

THE WORLD BANK GROUP ARCHIVES

PUBLIC DISCLOSURE AUTHORIZED

Folder Title: Urban Projects - PUR - Tourism Advisory Services 1981 - 1983

Folder ID: 1064464

Series: Operations policy and project support records

Dates: 04/24/1981 – 05/17/1982

Subfonds: Transportation, telecommunication, water, and urban development

Fonds: Records of the Senior Vice President of Operations

ISAD Reference Code: WB IBRD/IDA WB_IBRD/IDA_106-01-01

Digitized: 10/17/2025

To cite materials from this archival folder, please follow the following format:
[Descriptive name of item], [Folder Title], Folder ID [Folder ID], ISAD(G) Reference Code [Reference Code], [Each Level Label as applicable], World Bank Group Archives, Washington, D.C., United States.

The records in this folder were created or received by The World Bank in the course of its business.

The records that were created by the staff of The World Bank are subject to the Bank's copyright.

Please refer to <http://www.worldbank.org/terms-of-use-earchives> for full copyright terms of use and disclaimers.



THE WORLD BANK

Washington, D.C.

© International Bank for Reconstruction and Development / International Development Association or

The World Bank

1818 H Street NW

Washington DC 20433

Telephone: 202-473-1000

Internet: www.worldbank.org

PUBLIC DISCLOSURE AUTHORIZED



RETURN TO NON-REGIONAL
INFORMATION CENTER

DECLASSIFIED
WBG Archives



1064464

A1994-070 Other #: 11

Box # 210833B

Urban Projects - PUR - Tourism Advisory Services 1981 - 1983

CLOSE - OUT SHEET

This file is closed as of July 31, 1983.

For further correspondence, please see PWU - Tourism Advisory Services.

urban Dev. Dept merged with
the water & wastes unit which
split from Transportation Dept.

RECORDS MANAGEMENT SECTION

OFFICE MEMORANDUM

pur. Tourism Advisory.

TO: Distribution List

DATE: May 17, 1982

FROM: J.A. Simmons, Tourism Adviser, URB

SUBJECT: Departmental Guidance Notes: Hotel Sub-project Evaluation

I attach Guidelines for the evaluation of hotel sub-projects submitted to the Bank under lines of credit to DFC's for the use of project officers. A draft of these guidelines, prepared by Mr. David Davis, was circulated earlier and comments received have been reflected in the new version. Would you please let me know how many copies of the Guidelines you require for staff in your Region.

Mr. Davis has been available in the past to assist with the evaluation of hotel sub-projects, and I hope that this service will continue to be available in the future.

cc: Messrs. Bronfman, Pouliquen, Golan, Geli, Carmignani, Glaessner, Nouvel, James G. Brown, Gould, David Williams, Zaidan, Renger, David A. Cook

DEPARTMENTAL GUIDANCE NOTES

HOTEL SUBPROJECT EVALUATION

Office of the Tourism Adviser
Urban Development Department

May 3, 1982

GUIDELINES FOR
HOTEL SUBPROJECT EVALUATION

Introduction

1. The evaluations of DFC hotel subprojects are normally carried out by the DFC and submitted to the Bank for review. The review cannot be a detailed evaluation itself. Its object is to check whether the major factors have been considered, whether the assumptions used for projections are reasonable and whether calculations are accurate so as to determine whether the subproject is suitable for onlending of Bank funds. The main elements to be considered are similar to those for other types of subprojects and include the technical and financial aspects of the proposed investment, the financing plan, the proposed organization and management, the financial projections (including the market justification for the revenue forecasts) and the economic analysis.

2. Because of the distinctive features of a hotel enterprise (see paras. 3-13, below), evaluations are greatly expedited by an understanding of the specific accounting systems used both for audit and particularly for management control. Reference should thus be made at the outset to the Uniform System of Accounts for Hotels, published by the Hotel Association of New York City (141 West 51st Street, New York, N.Y. 10019) and adopted by the American Hotel and Motel Association. This accounting system, or variations on it, are widely used internationally and are a useful analytic tool for operational forecasting.

Distinctive Features

3. Hotels are distinctly different from other industrial enterprises, because they provide services which are largely intangible and are consumed at the same time as they are provided. They involve personal contact between producer and client and are provided at specific times. These factors combine to create a business whose characteristics have led to financing and management peculiar to the industry.

4. Fixed assets account for the major portion of assets in a hotel and consequently the ratio of net book value of fixed assets to sales usually is 100-150% in a hotel, which compares with 50-75% for many manufacturing industries. In addition, a hotel is "purpose built" and has few, if any, alternative uses without considerable further capital investment.

5. Fixed assets have to be replaced over a hotel's life simply to maintain operating efficiency and to preserve projected earnings capacity.

This is because, in addition to physical depreciation, hotels are subject to obsolescence caused, for example, by customers' changing tastes. These replacements are not strictly capital improvements, but replacements whose main purpose is to maintain (rather than to improve) the earning power of the hotel. Depreciation and obsolescence allowances have to be sufficient not only realistically to reflect profits but also to provide adequately for necessary replacements.

6. Accounts receivable and inventories together are usually less than current liabilities and a current ratio of 1:1, rather than 2:1 and upwards which is more usual in many other industries, is considered adequate. Net working capital is minor (except for highly seasonal hotels) but the cash cycle is short, from three to four weeks. Because of the minor importance of net working capital, credit is difficult to obtain for an individual existing hotel because its fixed assets are usually pledged against the long-term debt, and there is no collateral security in accounts receivable since they represent services which have already been consumed. A hotel is thus restricted to the flow of operating income and to trade credit for working funds and in periods of slack sales (either for seasonal or other reasons) the current position can deteriorate quickly.

