number of tourist arrivals in the country, and has brought in increased tourism revenues. An individual tourist has to now pay a minimum of US\$10 for a double-entry visa for Sri Lanka.

The government has identified some **key areas for tourism development** and is promoting them for hotel and resort projects. Some of these destinations are Kuchchaveli (530 acres) in Trincomalee district on the northeastern coast, Passikudah on the east coast, Kalpitiya on the northwestern coast consisting of 14 different islands, and Deeduwa comprising 1,800 acres of wetland near the river Madhu Ganga located close to Bentota on the southwestern coast.

Continued developments in infrastructure and the pro-investment stance of the government have helped it attract foreign investment. Several large tourism projects are planned in the country and many international hotel operators such as Avani, Six Senses, Hyatt, Marriott, Mövenpick, Starwood, Onyx, Shangri-La, and ITC have either commenced operations in the past year or announced projects in the country. The following section presents the trends in tourism, including tourist arrival figures, purpose of visit of arrivals in the past two years, and changes in the source markets for tourism.

## Tourism Trends

Sri Lanka experienced robust tourism growth in 2011 with a growth of 45.7% in tourism receipts over that in 2010; the country recorded US\$840 million in tourism receipts in 2011 as compared to US\$576 million in 2010. The Sri Lankan government had set a target of achieving 750,000 tourist arrivals in 2011; not only did the country achieve the target but it more than doubled the targeted 15% growth, with a year-on-year growth of 31% in tourist arrivals. The country is experiencing continued growth in 2012 as well, with the first half of the year achieving a growth of 19% over that in the first half of 2011. The government has set the target of achieving 1.5 million tourist arrivals in 2012<sup>3</sup>. HVS believes that this target is optimistic; assuming the growth trend of the first six months to continue (19% over last year), we expect the country to just cross the 1 million tourist arrivals mark in 2012. Figure 2 highlights the tourist arrivals and year-on-year growth trends from 2006 to 2011. Figure 3 highlights the month-on-month growth in tourist arrivals from January to June 2012, as compared to the same months in 2011.

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<sup>3</sup> Tourism Sector Plans by Board of Investment, 2010

