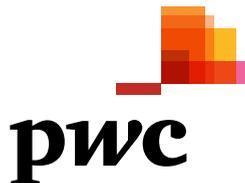

Hospitality insights

From the Indian CEOs' desk



Confederation of Indian Industry

February 2012





Foreword

Indian hospitality sector falls within the spectrum of travel and tourism which is estimated to contribute between 8-9% towards India's GDP. According to the estimates of World Travel & Tourism Council (WTTC), the direct and indirect contribution of travel and tourism to GDP is expected to grow consistently in the next decade. Past indicators in Foreign Tourist Arrivals (FTAs) as well as domestic travel in 2010 suggest that the number of travelers have almost doubled since 2005. However with around 6 million FTAs, India accounted for only about 0.6% of the global tourist arrivals indicating a huge area of untapped opportunities in travel.

Growth opportunities in travel & tourism cannot be realised without the development of the hospitality sector. India presently has an estimated 114,000 hotel rooms spread across various hotel categories. This is around 150,000 rooms short from what is required. While the opportunities are immense, there are also challenges associated with it. The Hotel industry universally is sensitive to economic cycles and does face its troughs as well as highs based on the supply and demand of rooms at any point. Specific India issues like poor infrastructure, high cost of land procurement and multiple licences as well as levies accentuates the challenge of development.

India, presently coming from a period of high growth, has hit a low point with persistent high inflation, high interest rates and policy paralysis in the government leading to reduced growth prospects. In addition, major developed economies like US, UK and Eurozone which have been our major inbound customers in the past, have either decelerated or have had no growth which could lead to reduced travel. On the positive side though, domestic tourism in India has come of age with better connectivity and is likely to counter any downfall in the international tourist arrivals. However, the increased domestic demand rides on the back of different consumer choices and the future investment plans by the global and domestic players will have to take into account these evolving choices.

Therefore, the Indian hospitality sector is at a very interesting juncture. With a view to bring out the relevant industry insights, we interviewed 20 eminent CEOs on the following parameters:

- Trends for the future
- Growth strategies
- Key to sustainable growth
- Challenges and expectations

Their responses form the basis of this survey. All hotel chains (Indian and international) having five or more operational properties in India have been considered for this survey. We hope the findings of the survey will help CEOs to make the right decisions and improvise strategies and developmental plans

We welcome your feedback on the subject.



Timmy S Kandhari

Executive Director
Leader, Hospitality and Leisure
PwC India



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Key findings

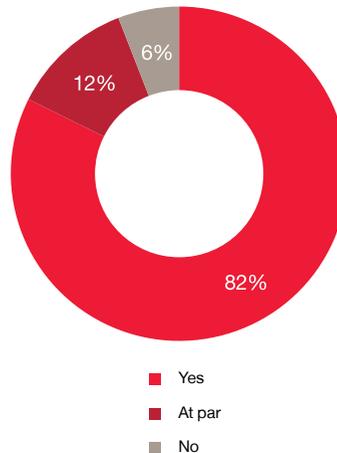
1. The Indian hospitality sector is expected to witness high growth over the long term. The next one or two years may be a phase of building before the high growth trajectory emerges.
2. Domestic travel is expected to be the primary driver of the sector's growth. High disposable income and the advent of better locations are driving this growth.
3. Business travel and MICE are expected to be the possible growth segments.
4. Evolution into a multi-location and multi-format player is emerging as the most preferred strategy for players in the sector.
5. Maximum investments are expected to take place in the Tier I towns followed by the Tier II towns.
6. Budget and mid-market segments have emerged as the most preferred investment categories.
7. Managing costs better is on the top of the agenda for CEOs, in the operational effectiveness space. Companies are looking at reducing energy consumption, investing in technology to reduce costs and making higher proportion of costs variable.
8. Potential synergies in operations exist in multiple functions including IT, procurement and sales and marketing. Over 80% of the CEOs believe they will undertake centralisation in procurement.
9. The hospitality sector has unanimously voiced the need for gaining an 'infrastructure status.'
10. Effective single window clearance for obtaining licenses has been identified as a key sector requirement.
11. Rationalisation of the number of tax levies and implementation of single tax regime will benefit the hospitality industry.
12. Talent management is a major challenge for the sector. Inadequate supply of quality talent and increased competition for talent within the sector and from competing service sectors has made attrition a significant issue for the industry.