7. Current assets in a hotel are a small portion of total assets because a hotel's "merchandise," mainly its rooms for rent, is not held in inventory, a current item, but in fixed assets. As a result, a hotel is largely denied the flexibility of planning its production according to changes in forecasts of business activity as a manufacturing concern would through control of its raw materials, goods in process and finished goods inventories. A hotel's supply of rooms is fixed whether the rooms are rented or not--and, an empty room overnight is a sale lost forever.

8. A high proportion of operating expenses in a hotel are also fixed and in the short run there is little opportunity to adjust them to changing levels of business. Expenses vary widely between departments but, after deduction of direct departmental expenses, the rooms department typically makes a much higher contribution to profit than the food and beverage department. This has given rise to many operators questioning the wisdom of providing food service, but in tourist and convention hotels the question does not arise since accommodation and food service are joint services which are not readily separable from a marketing point of view.

9. Gross operating profit 1/ (revenues minus operating expenses) typically varies from 20-35% of total revenues. Net profit (gross operating profit minus depreciation, financial charges, taxes and insurance) is often very low in hotels. On the other hand, cash generated by a hotel, like other real estate ventures, is typically substantial, principally because of depreciation and amortization allowances which, although a cost of doing business, are a non-cash item. Depreciation and amortization is typically

1/ Now designated "Income before Fixed Charges" in the US Uniform System of Hotel Accounts.

a much greater portion of cash generated in a hotel than net profit (typically 2-4 times as great). Net cash flow after servicing long-term debt and provision for dividends can be used for a variety of corporate activities including replacements, expansion in the same field or in different directions, debt reduction, servicing subordinate debt or even partially liquidating the enterprise. The cash flow aspect is considered one of the attractions for hotel investors in the hotel industry.

10. Ownership and management of hotels are often in different hands. Owners often consider their hotel investments as real estate--and beyond generation of adequate earnings they have no interest in operating the building as a hotel. Consequently, they lease the building to competent hotel operators or retain managers for a fee. The introduction of an additional party requires that the hotel generate earnings which will satisfy the minimum requirements of both investors and operators.

11. The minimum requirements of investors and operators are conditioned by the risks and rewards involved in a project and by their several objectives and policies. As pointed out above, net profits can be very low--particularly if there is an intermediary operator or lessee--but cash flow can be attractive. Beyond this, both operating leverage and financial leverage are possible in hotel operations.

12. Operating leverage arises because of the structure of low variable and high fixed expenses. If a hotel is operating at a level where profits are only adequate, any increase in operating revenue (through increased prices and improved occupancy, for example) or any decrease in fixed expenses, will carry through substantially to net profit. But the contrary is also true--a hotel is so sensitive to changes in occupancy and room rates that the downside risk is substantial if the hotel fails to attain projected occupancy or room rates. However, operating leverage is considered an incentive--specially to the groups and chains which rely on marketing networks to generate business between the units of the group.

13. Hotels in many respects are financed according to norms used in the real estate business. Real estate projects usually have slow capital turnover, involve large investments and small annual returns. Lenders make loans available because real estate is considered a stable investment with considerable long-term growth potential, and possible appreciation in land value. Investors, on the other hand, often are interested in the cash flow or tax sheltered earnings possible because of accelerated depreciation allowances. To this extent, hotels are like any other real estate improvements. However, hotels differ from other real estate projects because of market uncertainties in a changing competitive situation both local and international: except in very rare circumstances, the occupancy rate cannot be determined before the hotel is built or open as it can in the case of, for example, an office building through lease commitments. In addition to uncertainty in the market, asset lives and residual values are very difficult to estimate for hotels.

Investment Costs

14. To assess the reasonableness of the estimated investment costs, the baseline should be compared with recently completed subprojects of

similar type and category, if any, at the location, within the region, and throughout the country. As a check, investment costs in comparable other countries could be examined. The comparison is facilitated by calculating the cost per room but, since this cost is derived by dividing the total investment costs by the number of rooms, consideration must be given to the scope of public areas and common facilities to be provided to ensure valid comparability.

15. If the total investment cost does not appear reasonable on the basis of the foregoing crude comparability, it is necessary to determine whether what has been proposed has been incorrectly estimated or whether what has been proposed does not conform with what is required.

16. An estimate of total investment costs would include all costs incurred prior to the start of commercial operations. These comprise:

- (a) studies,
- (b) land,
- (c) civil works,
- (d) furniture, fittings and equipment,
- (e) professional fees,
- (f) interest during construction,
- (g) preopening expenses,
- (h) working capital,
- (i) physical contingencies,
- (j) price contingencies.

As a very general rule, land may be expected to cost 5-10% of total investment costs, civil works 45-60%, furniture, fittings and equipment 20-35% and all other costs 10-15%. Variations outside the foregoing ranges would suggest either faulty assumptions or unusual factors which should be identified.

