Indian hospitality: the industry, regulations and incentives

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HOSPITALITY IS ONE OF THE OLDEST AND most complex commercial activities in the world. At present, global tourism is growing, thanks to rising levels of income, the thriving aviation industry and developments in the transport sector, such as express motorways and super-fast trains, while many countries survive on so-called 'tourist money'.

Tourism in India is following this trend. In 2006, foreign tourist arrivals in India reached a record 4.4 million. The Readers' Travel Awards 2006, conducted by *Condé Nast Traveller*, placed India at number four among the world's must-see countries, up from number nine in 2003. India's easy visa rules, public freedom and its many historic attractions make tourism development easier here than in many other countries.

The World Travel & Tourism Council estimates that the Indian tourism industry will grow at 15% each year over the next decade – the highest growth rate in the world. This figure will skyrocket in 2010, when Delhi hosts the Commonwealth Games. More than 50 international budget hotel chains are already moving to India to stake their turf.

SOME FACTS AND FIGURES

Economic liberalisation has given a new impetus to the Indian hospitality industry. In India, building a five-star hotel, with around 300 rentable rooms, costs around $50m to $80m, and takes between two and three years. Hotels with a lower star rating are obviously cheaper and take less time to develop, but international hotel chains are expected to go into the five-star category.

Many foreign companies have already entered into partnerships with prominent Indian companies to set up new hotels, motels and holiday resorts. International hotel chains, including Sheraton, Holiday Inn, Intercontinental, Hyatt, Radisson, BestWestern, Days Inn, Hilton, Quality Inn, Ramada Inn, Meridien, Kempenski, Four Seasons Regent, Accor and Marriott International, are entering the country or expanding their existing Indian hotel network.

Food chains such as McDonald's, PepsiCo, Kentucky Fried Chicken, Domino's Pizza and Pizza Hut have also been established, giving an international flavour to the hospitality sector.

REGULATIONS

The raft of legislation governing the hospitality industry can be divided into three sectors. The first governs the construction and commissioning of hotels, restaurants, guest houses and other establishments, and includes the Foreign Exchange Management Act, the industrial licensing policy, the Transfer of Property Act, and various development control orders issued by central and state governments and local municipal councils.

The second governs the operation, maintenance and management of establishments, and the health and safety of occupants. This legislation includes the Indian Contract Act, health and safety laws, insurance laws (notably public liability insurance), and fire safety and hygiene regulations. Establishments must obtain various licences, such as a liquor licence, dance licence, lodging house licence, eating house licence, police permissions, a licence under the Shop and Establishment Act, or a licence under the Food and Drug Administration Act, all of which are granted on an annual basis. If an establishment fails to meet the requisite criteria the licence is not renewed, effectively closing down the business.

The third set of rules governs taxation, employment and other contractual relationships. This includes laws on income tax, service tax, expenditure tax, excise duty, luxury tax, entertainment/amusement tax, as well as laws on pension, gratuity and provident funds, and other employment laws.

CLASSIFICATION SYSTEM

From a regulatory perspective, the hospitality industry can be split into the following six categories. Each category needs a specific set of approvals and must fulfill specific regulatory requirements.

The premium or luxury sector: five-star or deluxe hotels catering generally to business and up-market foreign travellers. Nearly 30% of all hotel rooms fall into this category.

The budget sector: four to one-star hotels catering to average and domestic leisure travellers, and generally found in smaller towns and cities.

Heritage hotels: palaces, *havelis* (mansions) and forts that have been converted into hotels, thus mixing effective preservation with commercial capability.

Resorts and clubs: located on the outskirts of a city, these venues can range from premium to budget quality.

Restaurants: food chains and outlets set up in India. They are usually run by international chains, like Domino's Pizza, Pizza Hut and McDonald's.

Serviced apartments: a new concept in India. Except for a few serviced apartments in Delhi and Mumbai, the market is in nascent state.

Within this broad classification the units are further sub-classified as tourism units for the grant of incentives under various central and state government policies. The classification includes:

1) hotels and restaurants;
2) resorts;
3) health farms;
4) motels and wayside amenities;
5) apartment hotels;
6) water sports complexes;
7) arts and crafts villages;
8) golf courses;
9) camping and tent facilities;
10) amusement parks;
11) water parks;
12) ropeways (cable cars);
13) heritage hotels;
14) convention centres;
15) caravan tourism;
16) adventure tourism projects; and
17) other projects.