Insights from the survey

Trends for the future

The CEOs of leading hospitality firms in India (our survey participants) believe that the sector will see robust growth in the coming years. It is expected to perform better than its global counterpart even during these challenging times. This optimism stems from the belief that as compared to other countries the Indian economy is not expected to be as severely hit.

Do you think the Indian hospitality sector will perform better than its global counterparts?



However, the ongoing Euro crisis and the recessionary environment in other countries are likely to have some impact on the Indian hospitality space. More than 90% of the survey participants expect to see a moderate to high negative impact on international arrivals in the short term. To substitute the lack of business coming in from traditional geographies such as the US and Europe, some CEOs are now focussing on other geographies such as East Asia.

Despite this impact, the Indian hospitality sector is well poised to move ahead on its growth trajectory.

“ UK, USA and Germany account for as much as 55% to 60% of the business in most of the premium hotels in India. These source markets have begun to put out and we have got to realise that, but what is a very positive thing and I think most hotels chains should do is that we must have a clear look east policy.

Nakul Anand,
Executive Director,
ITC Hotels

”

“ The domestic market is still not that badly affected but may get so if there is any major problem with time as the effect of the global economic situation is going to have an impact on India sooner or later.

Apurv Kumar,
Joint Managing Director,
Clarks Group of Hotels

”

“ Business travel primarily focusses at the mega cities. But if you look at Bangalore it has got 8% growth in a year. As the secondary and tertiary cities develop, there is an opportunity for expanding business from business travellers, and MICE is a natural by-product of this. ”

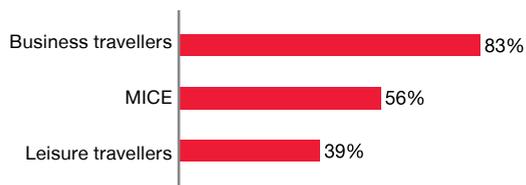
**Chris Moloney, Chief Operating Officer
South West Asia, InterContinental Hotel Group**

A. Segments driving growth

Our survey participants believe that the growth trend is likely to be driven across all segments, with international and domestic travel all growing at a healthy pace. However, domestic travellers, who constitute a significant majority of the Indian hospitality sector, will fuel growth in newer geographies and help develop different categories for hotels.

Over 80% of the CEOs we interviewed believe that revenues from business travellers will grow significantly over the next few years. Although MICE has not been a significant contributor to the Indian hospitality sector so far, this trend is likely to change with better planning as well as improved infrastructure. On the other hand, few CEOs believe that leisure travel will keep pace with growth seen in business travel and MICE. Large section of leisure travellers continue to perceive hotels as a luxury.

Which segments do you see as possible growth areas?



Note: Values indicate the proportion of respondents who believe the segment will be a growth area.

“ What we are experiencing today is MICE being very strong and see immense growth, its a big part of our success story. But, challenge in India is the infrastructure. When we look at major MICE destinations like Singapore, Sydney, Hongkong, and even Dubai, etc. the government has created phenomenal infrastructure to attract global MICE players. Because of less developed infrastructure the MICE business goes out of India. ”

Rajeev Menon, Area Vice President - India, Malaysia, Maldives and Australia, Marriott International

“ Higher disposable income is driving domestic tourism. In terms of promotion, all the options available today can be seen online and it is very convenient for customers to access the available options. This has made a huge difference to the industry. ”

Chander Baljee,
Chairman and Managing Director,
Royal Orchid

B. Key drivers in domestic travel

The CEOs interviewed believe that the key drivers of domestic travel in India are as follows:

High disposable income: With the buoyant growth in the Indian economy, the Indian middle class has higher disposable income. This has been identified, by about 94% of the respondents as a key factor for the increased domestic travel across the country.