17. The cost of certain studies may be subsumed under professional fees, particularly those connected with engineering and architectural design, but others, such as market analysis, pre-feasibility, investment promotion, usually are not. The cost of the land should be the price paid by the investors, even if land values have changed between acquisition and the launching of the subproject; however, if a long-standing owner of the land is providing it as all, or part, of his equity participation, a fair market valuation of the land at the time of subproject formulation may be used. Civil works include site clearance, construction and landscaping and, where required, connection of public infrastructures within the property. Furniture and fittings may include a reasonable inventory beyond opening requirements. Equipment may be distinguished as between heavy equipment, such as boilers, ovens, elevators, cold rooms, and central airconditioning, which are not in practice movable, and lighter equipment, such as kitchenware, dishes, cutlery, linens, television sets, vacuum cleaners, lawn movers and vehicles, which

are movable. ^{1/} Interest during construction will vary according to the sequence in which subproject execution is financed. Preopening expenses is an item frequently overlooked in subproject evaluations: they arise from the necessity to "operate" the hotel for a few months prior to the commercial start and include the salaries of supervisory personnel, the wages of other workers as and when hired for training and practice operations, together with other operational inputs--food, utilities, administrative overheads--and preopening marketing and sales costs. While the preopening expenses may be amortized over an initial period of commercial operations, working capital will always need to be replenished. The amount of physical contingencies will depend on the degree of detail and accuracy of specifications. Finally, price contingencies depend on the projected general inflation and the projected inflation specific to the various expenditure items; the contracting trade in many countries often publishes standard projections for many of the latter.

18. If total investment costs have been correctly estimated but are nevertheless at significant variance from those for apparently comparable hotels, then a further examination of the project components is required to determine whether they conform with those of hotels of similar type and category. Such an examination would include construction standards, space allocations, quantity and quality of public facilities and quality of fixtures, fittings and equipment. Many countries prepare hotel classifications and related standards which can be useful in such an examination.

19. Even so, the nature of site, the location and special design features may be important variables. If site selection is constrained and the location can be justified on such grounds as market demand and/or regional development requirements and special design features are related to marketing objectives, then cost variance from hotels of a similar type and category may be acceptable.

20. In any event, the primary objective is to determine the least-cost solution for the given situation, in order to optimize the rate of return.

Financing Plan

21. Having validated the projected investment costs, the next step is to assess whether they will be adequately and suitably financed. The subproject sponsors sometimes are hoping to use the promise of the DFC subloan as a tool for attracting other finance. Whereas the mobilization of all sources of funds is inevitably interrelated, an assessment needs to be made that any potential shortfall is not likely to entail a premature

^{1/} This is particularly relevant in francophone countries where it is common to organize two companies, one owning the real estate and the other the right to operate the hotel, the former owning the immovable equipment and the latter the movable.

commitment of a DFC subloan thereby diverting its proceeds from other productive investments and also imposing an excessively early commitment cost on the subproject.

22. The equity participants should have satisfactory credentials, suitable business experience and adequate funds. Land may be included in equity at its purchase price if recently acquired by the sponsors for the purpose of the subproject or at a market valuation if contributed to equity by a long-standing owner (see para 17, above).

23. As for all projects, the debt-equity ratio should balance the advantages of gearing and leverage against the required coverage of debt servicing and the risks of exposure. The Bank has normally expected a minimum of 40% of investment costs to be financed from equity funds. A lower percentage can only be justified if the financial projections (see paras. 32-44 below) indicate an adequate margin for the consequent debt service burden.

24. The conditions for the onlending of Bank funds will be related to conditions laid down for the Bank's own line of credit to the DFC. Other loan finance will of course vary according to its source, ranging from short-term suppliers' credits through variable interest rates (often linked by an agreed margin to the LIBOR) to other long-term, fixed-interest loans. The annual coverage requirements can be checked against the financial projections (see paras. 32-43, below). Grace periods for a substantial portion of loan funds are usually required in view of the two-to-three year normal construction period and the start-up operational period thereafter. Furthermore, since the major portion of a hotel's assets are fixed (see para. 3, above) and the payback period on investment is lengthy, the average term of loans should be relatively long.

25. Finally, even though estimated total investment costs should include physical and price contingencies (see para. 17 above), assurances should be obtained that the equity participants would be able to mobilize additional resources in the event of cost overruns.

Organization and Management

26. If the owners plan to manage the hotel themselves, then previous experience of hotel operations becomes a required qualification. In any event, the evaluation must demonstrate that the development of the subproject and its prospective operation, both internally and with respect to marketing and sales, will effectively optimize its profitability.

27. Even though ownership and management of hotels, particularly of the larger enterprises, are often in different hands (see para. 9, above), the experience and background of the equity participants is always relevant.

The owning company must itself be managed, decisions must be taken for capital improvements and management arrangements have to be contracted and monitored.

28. The advantage of a management agreement to the owner is that it provides a proven system of management and marketing, backed by a substantial pool of experienced personnel. Also, it usually makes available technical assistance in design and construction which assures development of an efficient plant. It also often makes available centralized procurement. The advantage of a management agreement to the operator is that it provides an expansion opportunity, and therefore economies of scale, with little, if any, investment, thereby creating a profit center without risk.

29. In evaluating the terms of a management contract, its net impact on the owner's income must be assessed. The management fee usually consists of a percentage of gross revenue together with a percentage of gross operating profit. These percentages are often 3% and 10% respectively, but vary according to circumstances and relative bargaining power. However, a number of other fee arrangements are occasionally used ranging from a specific annual payment (sometimes indexed) to a percentage of net profit (gross operating profit minus fixed charges). The total value of the fee may be expected to range from 5% to 8% of projected total revenues. The final test of the suitability of the management fee is whether the financial projections show an adequate return to the investors after its payment. The countervailing consideration is whether the absence of experienced managers would so reduce efficient operation that profitability would be less than that net of the fee if paid.

30. An alternative to a full management contract is a franchise agreement under which the hotel acquires the right to use the name, management system, technical design and construction services of a hotel chain. The owner pays an initial fee to acquire the franchise and a continuing monthly fee, usually expressed as a percentage of room sales. A franchise is usually less expensive than a management contract, but requires operational experience of the owners.