The Hotel and Restaurant Approval and Classification Committee (HRACC) inspects and assesses establishments based on the facilities and services they offer (see box, right). The Department of Tourism then grants star status based on how well the establishment scores in the HRACC report: 90% = five-star deluxe; 80% = five star; 75% = four star; 65% = three star; 55% = two star; and 50% = one star.

Classification is valid for five years from the date of issue or, in the case of reclassification, from the date of expiry of the last classification. The hotel is expected to maintain the required standards at all times. The HRACC may inspect a hotel at any time without prior notice, and may request that its members be accommodated overnight to inspect the level of services. Based on an inspection report, the establishment may be downgraded instantly. Upgrades are allowed on a fresh application for a stated category.

HOTEL AND RESTAURANT APPROVAL AND CLASSIFICATION COMMITTEE: QUALITY ASSESSMENT

CRITERIA	MAXIMUM MARKS	MARKS GRANTED
Exterior and grounds	8	Approach (2) / landscaping (2) / exterior lighting (2) / parking (2)
Guest rooms	10	Furniture (2) / furnishings (2) / decor (2) / room facilities and amenities (2) / linen (2)
Bathrooms	8	Facilities (2) / fittings (2) / linen (2) / toiletries (2)
Public areas	8	Furniture (2) / furnishings (2) / decor (2) / restrooms (2)
Food and beverages	8	Choice of cuisine and menu (3) / decor (2) / food quality (3)
Kitchens	8	Equipment (3) / state of repair (2) / food storage (3)
Cleanliness	8	Overall impression
Hygiene	8	Pot and dish washing (2) / drinking water (2) / staff facilities (1) / pest control (2) / garbage disposal (1)
Safety and security	8	Fire fighting equipment (2) / signage (2) / awareness of procedures (2) / public area and room security (2)
Communications	6	Phone service (2) / e-mail access (2) / internet access (1) / PC and other equipment (1)
Guest services	5	Overall impression
Eco-friendly practices	5	Waste management, recycling, no plastics (1) / water conservation or harvesting (1) / pollution control – air, water, sound, light (2) / alternative energy usage (1)
Facilities for the disabled	5	At least one room for disabled persons (1) / public toilet in lobby (1) / telephone in public places (1) / ramps etc (1) / facilities for aurally or visually handicapped (1)
Staff quality	5	Overall impression
TOTAL	100	

PROMOTING INTEREST OF MEMBERS

The Federation of Hotel & Restaurant Associations of India (FHRAI) is the apex body of the four regional associations representing the hospitality industry:

- the Hotel & Restaurant Association of Eastern India (HRAEI);
- the Hotel & Restaurant Association of Northern India (HRANI);
- the Southern India Hotel & Restaurant Association (SIHRA); and
- the Hotel & Restaurant Association (Western India) (HRAWI).

The FHRAI has more than 3,300 members (approximately 2,052 hotels and 1,016 restaurants) and 150 associate members, not including the members of the four regional associations. It is committed to promoting and protecting the interests of its members, and provides an interface between the industry, political leadership, academics, international associations and other stakeholders. Its members are kept up-to-date with developments in the international hospitality industry, and are provided with the latest trade information and trends, statistical analysis and reports on topics that have a direct impact on the industry, and government notifications and circulars.

GOVERNMENT INCENTIVES

The construction of hotels is a capital-intensive activity. The Tourism Finance Corporation of India gives financial assistance to the private sector for the construction of hotels and other tourist facilities. The government also offers a number of incentives.

Export Promotion Capital Goods Scheme (EPCG)

Under this scheme, the customs duty on imported capital goods is only 5%. Importers are, however, subject to an export obligation equivalent to eight times the value of the duty saved on capital goods imported under the scheme. The obligation must be met within the eight years following the date of issue of the EPCG licence.

Capital goods include spares (including refurbished/reconditioned spares), tools, jigs, fixtures, dyes and moulds. An EPCG licence may also be issued for the import of components required for the assembly or manufacture of capital goods. Second-hand capital goods (with no age restrictions) may also be imported under the EPCG scheme.