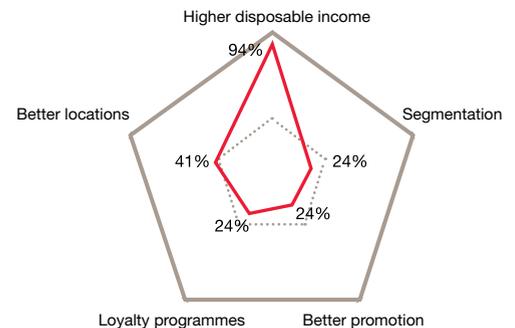
Advent of new locations: Over 40% of the respondents believed that the increased demand would come from new locations largely due to better access and improved infrastructure. Therefore, a significant supply is being developed and likely to develop at such locations.

Segmentation of hotels: Growth in the domestic travel has also accentuated the demand for different categories of hotels. Affordability and quality of experience are key factors in defining this shift away from five star to more budget category hotels.

Loyalty programmes and promotion: Although travellers value loyalty programmes and promotional schemes, our survey participants do not see it as a key determinant in selecting their accommodation.

Other factors that are contributing to the growth in domestic tourism include access to online travel and hotel bookings.

What are the key factors providing impetus to growth in domestic travel?



Note: Values indicate the proportion of respondents who named the factor in their top two drivers of domestic travel growth.

“ All categories are under served at this point of time. Though there are fewer cities where you can have five-star hotels but much larger number of cities with greater potential for budget category hotels in India. ”

Anil Madhok, Managing Director,
Sarovar Hotels & Resorts

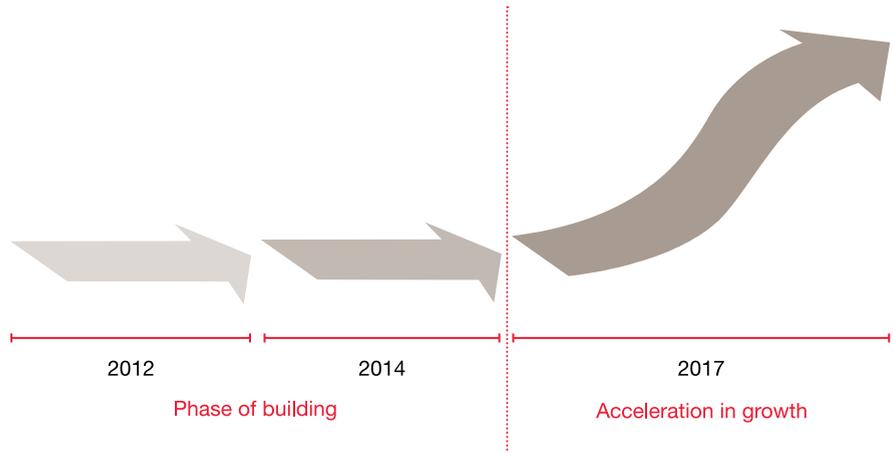
“The sector shall continue to grow, this sector has a very stable life and long term outlook as the asset itself takes 3 years to develop and 2-3 years to mature. Hence from vision to end it takes a good five years.”

Vikram Kamat, Executive Director,
Kamat Hotels (India) Limited

Growth strategies

As shown earlier, participants of the survey have a very positive outlook on the long-term prospects of the sector in the country.

Most believe that for the next two to three years the sector will witness muted growth, but a phase of high growth is expected to emerge post that. To make the most of the long-term growth of this sector, hoteliers are expected to invest significantly in the next two to three years.