31. Finally, a growing number of independently owned and operated hotels are joining marketing and sales consortia. Under this arrangement, each hotel operates under its own name (although sometimes with the consortium name as a prefix or suffix), but utilizes a common marketing system which includes advertising, referrals, sales and reservations. The fee is usually a combination of a fixed charge (according to size) and a percentage of sales made through the consortium.

Financial Projections

32. The assessment of the reasonableness of the financial projections should be based on the experience of comparable hotels in the country. If

such experience is inadequate, and in any event as a check, reference can be made to the annual editions of the two leading publications of the most experienced international hotel accounting firms and management consultants, Worldwide Lodging Industry, Horwath and Horwath International, and Trends in the Hotel Business, International Edition, Pannell, Kerr, Forster and Company, each of which provide analytic aggregate financial data for a large sample of hotels. ^{1/} Reference should also be made to the Uniform System of Accounts for Hotels (see para. 2). Whereas it is not mandatory that subproject borrowers utilize this system of accounting, it is helpful if the financial projections provided are in such a form that they may be cross-checked against it.

33. In making financial projections, the first step is to forecast revenues over the life of the subproject. These are a function of occupancy rates and prices charged which are themselves interrelated.

34. Forecasting occupancy rates for an individual hotel is complex and uncertain. A "desk" evaluation of occupancy assumptions can only assess their reasonableness as marketing targets. Some of the major factors affecting occupancy are sectoral while others are internal to the individual hotel.

35. The prospective supply and demand for hotel capacity provides a general context. Clearly, the projected number of bednights available divided by the projected number of bednights demanded will give the average occupancy for all hotels of a similar type and category. However, whereas the number of bednights available at a given period of time is fixed, the number of bednights actually demanded during that period will be variable according to seasonality. Thus, the projected average occupancy rate takes into account not only the crude supply-demand relationship ^{2/} but also the limitations on aggregate demand over a period posed by seasonality. However, the latter can be changed over time, although experience shows only rather slowly, so that factors modifying the seasonality pattern in existing hotels in the recent past need to be examined.

36. An individual hotel's occupancy will of course vary from the sectoral average. Thus, special factors regarding prospective occupancy for the subproject should be considered to establish the reasonableness of such variances. Among such factors might be that the hotel is designed to appeal to a market segment not previously tapped at the destination. This might generate extra traffic beyond sectoral trends both in terms of numbers of

^{1/} Since the samples are drawn from the respective company's own clients for audit, they are not representative for all types of hotel operations in the various countries.

^{2/} Quite frequently, the maximum achievable occupancy rate even in the short run is less than 100% because of "no shows" on reservations and other operational imperfections.

guests, average length of stay and, therefore, bednights, and possibly by modifying sectoral seasonality. Another possibility is that the hotel will institute different marketing techniques and policies which could change traffic volumes and patterns in its case. Examples of this type of variable include linkage with international reservations systems, negotiation of group contracts and emphasis on conference travel. Finally, managerial efficiency might vary from the norm. Furthermore, the occupancy of a new hotel will vary from the sectoral average during the initial years. On the one hand, normal start-up problems will inhibit occupancy for a few years while, on the other hand, the very novelty of the hotel may endow it with an initial premium in occupancy, particularly if there is an effective pre-opening marketing campaign.

37. The degree to which a new hotel's occupancy is affected by sectoral constraints as against its own individual factors depends on the type of hotel and its major markets. Where demand is fungible, sectoral trends will be dominant. For example, a city hotel, serving primarily business guests who within limits will stay at available accommodations, is likely to conform more to sectoral trends than a resort hotel, serving primarily vacation guests with a greater degree of discretionary choice, particularly at a resort destination with substantial remaining untapped market potential.

38. In establishing the reasonableness of prices for rooms and for food, beverage and other hotel sales used in financial projections, their comparability with those of existing hotels, if any, of similar type, category and location should be assessed. Competitiveness with alternative destinations should where possible be considered and in this connection Horwath and Horwath and Pannell, Kerr, Forster ^{1/} may be useful. Prices to be considered are those net of commissions, discounts and negotiated group rates rather than the published prices. Commissions are usually standard while many discounts are often hidden. Group rates are particularly important at resort destinations where inclusive tours (comprising a "package" of transport, hotel services and other destination activities marketed with a single price) are a dominant marketing segment. It is frequently difficult to discern the effective net price charged by the hotel, particularly if bulk prices vary according to volume. In assessing the competitiveness of inclusive tours, it is the package price, rather than the hotel component alone, which is relevant.

39. The overall average room revenue per occupied night may be obtained arithmetically for an existing hotel by dividing total room revenue by the volume of occupied nights. But the comparability of the average so obtained with the subproject under consideration will depend on proposed marketing policies and the consequent relationship between published prices and the net revenue received. The average room rent per occupied room is frequently 20% - 40% below published rates, depending both on the mix between

^{1/} Op. cit.

individual full rates, individual discounted rates and negotiated group rates and on existing competition forces.

40. Another check on the reasonableness of projected average room rent per occupied room is its relationship to investment cost per room. The "rule of the thousand" is the frequently used rule of thumb. This states that for every thousand of investment per room a single unit should be obtained in average room rent per occupied night if the enterprise is to be viable. Thus, for a hotel with an average investment per room of \$60,000, an average room rent of \$60 per night should be obtained. As with most rules of thumb, while empirical experience varies, it serves as a useful initial check as to whether special circumstances pertain.