Cars, sports utility vehicles/all purpose vehicles may only be imported by hotels, travel agents, tour operators or tour transport operators whose total foreign exchange earnings in the current year and preceding three licensing years are 15 million rupees. However, spare parts for cars and sports utility vehicles/all purpose vehicles cannot be imported under the EPCG scheme.

The transfer of capital goods is permitted to group companies or managed hotels under intimation to the regional licensing authority. Other goods, excepting tools, imported under the EPCG scheme cannot be transferred for a period of five years from the date of import, even where the export obligation has been fulfilled.

Every EPCG licence-holder shall maintain a true and proper account of exports/supplies made and services rendered towards fulfillment of the export obligation under the scheme for three years from the date of redemption.

Served from India Scheme

This scheme is available to hotels that are rated one star and above and are approved by the Ministry of Tourism (including managed hotels and heritage hotels), and other service providers in the tourism sector registered with the Ministry of Tourism. They are entitled to duty free credit equivalent to 5% of the foreign exchange earned by them in the preceding financial year (under previous rules, the average foreign exchange earnings of the preceding three years were taken into account). Standalone restaurants will be entitled to duty credit equivalent to 20% of the foreign exchange earned by them in the preceding financial year (compared to 5% of the average foreign exchange earnings of the preceding three years under the previous rules).

In the case of one and two-star hotels and standalone restaurants, the foreign exchange earned through international credit cards and other notified sources shall be taken into account for the purposes of calculating the duty credit entitlement under the scheme.

Export house status

The Indian government has introduced the 'export house' scheme to promote exports and foreign exchange earnings. Under this scheme, a commercial unit earning foreign exchange beyond a specific limit is given special status, and enjoys preferential treatment with all government departments. The government has accorded 'export house' status to tourism. Hotels, travel agents, tour operators and tourist transport operators can be recognised as 'export houses', 'trading houses', 'star trading houses' or 'super star trading houses', and are entitled to benefits including:

i) Licence/certificate/permissions and Customs clearances for imports and exports on a self-declaration basis.
ii) Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels.
iii) Permission to retain 100% of the foreign currency in an Exchange Earners' Foreign Currency Account.

Foreign investment

Foreign direct investment and technical collaborations form a major platform for economic reform. With a view to attracting investment in this sector, the hotel and tourism-related industry has been declared a high-priority industry for foreign investment, and 100% foreign direct investment is therefore allowed under the automatic route.

Foreign collaboration

The government recognises that the adoption of the latest technology translates into improved profitability. In the fast-changing world of technology, the interests of technology suppliers must be protected. The government accords automatic approvals for technology agreements where companies are running or managing hotels with at least 500 rooms, and the IT systems are provided by foreign suppliers. Automatic approval is subject to certain parameters:

i) the technical and consultancy services, including fees for architecture, design and supervision, do not exceed $2m (less cost of land and finance);
ii) the franchising and marketing/ publicity support fee is up to 3% of the net turnover; and
iii) management fees (including incentive fee) are up to 10% of the gross operating profit.

Government permission is no longer required for hiring foreign technicians.

Applications for automatic approval for foreign investment in technology agreements and/or management contracts can be made to the Reserve Bank of India (RBI). The RBI accords automatic approval and the entrepreneurs can approach authorised dealers for release of foreign exchange. Agreements that involve a variation in the parameters will he considered on merits by the Foreign Investment Promotion Board.

New industrial policy

With a view to accelerating industrial development, boosting investor confidence and generating additional employment, the Indian government has announced that eco-tourism is a 'thrust industry' in the states of Jammu and Kashmir, Sikkim, Himachal Pradesh and Uttaranchal. A range of incentives are available. The eco-tourism projects identified include hotels, resorts, spas, entertainment/amusement parks and ropeways.

CONCLUSION

The legislation in this area may look complex, but it is geared towards the healthy development of the Indian hospitality industry. Demand continues to rise in this sector thanks to:

- growing business and commercial activities;
- rising disposable income;
- the improved image of the international tourism sector;
- increased leisure time;
- better transport facilities; and
- technological developments facilitating remote tour management from overseas.

The government has given its full support to the industry. By introducing friendly legislation, a liberal policy framework, support infrastructure and open-sky policies allowing foreign airlines to operate in India, the government has ensured there are more opportunities for more players.