“India will emerge as a preferred tourism destination on world map with overall expected growth of above 8% p.a., the later half of five years may witness growth of approximately 9% to 10%.”

Sanjay Gupta,
Promoter and Chairman,
Neesa Leisure Ltd.

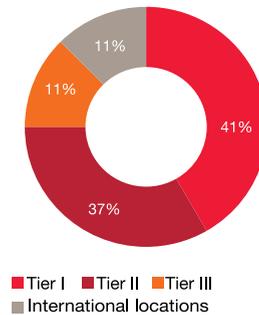
“Currently the market is very competitive with India being the focus for almost all the major hospitality companies. Certain market especially Tier 1 cities will see a lot of new hotels openings in the next two to three years which will slow down RevPAR growth in the short term.”

K B Kachru, Executive Vice President, South Asia, Carlson Hotels, Asia Pacific

A. Tier I cities preferred for expansions

Tier I cities, primarily Mumbai and Delhi, as per the views expressed, continue to be the most preferred locations for expansion. However, more than one-third of the respondents did indicate a willingness to invest in Tier II towns to capitalise on the growth of domestic travel. Although most players are not looking for international locations actively, some (especially the larger Indian chains) are open to expanding internationally, provided there is opportunity available.

Which geographies will drive your growth?

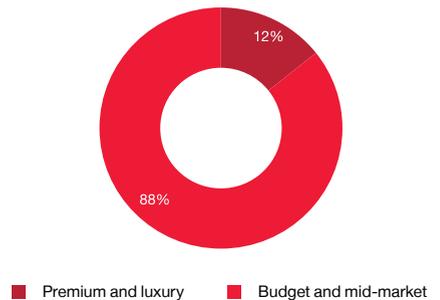


B. Segments that attract investments

More than 85% of the respondents indicated that the mid-market and budget segments are likely to receive most of the investments.

In case of premium and luxury segments, investments are likely to come in only from players already operating in that segment.

Which segments will attract maximum investments?



“The share of population and the on-going development in the country itself leads to potentially a long-term growth. The middle class is emerging strong, so there will be growth in the mid-market and budget segments. As more international travellers arrive in India, all segments will witness growth, and most importantly the upscale or 5 star segment.”

Deepika Arora, Vice - President, International Development, Indian Ocean Wyndham Worldwide

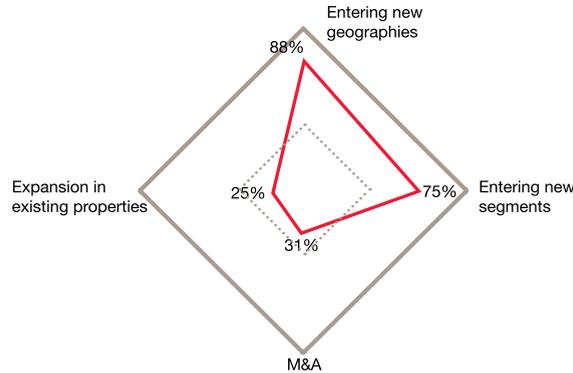
“The mid-market and the budget hotels in India have the maximum potential given the domestic demand from business and tourism sources. Luxury hotels call for a huge investment (per project) and have longer gestation periods, as compared to mid-scale budget hotels given the investments involved in projects. However, overall investment is likely to be maximum in the mid-scale hotels.”

Vilas Pawar, Chief Executive Officer, Choice Hotels

Several players are opting for the multi-location and multi-format strategy to expand their business. Over 85% of the respondents said they would be entering new geographies for growth, while almost 75% said they would opt for new segments.

With this multi-format and multi-location strategy, managing brands to ensure clear positioning and identifying the strategic role of each brand within the portfolio is likely to be very critical. While some of the international chains have clear views on the distinct positioning of their brands some of the Indian chains are in the process of formulating their brand strategies. This could be key to sustainable growth in the future.

What is the growth strategy you would adopt to tap the market potential?