41. The projection of room revenues is all the more important when other revenues are expressed as ratios to room revenues. An examination of the financial accounts of comparable existing hotels (either locally or worldwide as published in the standard reference publications) will be meaningful only if the sales mix is also comparable. For example, a heavy emphasis on food and beverage service to non-residents, either as individuals or as participants at conferences and banquets, could change the ratio of food and beverage revenues to room revenues.

42. Operating costs may be expressed as ratios to revenues or calculated by an individualized budget. For example, marketing costs are frequently established as a percentage of projected revenues, while the wage bill is usually calculated by establishing a manning table and deciding on the wages to be paid to each different category of employee. The direct cost of sales in the operated departments (exclusive of payroll) are usually budgeted as a percentage of revenues. In the case of the rooms department, these costs (for cleaning materials, laundry, linen, etc.) are relatively minor and usually amount to 8-10% of room revenues. Costs of sales for food and beverages generally amount to about 35% and 25% respectively. Room payroll amounts to about 15% of room revenues, so that departmental income is in the range of 75%. Food and beverage payroll and other department expenses amount to 40-45% of department revenues so that departmental income is usually in the 20-30% range. Undistributed operating expenses (general administration, marketing, utilities, maintenance, etc.) tend to amount to 25-30% of total revenues. Allowing for net income from minor operated departments (laundry, telephone, store rentals, etc.) gross operating profits tend to be 20-35% of total revenues.

43. In evaluating profit and loss projections for an individual sub-project, there can of course be a variety of special factors which result in variations from the norm for each cost item and therefore in the projected gross operating profit. Thus, the calculation of the financial rate of return entails a considerable degree of uncertainty and therefore such a calculation should be subjected to a series of sensitivity analyses. The calculation should be tested at least for variations in investment costs and timing, in revenues (a combination of occupancy rates and prices charged) and in operating costs.

44. In addition to calculating rates of return, cash flow and debt coverage should be projected in both constant and current terms.

Economic Analysis

45. The economic analysis should be in constant, base-year prices (and therefore does not include price contingencies for investment costs). The analysis consists of an adjustment of the financial cost and revenue flows for the hotels to reflect their economic values together with costs and benefits external to the hotel but induced by it. These latter costs and benefits are associated with (a) expenditures by hotel guests outside the hotel and (b) provision of infrastructure in support of the hotel.

46. Expenditures outside hotels can usually be projected from tourist expenditure surveys frequently undertaken by governmental authorities. Investment and operating costs of these expenditures should be included as cost streams and, in the absence of detailed data, a net revenue flow as a percentage of total expenditures may have to be used.

47. Infrastructure investment costs represent economic costs to be allocated in part to the subproject. On the other hand, payment for public utilities, where tariffs fully reflect investment and operating costs, having already been included in the hotel's cost stream, should not be counted again.

48. The economic adjustment of revenue and cost streams include the valuation of land at its opportunity cost and the shadow pricing of foreign exchange, unskilled labor and other domestic resources. In addition, taxes and duties, as transfers, should be removed from all revenue and cost streams. The cut-off rate for the acceptability of a subproject is the opportunity cost of capital for the country at the time of analysis.

49. The revenue and cost streams should ideally be adjusted to reflect the net increment in these streams as a result of the subproject as compared with those in its absence. In many situations, the new hotel would derive some of its business from clientele which otherwise would have gone to existing hotels. In other situations, the new hotel, by helping to make a new destination more credible, both in terms of the total facilities available and of the marketing of the destination as such, may attract new traffic not only to itself but to other hotels. By the same token, in adding to competitiveness, the new hotel may exercise a downward pressure on hotel prices in general while, in enhancing the marketability of the destination, it may on the contrary help maintain, or even increase, price levels. These countervailing influences of "diversion" as against "generation" and of "dilution" as against "consolidation" are easier to discern conceptually than they are to quantify. Accordingly, they are frequently best taken account of in sensitivity tests for projected revenues and related costs.

50. Other sensitivity tests should be applied for variations in investment and operating costs and for differing assumptions of shadow prices.

51. In addition to a rate of return analysis, various measures of economic impact are of interest. These include employment generation, foreign exchange earnings (gross and net of capital and operational foreign exchange costs) and contribution to government revenues (taxes, duties, fees, etc.).

F338

Pub. Tourism. Advising.

DEPARTMENTAL GUIDANCE NOTES

TOURISM SECTOR REVIEWS

Office of the Tourism Adviser
Urban Development Department

May 3, 1982

GUIDELINES FOR
TOURISM SECTOR REVIEWS

Introduction

1. The purpose of the sector review is to investigate the existing position of tourism in the economy, to evaluate the potential for tourism development, to record public and private plans and investments in tourism development, and to make recommendations on appropriate policies for the sector. Areas for possible future Bank involvement should be identified and described. The information and particularly the statistical data on the sector varies greatly from country to country. While the following paragraphs attempt to set out the main topics to be covered in a sector review, the extent and depth of the review will of course be affected by data limitations. Apart from data limitations, the major determinant of the extent and depth of the analysis is the importance of tourism in the economy under review: for example, the Bahamas, Mexico or Tunisia would warrant a more detailed analysis of the tourism sector than the many developing countries where tourism is still of minor importance.

Tourism Attractions

2. The review should include an assessment of the area's or country's tourism assets and liabilities including: (a) natural attractions (e.g. climate, scenery, sea/beaches/lakes, wildlife); (b) historical and cultural attractions; (c) adequacy of services and facilities (e.g. local transportation, communications, hotels, food, sport, night life); (d) social conditions (e.g. health, attitude of residents, security considerations); (f) accessibility in terms of the distance and cost of travel by different means of transport from main tourist generating markets; (g) relative price levels. Reference should be made to the country's attractions and cost levels (both travel and destination costs) in relation to competing destinations, either within the region or elsewhere.