FIGURE 2: TOURIST ARRIVALS TO SRI LANKA – 2006-2011

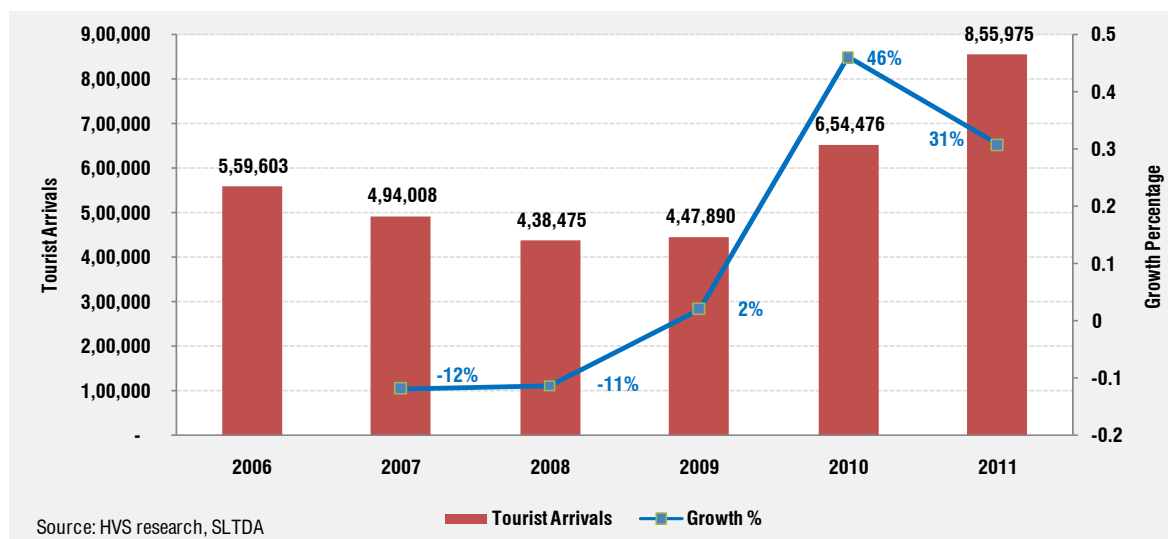


FIGURE 3: MONTHLY GROWTH IN TOURIST ARRIVALS – 2012 OVER 2011

Monthly Tourist Arrivals			
	2011	2012	Growth (%)
Jan	74,197	85,874	16%
Feb	65,797	83,549	27%
March	75,130	91,102	21%
April	63,835	69,591	9%
May	48,943	57,506	17%
June	53,636	65,245	22%
Jan-June year on year growth			19%

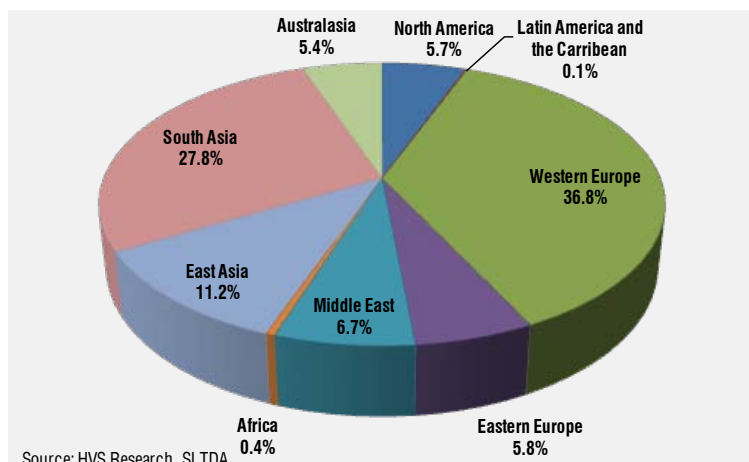
Source: HVS Research, SLTDA

The **purpose of visit** for arrivals into the country was similar to that as last year's; a majority (80%) of the travelers visited the country for pleasure in 2011 similar to the 79% travelers in 2010. The percentage of business tourists declined from 12.7% in 2010 to 8% in 2011, although the actual numbers of both leisure and business tourists increased. The top ten source markets for Sri Lanka remained largely unchanged in 2011 as compared to 2010. India continued to be the largest market, with arrivals growing by 35% over those recorded last year. The United Kingdom and Germany remained the second-largest and third-largest markets respectively. France, up from the sixth rank in 2010, emerged as the fourth-largest source market replacing Maldives, with a growth in arrivals of 56% from that in 2010. The other major source markets including Maldives, Australia, Canada, U.S.A, and Netherlands, all recorded a growth of more than 15% over that achieved last year. Although Japan, ranked as the tenth-largest source market in 2011, witnessed a growth of 43% over last year's arrivals; Russia replaced Japan as the tenth-largest market in 2011 with a massive growth of 61% over the arrivals in 2010. Figure 4 presents the top ten source markets and their share of arrivals in 2010 and 2011.

FIGURE 4: TOP TEN SOURCE MARKETS AND PERCENTAGE SHARE – 2010 AND 2011

Top Ten Source Markets					
2010			2011		
Market	Total Arrivals	Percentage Share	Market	Total Arrivals	Percentage Share
India	1,26,882	19.4%	India	1,71,374	20.0%
UK	1,05,496	16.1%	UK	1,06,082	12.4%
Germany	45,727	7.0%	Germany	55,882	6.5%
Maldives	35,791	5.5%	France	48,695	5.7%
Australia	33,456	5.1%	Maldives	44,018	5.1%
France	31,285	4.8%	Australia	41,728	4.9%
Canada	21,123	3.2%	Canada	24,671	2.9%
U.S.A	19,093	2.9%	U.S.A	24,386	2.8%
Netherlands	17,861	2.7%	Netherlands	23,966	2.8%
Japan	14,352	2.2%	Russia	21,385	2.5%
<b>Total</b>	<b>4,51,066</b>	<b>68.9%</b>	<b>Total</b>	<b>5,62,187</b>	<b>65.6%</b>



**FIGURE 5: CONTRIBUTION OF VARIOUS REGIONS TO TOURIST ARRIVALS**

It is interesting to note that the overall contribution of the top ten source markets declined, and some nontraditional countries gained market share. Increased arrivals were witnessed from nontraditional source markets such as U.S.A and Latin America, and from Western European nations such as Austria, Belgium, and Sweden. Visitation from China increased by 56%, and is expected to continue to increase in the future, as China becomes one of the most important and largest source markets for global tourism.