Note: Values indicate the proportion of respondents who named the strategy in their top two strategic options.

“Degree of synergies and centralization depends upon the brands you are using. The higher or unique the experience the more decentralization is needed. The more you are in mid-market the more efficiency you can drive from centralization.”

Chris Moloney, Chief Operating Officer,
South West Asia, InterContinental Hotel Group

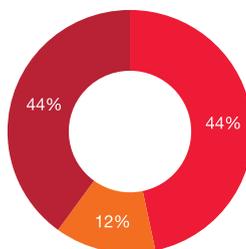
Key to sustainable growth

A. Achieving operational synergies

With the emergence of multi-location and multi-format strategies, an appropriate exploitation of synergies will be critical. Majority of respondents believe that to ensure consistency of service and fulfilment of brand promises, it is best to build synergies only across properties under the same brand or formats. However less than 15% of the respondents also plan to avail synergies across different formats and locations.

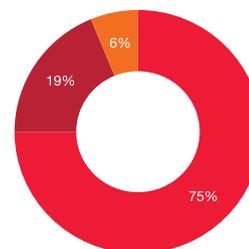
Almost 75% of the respondents consider procurement as a suitable function for centralisation. There is a belief that introduction of goods and service tax (GST) will make it easier to avail synergies in procurement. Apart from procurement, respondents also saw IT, sales and marketing as suitable areas to derive synergies.

What is the level of synergy you are looking to build in the next three to five years?



- Across locations for same formats
- Every property as separate profit center
- Across formats and locations

What is your procurement strategy?



- Centralised
- Decentralised
- Partly centralised

“Synergy exploitation should be by brands, independent of geography. Over the next one to two years it will be more geography driven and after that it will be more brand focus.”

Rahul Pandit, Chief Operating Officer,
Lemon Tree Hotels

“ Any business that is derived and cyclical in nature must be able to vary its costs according to the cycle that it is in. Therefore, you must creatively look to see how much of your cost you can keep as variable. At any point of time, a good measure of success is the variable to fixed cost ratio. ”

Nakul Anand,
Executive Director,
ITC Hotels

B. Building efficiencies

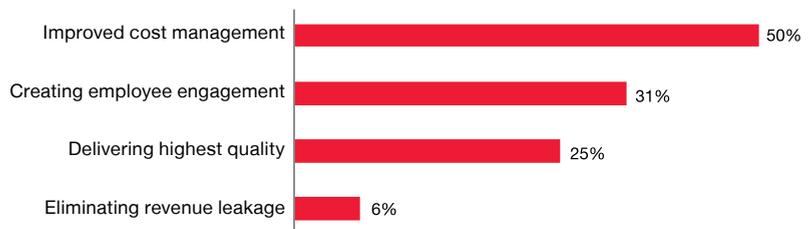
While CEOs are putting in place strategies to expand, they are taking initiatives to build efficiencies in their current operations. Better management of costs is at the top of the agenda. Almost half of the respondents said that improved cost management would be their primary imperative. The big ticket initiatives to reduce costs include the following:

- **Converting fixed costs to variable:** Increase proportion of non-contracted labour and outsource back-end operations.
- **Reducing energy costs:** Eliminate wasteful consumption and adopt ‘green’ building methods.

- **Managing manpower costs:** Train employees across multiple skills, invest in technology, explore outsourcing and manage attrition better.
- **Decrease project costs:** Reduce construction costs and crash time for new project development.

Other initiatives taken by CEOs include ensuring high quality in service and delivery, creating employee engagement and eliminating revenue leakages.

What are your primary imperatives for building efficiencies in operations?



Note: Values indicate the proportion of respondents who named the option as their first ranked imperative

“ There are three major heads of operational costs: F&B, manpower and energy. Considering the industry requirement, energy cost reduction is achieved through sensitising employees and by projecting hotel which is using green and environment-friendly practices. Reduction in manpower cost is achieved through IT support and working with optimal manpower with scope to increase or decrease it based on the seasonality of the business. F&B costs are controlled through ARCs and regular cost audits. ”

Sanjay Gupta,
Promoter and Chairman, Neesa Leisure Ltd.

