

Assessment of industry risk is an essential part of credit rating process. The industry risk assessment sets the ceiling for ratings of individual entities within a given industry. It focuses on the degree of cyclicity and the strength of competitive forces along with the extent of capital intensity, vulnerability to technological change, level of regulatory interference and energy sensitivity. All these factors are assessed on a scale ranging from High to Low to assign an overall risk level to each industry. Industry risk categorization for different industries is available on our website under Sector Updates “Industry Risk Analysis” (<https://docs.vis.com.pk/docs/Industryrisk062021.pdf>).

This document explains VIS approach to assess industry risk of Hospitality industry of Pakistan.

Hospitality Industry in Pakistan

The hospitality industry in Pakistan is comprised mainly of lodging services along with related supplementary services like transportation, dining and event management. The progress of the lodging industry is greatly dependent upon the progress of the tourism sector which comes under the services sector. The accommodation required for business and leisure derives the lodging demand for both local and international travelers. Over the years, Pakistan’s tourism industry has shown improvement with a higher influx of international visitors, largely coming from the emerging economies.

The hospitality industry can be divided into three major sub-sectors: lodging, food and beverages and recreation. All of these sub-sectors are interlinked and interdependent. The lodging sector is further divided into hotels, hostels, motels etc. The sector is divided into organized and non-organized sector. The major players in the organized sector includes Pearl Continental, Serena, Hotel One, Marriott, Avari, Movenpick and Nishat Hotels.

OVERALL INDUSTRY RISK

High
High to Medium
Medium
Medium to Low
Low

Cyclicity Risk

The demand for hotels and lodging in Pakistan is primarily generated by business and leisure travelers. Domestic travelers account for the vast majority of demand. The empirical data suggests a strong negative correlation between GDP growth in the country and the business activity in the hospitality sector.

The risk level is also derived from the fact that the demand for the sector is dependent on a number of economic factors. Economic down-cycles such as COVID19 impacted the hospitality industry significantly as both local and international travel came to halt. With most of the demand coming from travel and tourism, the industry was impacted severely. Another critical factor is the disposal income, mostly related to the local tourism. Hence the changes in these variables also reflect a high correlation with the financial performance of companies operating in hospitality industry.

Hence, the hospitality industry is classified into ‘high to medium’ risk in terms of cyclicity

Competitive Risk

Barriers to Entry Risk

The effectiveness of barrier to entry in hospitality sector is low. The Department of Tourist Services has identified a number of requirements to be fulfilled including approval and licensing but those are unevenly implemented between formal and informal sector. The capital investment required to establish a hotel is on higher side, but it can easily be financed through debt and equity. Existence of brand name within the hospitality industry is limited to formal sector only. Overall assessment of risk with respect to barrier to entry is considered to be High.

Risk of Substitution

When it comes to the international tourist, the substitution risk is significantly lower for the existing brands. In addition to the service quality, the level of security is always a major concern for the international tourist and hence, the major players in the organized sectors attract most of the traffic. For the local tourist, there are some substitutes in the informal sector such as AirBnb which is preferred due to affordable rents. However, the lack of ambiance and security, these options are mostly unattractive. Hence, the risk of substitution is assigned a rating of ‘low’.

Growth Trends

The risk impact in growth trends is derived from its strong relation with the GDP. The empirical data suggested a strong dependence of the hospitality sector growth with the GDP growth. The relationship was more evident during COVID19 as the hospitality sector was impacted significantly due to ban on local and international tourism. Considering this, a medium risk is assigned.

Based on medium to low risk of substitution along with high risk of effectiveness of barriers to entry and medium risk of growth trends of the industry, the overall competition risk is assessed as medium

Capitalization Levels and Technology Risk

The major requirement for capital in the hotel industry is to acquire land, construct buildings and furnish rooms. However, the availability of this capital via debt or equity is not a concern, more specifically for the big players in the formal sector. The capital recovery period is considered to be in the medium to long term range of about 7 years. Hence, the capital intensity risk is considered to be medium.

On the technology front, the risk is considered to be medium to low. There are requirements to have current knowledge regarding new technological emergence within the industry to have overall competitive edge. Though, the majority of the operations are labor intensive with low product obsolescence. With an introduction of online booking platforms, most of the players in both formal and informal sectors are getting advantage of the technology, but no imminent risk is noticed in this area.

Regulatory Practices

The regulatory landscape of the hospitality sector is derived by the Pakistan Hotels & Restaurants Act, 1976. However, the implementation of act is not as diligent as compared to other sectors. The companies are independent to set their prices and margins are usually moderate as compared to other sectors. These margins also depend upon cost efficiency, growth in tourism and law and order condition, and have been lower in recent years. Hence, a low risk is assigned to regulatory practices.

Energy Consumption

As per the available empirical data of hotels operating in Pakistan, energy consumption in the hospitality sector constitutes less than 20% of total cost of sales and services. However, the sensitivity to energy is low as these costs are usually passed on to the customers.

On overall basis, based on the factors discussed above, industry risk of Hospitality sector is assigned as Medium to Low

Table 1: Summary of Industry Risk Factors

HOSPITALITY SECTOR									
Cyclicality	Competition				Capital Intensity	Technology Risk	Regulatory Framework	Energy Sensitivity	OVERALL RISK
	Risk of Effectiveness of barrier to entry	Risk of Substitutes	Risk in Growth Trends	Overall					
High to medium	High	Low	Medium	Medium	Medium	Medium to Low	Low	Medium to Low	Medium to Low

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