Figure 5 presents the contribution of tourist arrivals from the major regions in the world.

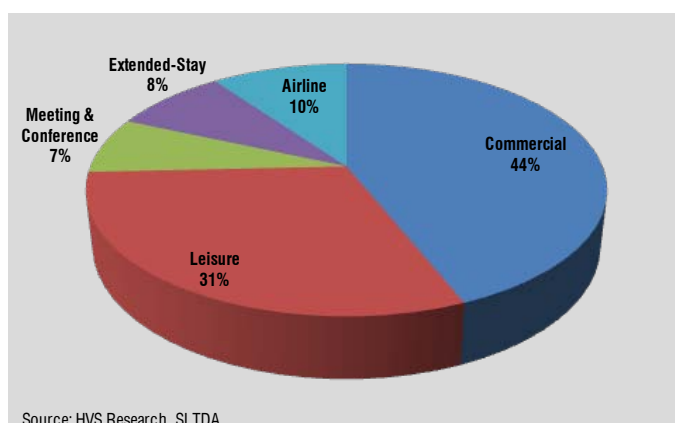
Several hotel markets in the country have performed well in the past two years, with many destinations being currently sold out in the high season. To evaluate the impact of the increase in tourist arrivals on hotel performance, we have analyzed two major hotel markets: Colombo and the Southwest Coast up to Galle. The improvement in performance and the future prospects of these destinations proves that there is room for new hotels to enter the country and benefit from the natural and cultural attractions drawing tourists to Sri Lanka. We have chosen to elaborate on these markets as they currently constitute the largest number of hotel rooms in the country and are the most mature markets that were not closed to tourists during the war. In the following section, we present the performance of these markets over the past three financial years and an outlook for their future performance.

## Colombo

The following analysis of the Colombo hotel market includes the major international and domestic branded five and four-star hotels and excludes the smaller boutique properties and one to three-star rated hotels. We have also included the airport hotels in our analysis. We have considered a competitive set of approximately 2,700 rooms in the city and airport areas.

**Hotel Market Overview:** Colombo is the commercial capital of the city and the primary destination for any investor, government official, or corporate representative. It also benefits from close proximity to the only international airport (Bandaranaike International Airport, Katunayake) in the country. Its

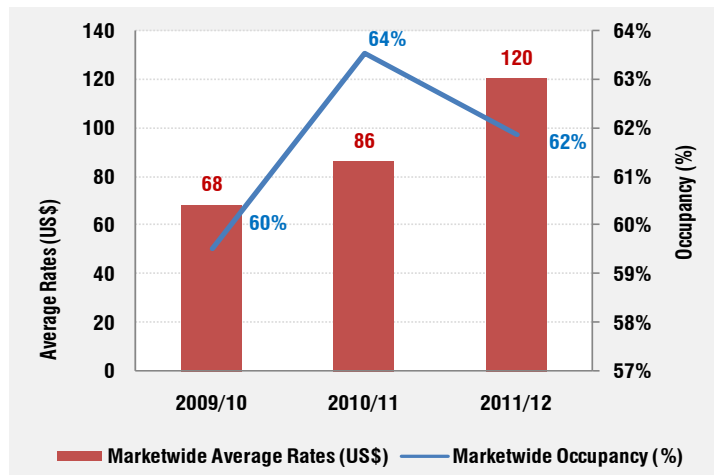
connectivity to the airport will be further enhanced with the completion of the Colombo-Katunayake Expressway in 2013. Colombo has witnessed improvements in infrastructure and the government has worked towards giving the city a facelift with steps such as widening of roads, cleaning of the Beira Lake, and redevelopment of areas around the Beira Lake.