“The design of a hotel plays a very important role in saving costs, so it is important to lay emphasis on this aspect. A good design can help hotels save on energy and manpower costs.”

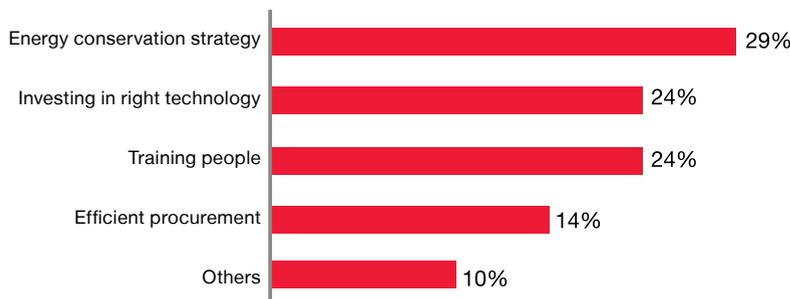
Anil Madhok, Managing Director,
Sarovar Hotels & Resorts

C. Cost management

While improved cost management was a priority among the participants, creating employee engagement and delivering high quality were also perceived as imperatives to deliver a unique experience to hotel guests.

As per the survey results, energy conservation strategy, investing in right technology and training workforce have emerged as the top initiatives towards managing costs in the hospitality industry.

What are your initiatives to manage costs better?



Note: Values indicate the proportion of respondents who named the option as their first ranked imperative

“Procurement is the biggest challenge, we do not vary our processes from one location to other location.”

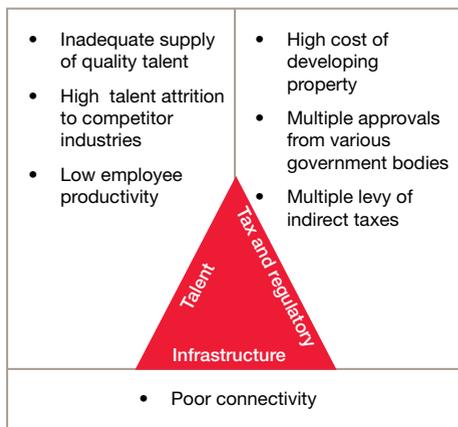
KB Kachru, Executive Vice President - South Asia,
Carlson Hotels, Asia Pacific

“The battle for market share in future will not be just fought over the guest it will be fought over talent. Hotel companies to attract talent would become the big differentiator. Hospitality is a business with people at the centre of it. Every hotel moment is an experience.”

Dilip Puri,
Managing Director (India)
and Regional V.P. - South Asia,
Starwood Hotels & Resorts

Challenges and expectations

While CEOs are working on expansion and building operational efficiencies, there are several other challenges that need to be addressed by various stakeholders. Key among them include talent management, tax and regulatory issues and addressing the infrastructure deficit.



A. Talent



The hospitality sector is facing the problem of inadequate number of quality institutes. Grooming and developing suitable human resources for the industry is a huge challenge. Increased demand for similar talent both within the hospitality sector and from other emerging service sectors such as airlines, retail and BPOs has further exacerbated this problem.

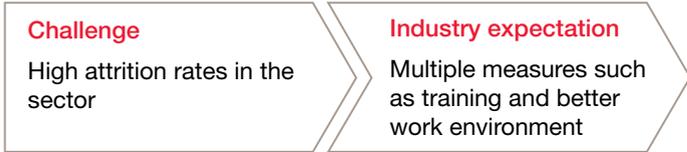
CEOs believe that there should be a considerable push towards setting up more quality institutes supplying talent to the hospitality sector.