Visitor Traffic

3. A description of trends over the past decade and current levels of visitor arrivals/departures should be given. An attempt should be made to analyze changes in trends reflecting e.g. political changes, changes in fashion for particular destinations, or changes in price levels relative to competing destinations. Information should be presented in as much detail as possible (monthly series for more recent years and annual totals) on:

- country of residence and/or nationality of visitors;
- purpose of visit (holiday, visiting friends/relations, business, pilgrimage, transit);
- mode of arrival/departure (with division of air visitors between charter and scheduled flights if information is available);
- visitor characteristics (income groups, age, professional categories, travel arrangements (group or individual, inclusive tour or independent arrangements). In some countries, a substantial fraction of visitors of some residence groups is made up by persons visiting friends/relations or school children visiting their parents during holidays. An attempt should be made to identify such groups;
- length of stay (visitor nights: total, and in commercial accommodations);
- seasonality (monthly variations in visitor arrivals, with an analysis of the reasons therefor);
- excursionists (commonly cruise ship visitors or day-visitors travelling by land); and
- the extent to which the destination is a single destination or included in tours with several other countries.

Tourist Facilities

4. This section should cover the development of accommodation capacity, other amenities (e.g. local tours, recreational facilities, restaurants, shopping, casinos, etc.) transport capacities both to and within the country, and other services (e.g. tour operating, both international and local) necessary for tourism development. Time series data should be presented on:

- hotel capacity (number of rooms and beds) by category of hotel, type (hotel, condo-hotel, motel) and principal locations (city, resort, wildlife area, etc.);
- capacity in other types of accommodation (self-catering units, pensions, villas, camp sites, etc.) by category and location;
- hotel occupancy rates (guest-nights and room-nights occupied by principal categories of commercial accommodation: monthly and annual figures; double occupancy factors);
- capacity of airlines (both scheduled and charter where applicable) and of other public transport modes serving the destination;

- load factors on the major airline routes to the destination with seasonal variations;
- capacity of local transport systems--buses, hire cars, taxis--used by tourists.

In addition to the statistical analysis of capacity increases, a qualitative analysis of tourist facilities and services should be made with conclusions about the adequacy (or otherwise) of these facilities and services in relation to the markets being served.

5. Increases in capacity in the sector reflect past investment. Data should be obtained on past investment in the sector, the sources of financing (domestic or foreign, private or public) and the terms on which loan capital can be secured.

6. The growth of employment in the sector should be described, as well as the development of training facilities and the adequacy of the arrangements meeting the needs of the sector for trained manpower.

Prices and Costs

7. Trends in holiday prices in the country under review should be described and compared with price trends in the principal competing destinations. Prices to be analyzed include prices in hotels (room rates and tariffs inclusive of meals) air fares to the destination country, prices of local services (excursions, hire cars, boats, etc.) and of inclusive tours offered by tour operators in the major market countries.

8. The reasons for price increases should be analyzed. Energy price increases have affected travel costs, particularly of air transport. Destination costs have been affected by such factors as the rising costs of imports consumed by the tourist industry, wage increases in the industry, special taxes levied on the industry and the increases in costs of construction of new accommodation. In some markets price increases appear to reflect mainly the strength of demand, though in a competitive market such as the tourism market this situation is likely to be short-lived.

9. The profitability of hotels should be analyzed and related to trends in hotel prices and the major cost categories. An analysis of trends in the costs of construction of various types and categories of accommodation should be included (by principal cost components--land, physical works, equipment, furniture, etc.) and compared with trends in hotel profitability.

10. Trends in costs and profits in other branches of the industry (local tour operations, car hire, etc.) should also be analyzed to the extent that data can be obtained.

Government Policies

11. A brief description of the organizational structure within the government relating to tourism should be given, identifying those ministries, departments or agencies having key roles in the development of the sector.

12. Government policies for tourism should be described and analyzed, particularly policies on entry formalities (visa and immigration controls), tourism promotion, investment incentives and taxation, employment (including employment of expatriates) and training, licensing, and pricing and price controls. The availability of foreign exchange may be a problem for hoteliers and others in the sector in some countries and policies and regulations affecting access to foreign exchange and imports should be considered in these cases. To the extent that they affect investment in and the development of the sector, broader government policies (e.g. policies on the roles of the private versus the public sector) should also be described and analyzed.

13. In some countries, governments have adopted a rather passive role in the development of the sector, leaving the initiative largely to the private sector. In others, there has been greater involvement, with the government setting priorities for the sector, determining the location of tourism development, and financing investment in tourism infrastructure and other supporting facilities. In a number of countries, government has financed hotels directly or has bought existing hotels when the latter have encountered difficulties threatening closure (e.g. Jamaica and Bahamas). The role of government in these contexts should also be analyzed.

14. Government policies regarding land-use planning, zoning and environmental controls as well as policies affecting land alienation (sale and lease) should be described.

15. An area which is of critical importance for tourism in most developing countries is government aviation policy. This includes government policy on the role of the national carrier (if any) and on foreign and/or domestic scheduled and charter airline operations.

Economic Impact

16. This section should cover, to the extent that data is available, the impact of foreign tourism on national income, employment, foreign exchange earnings and government revenues. In a number of countries tourism expenditure surveys are conducted regularly and these may provide data on:

- expenditures by visitor types, possibly analyzed by length of stay (normally average daily expenditures fall with length of stay);
- expenditures on different items (food and lodging, drinks and tobacco, internal transport, entertainment, handicrafts and

souvenirs, etc.). If inclusive tours are important (in which clients pay agents in the country of origin), this should be noted, and the basis of estimates of these receipts explained.