**FIGURE 6: MAJOR CUSTOMER SEGMENTS FOR COLOMBO HOTELS**

**Customer Segments:** The Colombo hotel market comprises various segments

including Commercial, Leisure, Meeting and Conference, Extended Stay, and Airline (includes airline crews). Figure 6 depicts the customer segments and their share of the market in 2011/12. We expect the Commercial segment to witness strong growth as the country receives increased visitation from investors and corporates looking to either commence or expand operations in the country. The Meeting and Conference segment is expected to grow significantly as new branded properties with large meeting spaces (such as the Shangri-La) open.

**FIGURE 7: HISTORICAL MARKETWIDE OCCUPANCY AND AVERAGE RATES – COLOMBO**



We expect the Leisure and Extended Stay segments to witness growth in the long term, but at a moderate pace since several competing leisure destinations are developing across the country.

#### **Hotel Market Performance – Occupancy:**

Colombo recorded an occupancy of 64% in 2010/11, an increase of 7% over the 2009/10 occupancy. However, the Colombo hotel market was an outlier as compared to the rest of the country in 2011/12, as it witnessed a decline of 3% in occupancy over that in the

previous year. Figure 7 presents the occupancies and average rates for the market for the past three financial years. Even though the occupancy declined, the hotels witnessed an increase in overall revenues as the market witnessed a significant increase in rates. We believe that the decline in occupancy occurred primarily due to the increase in rates in the past year.

**Hotel Market Performance – Average Rates:** The average rates for the Colombo market witnessed an increase of 26% in 2010/11 over that in 2009/10 and 40% in 2011/12 over that in 2010/11. The room rates charged by hotels in Colombo are governed by the minimum rate policy that was introduced by the government in 2009 after the ending of the war in an attempt to improve market performance. The minimum rate for one room night for a five-star hotel in Colombo was US\$75 in 2009, however, it was increased to US\$125 in April 2011. Due to the high rates with no flexibility for large groups or tour operators, several Leisure visitors and Meeting and Conference groups choose to avoid staying an extra night in Colombo and commute directly to a beach or hill leisure destination after landing in the country, therefore, affecting the marketwide occupancy.

**Future Outlook:** The Colombo hotel market is expected to witness a large increase in supply over the next five years. Several major international hotel operators including Hyatt, Starwood, Onyx, Mövenpick, Shangri-La, and ITC have announced large hotel projects in the city, in addition to projects by domestic hotel companies such as John Keells, Jetwing, and Aitken Spence. A number of these hotel projects are actively under construction. Projects with a combined inventory of 5,000 rooms have been announced for development in Colombo; however, we expect 65-75% of the inventory to be developed in the next five years. As the new supply enters the market, we expect some pressure on the marketwide occupancies in the short term. However, we expect the new branded hotels with large-scale meeting and conferencing facilities to induce demand into the market and help in promoting Colombo as a global tourism destination. We expect the average rates to continue to grow in the next two to three years as new international brands in the upscale and luxury segments enter the market. However, we expect the rate growth to be slower than that in the previous two years since those increases were largely influenced by the government-mandated increase in minimum rates charged by hotels.

We consider Colombo as a key hotel market since it will be the most important commercial destination in the country for the next five years, with no other city matching up to it in terms of infrastructure and office space present in the city. Colombo will witness the development of several iconic projects in the next five years such as the Lotus Tower that is planned as South Asia's tallest telecom tower, a large-scale retail project near the Beira Lake by Indocean developers from India, and the massive Shangri-La and ITC Hotels by the Galle Face Greens. Although an increase in new hotel room supply will affect market performance in the short term, we believe that Colombo will gradually become an important Leisure and MICE destination and will continue to attract tourists, along with maintaining its status as the financial and commercial capital of the country.