“Companies are also taking the initiative of opening institutes and hotel management programmes due to acute shortage of quality training centres. There is a big gap in this segment, with dearth of good colleges and lack of quality training.”

Sudhir Sinha,
President and Chief Operating Officer, Best Western

“There is a talent war in the industry. The churn rate in front office in many hotels can be as high as 100% and employee retention becomes important. We take efforts to create a healthy and fun work environment starting right from induction program with activities like giving them a make over, team building and work culture oriented events.”

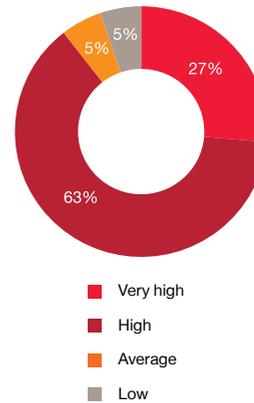
Sanjay Sethi, Managing Director and CEO,
Bergruen Hotels Private Limited



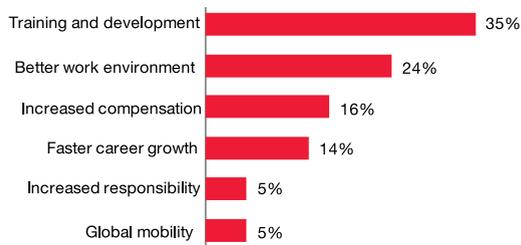
More than 80% of the respondents expressed high to very high attrition rates as a challenge. The challenge is more acute in the front office and food and beverage (F&B) sections.

Companies are introducing multiple policies to retain talent. Almost one-third of the respondents are investing in training. Ensuring a better work environment and offering competitive remuneration have also emerged as important tools to retain talent. Some companies are taking more innovative steps such as assisting employees in grooming by sponsoring makeovers.

How are the attrition levels in the sector?



What are your preferred strategies for talent retention?



Note: Values indicate the proportion of respondents who named the option as part of their talent retention strategy

“ The key lies in hiring best people, and in making them more productive by imparting training programmes. If employees of any organisation are happy, they take it as their own work and give their best output. ”

Vilas Pawar, Chief Executive Officer, Choice Hotels



Increased focus on measuring and improving employee productivity has become critical. There is a divided view on amenability to measurement of employee productivity. Some CEOs believe it is difficult to measure the service experience provided and the quality of interaction with customers. This leads to an increased dependence on qualitative customer feedback. Others believe in working towards introducing well-defined metrics and ratios to measure and monitor employee productivity.

“ We continuously track the employee productivity through CRM software. Motivational programmes and incentives for meeting sales targets keeps them motivated. ”

S P Jain, Chairman and Managing Director, The Pride Hotels

“REIT should be encouraged and those type of models should be brought in India. If you really want to see institutional equity, you have to give those kind of tools for people to invest.”

Dilip Puri, Managing Director (India) and Regional V.P. - South Asia, Starwood Hotels & Resorts

B. Tax and regulatory

Challenge

High cost of developing property

Industry expectation

- Rationalising floor space index (FSI) norms
- 'Infrastructure status' to hospitality sector
- Facilitate the Real Estate Investment Trust (REIT) model or other suitable models to achieve financial viability
- Investment linked Income-tax incentives for MICE and convention centres

The rising land prices in India and the high financing costs have resulted in high room tariffs and long gestation periods for achieving break even. Preferential FSI norms to the sector will lead to rationalisation of per room cost and hence result in better economies of scale.

Additionally, the recognition of the hospitality sector with an 'infrastructure status' has been a long pending demand. This recognition will facilitate availing loans at lower interest rates, extend other fiscal benefits under the Income-tax Act, 1961 and ease the utility of ECB regulations.

Further, REIT has been a successful model for setting up hotels globally due to the low cost of financing projects. REIT as well as the other structures which allow for differentiation of returns for property ownership and its operation would help attract the right type of investors for the sector this will increase financial viability and benefit growth in the sector. Majority of such structures can be facilitated through prudent tax incentives.