17. In several countries, detailed studies have been made of the impact of tourism expenditures on national income. These show that in island economies like the Bahamas and Bermuda where the propensity to import is high, the tourism multiplier (the relationship between tourism receipts and income generated in the economy) is of the order of 1.0. In more complex economies, where a much greater proportion of goods consumed by tourists is produced domestically, the multiplier would be larger. It is unlikely that sufficient data could be collected in the course of a Bank sector review mission to enable the tourism multiplier to be calculated with any precision, but the extent to which the local authorities might have collected such data should be checked.

18. Data on employment in the tourism sector and on gross foreign exchange earnings from tourism are usually more readily available. Direct as well as indirect employment in the tourism sector should be assessed, and the extent to which tourism development has opened up employment opportunities for possibly disadvantaged groups (e.g. the unskilled or women) should be examined. The extent of seasonality in employment should also be considered as well as identifiable impacts on employment in other sectors (e.g. a shortage of labor in agriculture following the development of a new resort). Data on the foreign exchange costs (on operating accounts) of tourism revenues should be collected to provide the basis for calculating net foreign exchange earnings from tourism. Accurate data on the foreign exchange content of tourism expenditures can only be obtained from special surveys; however, in the absence of survey data, an approximation is normally possible and experience indicates that the direct import content of tourism expenditures varies from less than 10% in more complex economies to a maximum of about 40% in some island economies. Net earnings from tourism will also be affected by the extent of foreign ownership of hotels and other tourism assets and the remittance abroad of profits and debt service payments on these assets.

19. Data on government revenues derived from the tourism sector are normally available only as a result of special surveys. In the absence of a survey, partial data is likely to be available (e.g. data on revenues obtained from a tourist departure tax or bed-night tax or tax on hotel revenues or any other taxes levied specifically on the tourism sector). Additional data on the share of import duties paid by tourists or of company profits paid by hotels may also be available in some countries or reasonable approximations may be possible.

20. A calculation of the domestic resource cost of earning foreign exchange in the tourism sector should be possible, utilizing data obtained from hotel accounts and the accounts of other major enterprises serving tourists (e.g. transport and tour companies, etc.). This calculation can be compared with the foreign exchange rate of the domestic resource cost of

earning foreign exchange in other export industries. Shadow prices of domestic inputs should be applied where appropriate: e.g. the economic costs of labor may be less than the wages paid while the price of a scarce resource (e.g. water in an arid zone) may be less than its economic cost.

Social Impact

21. This section should describe social/cultural impacts which are believed associated with tourist development and identify groups which seem to feel these most keenly. Examples of social impacts might include: disruptions of local communities by immigration of workers to handle new tourist resorts; sharp shifts in prices of land or foodstuffs due to tourism development leading to reductions/increases in incomes/living standards of local people; increasing importance of "outsiders"--expatriates in the country, or migrants from other areas within the country--in the community due to tourism; reduction in the quality of local plastic and lively arts due to commercialization of these for tourists; exploitation by previously disadvantaged groups (youth, women) of new income earning opportunities in tourism activities leading to reduction in their dependence on traditional authority and values; demonstration effects. To what extent, if any, do these impacts vary with the type of tourism (e.g. beach tourism, cultural tourism) or the volume of tourism? To what extent are they perceived as positive rather than negative? By whom? What aspects of current developments would be modified in the light of these factors?

Development Prospects

22. With respect to existing traffic, an evaluation should be made of market prospects, having regard especially to prices and costs in the tourist destination country in relation to prices and costs in competing destinations, and to income and price trends in the major market countries. Market prospects will vary across the different segments of the market. In a period of economic expansion, all market segments may be growing. In a period of recession, different market segments will be affected differently. Destination countries catering to the upper end of the market may fare better in a recession than countries catering to the middle or lower end of the market, though in general the demand for international travel has been well maintained during recessionary periods over the past decade. Traffic flows to particular destinations have been more affected by relative changes in destination costs resulting from e.g. differential inflation rates or exchange rate changes.

23. The potential for exploiting new markets should also be assessed. In this context, the following questions should be considered: Would new markets entail the expansion or fuller exploitation of attractions within the destination country (either by making new regions or locations accessible or by increased exploitation of existing attractions)? Would it entail a new travel structure such as encouragement of air charter operations or different types of accommodation--camping or villages de vacances, or different categories of hotels? Could there be a change in seasonality by such devices as price differentials? Could general accessibility to the country be improved, and in what ways?

24. The potential for the development of domestic tourism should also be reviewed, and the extent to which these demands are complementary/competitive with foreign tourist demands.

Investment Requirements

25. This section should review ongoing and planned investment in the sector and assess the need for further investment (over, say, the next five years) in relation to the prospective growth in tourist traffic. The assessment should distinguish between investment in accommodation capacity and other investment directly related to tourism. New accommodation (under construction or in an advanced planning stage) should be identified by capacity (rooms and/or beds), type (hotel, motel, etc.) category and location. Investment costs in total, per project and per room and/or bed should be assessed, and a preliminary evaluation made of the likely financial viability of the various types of accommodation (taking into account the average room rates obtainable in existing accommodation).

26. Infrastructure projects (airports, roads, electricity, water, sewerage, etc.) needed to support the expansion of accommodation capacity should be identified to the extent possible and the costs assessed, as well as the investments required in supporting services and facilities: restaurants, local transport, recreation facilities, handicrafts and shopping. To the extent that infrastructure projects serve other users, the allocation of costs to tourism may be difficult and perhaps somewhat arbitrary. An assessment should be attempted of the extent to which the tourist sector is bearing its fair share of the costs of systems serving several users. A breakdown between the domestic and foreign exchange costs of the investment program should also be given.