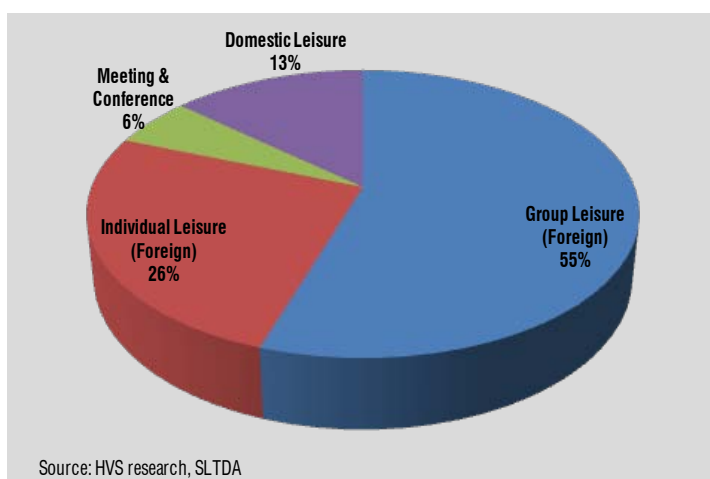
## Southwest Coast (Up to Galle)

In our analysis of the Southwest Coast hotel market, we have included the major beach destinations south of Colombo up to Galle including Wadduwa, Kalutara, Bentota, Hikkaduwa, and Galle. Our analysis of the market takes into account an inventory of approximately 2,000 rooms of major three, four and five-star resorts, excluding the smaller boutique properties of less than 50 rooms. It is to be noted that although we have tried to include most major resorts, the numbers presented here do not include each property present in this region.

**Hotel Market Overview:** The Southwest Coast of the country offers access to pristine beaches and the Galle Fort, a UNESCO World Heritage site. Other attractions are turtle hatcheries in Kosgoda, local handicrafts, and gems and jewellery shops. The Southwest Coast hotel market is seasonal and witnesses increased tourist arrivals from October to March. The high season is characterized by better weather conditions, calmer seas, and increased travel from European countries during their harsh winters. The period from April to August is the low season due to the onset of monsoons and hot summers. The other months of the year experience moderate demand. The market benefits from a long duration stay, averaging at approximately 10 nights.

The years 2011 and 2012 saw a lot of mergers and acquisitions in hospitality companies, with ownership and brand changes for a number of resorts on the Southwest Coast. Some examples include two Serendib Leisure properties that were branded as Avani (a hotel brand by Minor International), two Amaya branded properties that were rebranded to Chaaya by the John Keells Group and Citrus respectively, and the independent Neptune hotel that was rebranded as Heritance by Aitken Spence Hotels. The market witnessed a decrease in the total inventory in 2011/12 over that in 2010/11, as several resorts were closed for renovation or refurbishments.

**FIGURE 8: MAJOR CUSTOMER SEGMENTS FOR SOUTHWEST COAST HOTELS**



**Customer Segments:** Figure 8 presents the major customer segments that formed the demand for Southwest Coast hotels in 2011/12. A majority, 81%, of the customers were Foreign Leisure visitors, comprising 55% Group and 26% Individual travelers. Currently, a majority of the bookings for these hotels comes from travel agents and tour operators present in various parts of the world. Europe remains the main source market for these beach destinations; however,

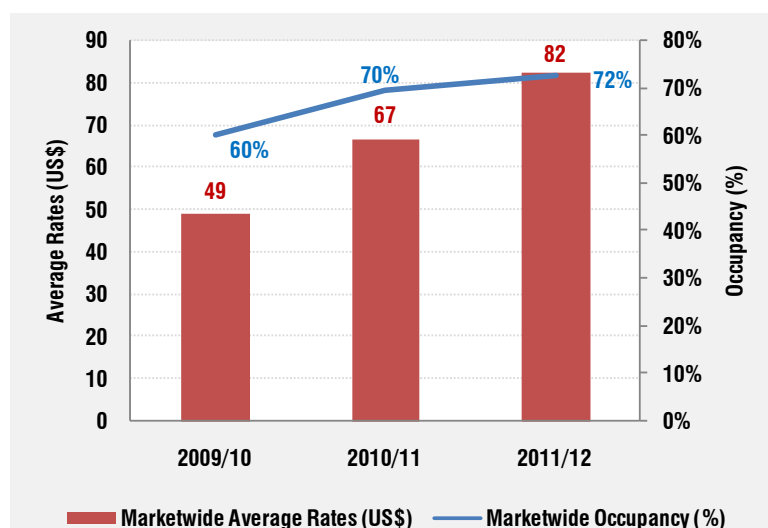


recently the resorts have witnessed increased travel from India and the Middle East. The European customers stay for a longer duration, about one to two weeks, as compared to only two to three days for visitors from Asia and Middle East.