Majority of survey participants have mentioned that MICE or convention centres can provide a huge boost to the hospitality sector. To promote setting up of such convention centres, the government should consider providing investment-linked income tax breaks in major locations across India.

“To propel the growth of the sector, it is imperative that the hospitality sector receives Infrastructure status.”

Chris Moloney,
Chief Operating Officer -
South West Asia, InterContinental
Hotel Group

“ The biggest challenge the industry faces is the approval or licenses process in India. These vary from state to state and there are approximately 80 permissions needed to set up a hotel in India. Though the government initiated formation of a committee to facilitate this process it never really took off. ”

Vivek Nair, Vice Chairman and Managing Director,
Leela Palaces, Hotels and Resorts



The Hospitality Development and Promotion Board (HDPB) set-up by the government to facilitate clearances and approvals for recipient applications hasn't been effective. Given that the gestation period for setting up a hotel in India is significantly more than the global norm, the sector has to incur higher costs and lower returns as compared to its global peers. As voiced by the survey participants unanimously, an effective single window clearance will provide the much needed impetus to the sector.

“ GST is likely to come in 2013 and would create a more friendly tax regime. This together with infrastructure status to hospitality should propel strong growth and turn around for this sector. ”

Vijay Dewan, Managing Director, The Park Hotels

“ Multiplication of taxes is becoming troublesome. Now even tips are to be taxed as we have to keep a track of who gets the tips and deduct taxes thereon ”

Francis Wacziarg, Co-Chairman, Neemrana Hotels



Existing multiple indirect tax levies complicate implementation across locations, not only with regards to compliance but also interpretation.

A uniform and single tax levy across services and locations will benefit the hoteliers and customers as well. Therefore, the implementation of GST is being looked at as a panacea for this challenge.

C. Infrastructure



Poor connectivity in terms of rail, road and air has a negative impact on the development of the hotel industry. A strong impetus must be laid on the development of more international airports, better rail and road networks and develop new geographies to augment the tourist flow to the hotels.

“ The airports and the infrastructure have improved. More and more international airports are open, people from Canada go directly to Amritsar today and do not have to come here (Mumbai), so all those changes are taking place. ”

Nakul Anand, Executive Director, ITC Hotels

Participants in the survey

We would like to thank all the industry leaders who shared their thoughts and perspectives on the Indian hospitality sector.



Anil Madhok
Managing Director
Sarovar Hotels & Resorts



Dilip Puri
Managing Director (India)
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About CII

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the growth of industry in India, partnering industry and government alike through advisory and consultative processes.

CII is a non-government, not-for-profit, industry led and industry managed organisation, playing a proactive role in India's development process. Founded over 117 years ago, it is India's premier business association, with a direct membership of over 7000 organisations from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 90,000 companies from around 250 national and regional sectoral associations.

CII catalyses change by working closely with government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sectoral consensus building and networking. Major emphasis is laid on projecting a positive image of business, assisting industry to identify and execute corporate citizenship programmes. Partnerships with over 120 NGOs across the country carry forward our initiatives in integrated and inclusive development, which include health, education, livelihood, diversity management, skill development and water, to name a few.

CII has taken up the agenda of "Business for Livelihood" for the year 2011-12. This converges the fundamental themes of spreading growth to disadvantaged sections of society, building skills for meeting emerging economic compulsions, and fostering a climate of good governance. In line with this, CII is placing increased focus on Affirmative Action, Skills Development and Governance during the year.

With 63 offices including 10 Centres of Excellence in India, and 7 overseas offices in Australia, China, France, Singapore, South Africa, UK, and USA, as well as institutional partnerships with 223 counterpart organisations in 90 countries, CII serves as a reference point for Indian industry and the international business community.

Confederation of Indian Industry

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We are located in these cities: Ahmedabad, Bangalore, Bhubaneshwar, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune.

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