27. The assessment should include an evaluation of the likely availability of the financing required for the projected investments and the sources of such financing. The realism of the projected investment program should be assessed, both in terms of the availability of finance and of the ability of the country to mobilize the necessary physical resources (manpower, management, construction capacity, imports, etc.). An evaluation of the likely economic returns on the proposed investment program should be made as well as a judgment about the appropriateness of the scale of the program.

28. Likely sources of finance should be identified, including sources of equity capital, and the role of financial institutions (DFCs) which are recipients of Bank funds should be reviewed in this context. The need for financial support for hotel financing from the Bank Group, either directly from IFC or through local DFCs, should be assessed, as well as the scope for Bank assistance in financing tourism infrastructure through its lending for broader infrastructure projects.

29. The implications of the investment program should be evaluated in terms of the growth of employment in the sector and the needs for trained

manpower. Training requirements should be assessed in the light of the capacity of existing and planned training facilities. Taking into account assistance from other sources, the scope for assistance for training from the Bank (possibly through a broader technical education project) should be reviewed.

Conclusions

30. The final section should include in summary form an evaluation of the priority of tourism in the country's economy and of government policies for the sector, with suggestions for necessary policy changes. On the basis of assumptions about government policies and "best estimates" of the growth of the sector, illustrative projections for the next five to ten years of the role of tourism in the economy should be included (foreign exchange earnings, employment, government revenues and possibly income generated). Recommendations for priority studies required for a deeper analysis of aspects of the sector or of particular government policies should be included, as appropriate, as well as proposals for studies needed to formulate development plans for the sector. 1/

1/ Terms of reference for priority studies should be prepared separately and recommendations made on how such studies might be financed.

Ms. Anne Vaughn, IRD

April 24, 1981

J. A. Simmons, Tourism Adviser, URB

Project Proposals from the World Tourism Organization (WTO)

1. I refer to the three project proposals forwarded by the Secretary-General of WTO on March 31, 1981:

- (1) Tourism Development in Eastern and Southern African Countries,
- (2) Creation of a Hotel Training School at El-Jadida (Morocco) for the benefit of Western and Northern African countries, and
- (3) Creation of a Regional Tourism and Hotel Training Centre at Abidjan (Ivory Coast).

(1) Tourism Development in Eastern and Southern African Countries

2. This proposal outlines the scope of work of a Regional Tourism Adviser serving Eastern and Southern Africa, supported by short-term consultants advising on special issues. The scope of work is wide in response to requests for (a) hotel classification and other tourism legislation (three countries); (b) setting up a modern system of tourism statistics (eight countries); (c) reorganization of the national tourism organization and its activities (two countries); (d) formulation of a marketing strategy (seven countries); (e) project appraisal and implementation (three countries); (f) tourism and hotel training (two countries); (g) sectoral studies in tourism (two countries); and (h) tour operations (two countries).

3. The proposal also envisages advice on planning the development of the sector and on marketing in relation to large trans-national corporations, as well as the promotion of regional activities in tourism.

4. While assistance in all these areas is needed, the overall scope of work appears large in relation to the proposed input of resources (effectively 36 manmonths). For example, to advise on and get established a system for collecting and analyzing tourism statistics in one African country would require a greater input than would seem possible under this proposal. There is a risk that in trying to do so much in a short time, little permanent benefit may result. I suspect that the WTO, having received requests for technical assistance from many African countries and not having resources of its own to be able to respond to these requests, has formulated this proposal for financing of a WTO Regional Tourism Adviser by UNDP. This may be a valid way of financing WTO operations, but I am sceptical about the practical value to the African countries of the proposal as formulated. A greater input of resources by UNDP might have greater chances of success.

(2) Creation of a Hotel Training School at El-Jadida (Morocco)

5. You will have noted that this proposal relates to the staffing of a hotel school earlier financed by IBRD. I suggest the proposal be forwarded to the EMENA Education Division for comment.

(3) Creation of a Regional Tourism and Hotel Training Centre at Abidjan Ivory Coast.

6. I attach a note from Mr. Davis on this proposal.

Attachments: 1) Note from Mr. Davis
2) Paper on the Moroccan proposal returned herewith.

JASimmons:is

Mr. J. A. Simmons, URBDR

April 24, 1981

H. David Davis, URBDR

IVORY COAST: Proposal for an "Institut Supérieur de Tourisme et d'Hotellerie"
to be financed by UNDP

1. You have asked for comments on this proposal which was sent to the Bank by the World Tourism Organization.

2. When I was in Abidjan last month, the UNDP Resident Representative asked to see me in order to discuss this proposal. He had serious doubts about it. In the first place, he thought the timetable of activities were not realistic. He thought that planning and construction could not be completed by 1983 as foreseen in the Project Document. Furthermore, he thought costs had been underestimated both in terms of current unit prices and salaries and because inflation was not taken into account.

3. Concerning the utility of the project, he pointed out that the Ivory Coast sends eight hotel managerial trainees abroad each year (out of a total of 20 students at all levels). French technical assistance provides eight scholarships and the European Development Fund provides additional ones. Thus, between three and six are financed directly by the Ivorian Government. He estimates the needs for the training of hotel managers in neighboring francophone countries at about 25 a year.

4. Taking account of the foregoing, he found the need to construct a high-level hotel training institute at an initial cost of US\$12.90 million to the Government(s) concerned and US\$4.53 million to UNDP was "not evident." I concur.

HDDavis:is