The other segments include Domestic Leisure customers who are concentrated over the weekends, and Meeting and Incentive groups from corporates in Sri Lanka and other countries such as India. Currently, the resorts offer limited amount of meeting space; we believe that there is a **huge potential for the meeting and conferencing segment to grow** as larger resorts with good quality meeting space open.

**Hotel Market Performance – Occupancy:** The Southwest Coast recorded high occupancy in the last two years, despite being a seasonal market. The market recorded an occupancy of 70% in 2010/11, an increase of 17% over that in 2009/10. The year 2011/12 witnessed an increase of 3% over the previous year's occupancy to reach 72%. The resorts were largely sold out during the high season starting in 2010/11; the increase in occupancies in 2011/12 was due to two reasons: increase in visitors during the low season and decrease in inventory in the market due to resorts being closed for renovations. During the low season, the market attracted visitors from other countries such as India and domestic tourists from other parts of the country. Figure 9 represents the occupancy and average rates for the Southwest Coast hotel market for the past three financial years, 2009/10 to 2011/12.

**FIGURE 9: HISTORICAL MARKETWIDE OCCUPANCY AND AVERAGE RATES – SOUTHWEST COAST**



#### **Hotel Market Performance – Average Rates:**

The average rates for this market have historically been low, primarily due to the limited amount of five-star resorts, and attractive package pricing offered to tour operators by a majority of resorts. However, the rates have grown considerably since the ending of the war in 2009. The average rates in the market witnessed an increase of 37% in 2010/11 over that in 2009/10 and 22% in 2011/12 over that in 2010/11.

**Future Outlook:** Going forward, we expect a number of branded

four and five-star resorts to open in the region. We are currently tracking a supply of 1,500 rooms slated to open in the next five years. We expect the new supply to add capacity to the market, which is currently experiencing a large number of sold out nights. Despite the increase in supply, we expect the occupancies to remain healthy given the long duration of stay of the guests and the continued attraction of pristine beaches and the heritage Galle city. The average rates are expected to increase with the influx of tourists to these regions and the addition of new branded resorts. We estimate the rates to grow between 10% and 15% in the next two years.

The accessibility of the beach resorts has improved after the completion of the Southern Expressway, and several tourists now choose to drive directly to the beach regions instead of spending a night in Colombo city. In the future, too, the improved connectivity to Colombo and the international airport will continue to be an advantage for this region. The Southwest Coast is an attractive destination for investment in tourism since it is an established market, offers good quality beaches, and currently has land parcels available with minimal development restrictions.

## Closing Thoughts

*With unexplored destinations, a rich cultural heritage, and a government committed to promoting tourism, Sri Lanka is definitely the market to look out for. Located strategically in close proximity to expanding economies and large source markets for tourism such as India, China, and Singapore, the country offers good potential for growth. We have highlighted that the infrastructure in the country is continuously improving, thereby supporting growth in tourism. We have also noted that markets such as Colombo and the Southwest Coast have benefited greatly from increased tourist arrivals in the country. Several new tourism destinations, especially in the northern and eastern parts of the country are expected to develop in the medium to long term and the country remains an attractive destination for tourism investments.*



## About HVS

**HVS** is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit [www.hvs.com](http://www.hvs.com).

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**Kaushik Vardharajan** is Managing Director, HVS Hospitality Services – India. He joined HVS's New York office in 2001 and moved to the New Delhi office in 2008. Kaushik has worked on over 1,000 market studies, feasibility analyses, and valuations in North America and India, with a special focus on large mixed-use projects and portfolio valuations. Kaushik is a member of the Royal Institute of Chartered Surveyors (RICS) and is part of the Valuation Working Committee of RICS, which is responsible for establishing professional standards for property valuations in India. He has also taught courses and spoken at New York University, Johnson & Wales University, and the Indian School of Business.