

**THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS / PUBLIC
ADMINISTRATION PROGRAMME
FINAL EXAMINATION 2012
MCP1653 – STRATEGIC MANAGEMENT
DURATION THREE (03) HOURS**



DATE: 9th December 2012

TIME: 1.30pm to 4.30pm

INSTRUCTIONS:

Answer Question **no. 1** (compulsory) and any **THREE (03)** Questions from others.

Question 1: Case Study

THE HOTEL NELUM IN COLOMBO

The *Hotel Nelum* is an 89 room, 3-star, business traveler-oriented hotel located on Galle Road in Colombo, Sri Lanka. It has 80 double-bedded rooms and 9 deluxe doubles. The hotel is positioned between existing four and five star hotels, and a number of guesthouses and two star hotels. The market in which it competes is mature. The Chairman/Managing Director (and majority owner) of the Hotel, Mr. Ravi Thambiayah, does not have an immediate concern about hotel results, but is reviewing operations with the hope that the hotel can be made more profitable. In particular he wonders whether to try to reposition the hotel, and if so, how.

Sri Lanka

Sri Lanka is a tropical island just to the south of India. It is 350 km long and 180 km at its widest point, about the size of Ireland. The population is about 20 million, with about one million people in the capital, Colombo.

Sri Lanka has distinct dry and wet seasons, with tourist peaks corresponding to the dry seasons. The country is subject to two monsoons. From May to August the southwest monsoon brings rain to the southern and western coastal regions and to the central hill country. December to March is dry. The northeast monsoon comes from October to January, bringing rain to the north and east of the island.

The Sri Lankan Tourist Industry

Sri Lankan tourism is promoted by the Ceylon Tourist Board, the national airline SriLankan, and by the private tourism and travel sector. Each has separate strategies, and there is little coordination among them.

Sri Lanka had experienced what Lankans refer to as “terrorist problem based on an ethnic issue”, and which the rest of the world views as a 26-year long civil war between Tamils in the north, and the majority Sinhalese in the south. The war continued from 1983 to 2009. Concerns about terrorism caused every western country to place Sri Lanka on its “caution for visitors” list.

Except for the business travel, Sri Lanka offers the tourists, golden beaches, eco-tours, village tourism, cultural tours, wilderness tours, diving, white water rafting, jungle safaris, trekking, and Ayurvedic herbal spa resorts. The greatest potential for growth is likely in eco-tours, as Sri Lanka has seven UNESCO world heritage sites.

However none of these activities take place in Colombo, which is crowded, suffers from substantial year-round air pollution from lack of vehicle emission control devices and heavy humidity, and has little of direct tourist interest. Colombo is however the site of the only international airport. Virtually all visitors originate and end their trips in Colombo. The city itself generally does not hold a visitor more than a day or two, but serves as a stopover for tourists visiting the interior. Thus the hotel industry in Colombo tends to service short-term transit visitors, a few visitors for family visits, and business visitors. Eighty eight percent of visitors list their purpose as "pleasure", only 5 percent as "business". The latter figure is almost certainly understated as many business visitors enter as tourists to simplify visa matters.

The Nelum Hotel

The Hotel Nelum consists of two physically separate buildings, connected by an overhead walkway. The older (built in 1972) but refurbished *Hotel Nelum* is next to the newer (1995) *Nelum City Hotel*. Both use the same reservation and check-in services, and share all hotel facilities. They are legally separate entities – one privately owned, one publicly, but few patrons are aware of the fact.¹ In this case, the two entities are simply referred to as "The Nelum".

The Nelum is one of the Nelum Group of Companies. Besides the hotel, the Group consists of two investment management companies, a residential real estate development company, and a publicly traded company handling large building projects.

The Nelum emphasizes personalized attention and friendly service, and does it amazingly well. There are 120 employees for 89 rooms, a ratio twice that in western hotels.

The Nelum is located on Galle Road, the major thoroughfare that runs north-south through Colombo, paralleling the Indian Ocean. (There are no expressways in Colombo). The hotel is 30 km (and 45-60 minutes) from Bandaranaike International Airport, 15 minutes from the major financial area and the main Fort train station. All other major hotels are an equal distance from the airport, closer to the Fort financial area but less convenient to embassies, the numerous non-governmental agencies with offices in Colombo and to smaller business, which are more diffused around Colombo than would be true in most cities.

The Nelum focuses on business travelers. The hotel has intentionally moved away from tourism, which the general manager thinks fluctuates too much in response to press reports on terrorism in the capital. The Nelum does not bid for group tours at all, because the coming and going of large tour groups are thought to be inconsistent with providing good service to business travelers.

The hotel's cost-per-room-per-night (employees, taxes, etc.) for an unoccupied room is between Rs. 12,750 to Rs. 14,000. The additional marginal cost for occupancy (room linen, supplies, and meals) is about Rs. 500.

Individual rooms are small, comfortable, and include individual air conditioning, color television, international direct dialing telephones with email access, mini refrigerators, and 24-hour room service. The hotel, like all 3-star hotels in Colombo, has little guest parking, but few guests arrive in their own cars. Special event, evening parking is available for a few cars on Galle Road itself. There are no open spaces near the hotel for surface parking, and raising an

¹ Nelum City Hotels Limited is the quoted subsidiary of the older Nelum Hotels Limited, an unlisted company.

existing building for a parking structure would be economically unfeasible. There is a very nice outdoor swimming pool in a separate building about 75 meters from the hotel. There is no health club.

The Palmyrah Restaurant is located in the basement of the Nelum. The Palmyrah offers one of the best northern Sri Lankan cuisines in the city, featuring hoppers, pittu, thosai pancakes, and an array of curries and sambols as well as western dishes. Most of the hotel's breakfast business is from hotel guests, while about 80 percent of the dinner business comes from outside the hotel.

There are conference facilities and business center. There are two separate bars, but no coffee shop. There is one retail jewellery boutique in the main lobby.²

The Nelum has six public rooms (including the Palmyrah Restaurant) which can accommodate seminars for 25-50 people, theatre configurations for 40-140 people, and receptions or cocktail party accommodation for 40 to 170 people.

Typically a meeting or conference, say of a non-governmental organization (of which there are many in Colombo), will use one of the function rooms, with most out-of-town attendees staying in the hotel, some for a few extra days. The hotel will be asked to provide lunch and refreshments to the people in the function rooms. Function rooms or breakout rooms are often provided free to any group which reserves a minimum number of rooms for attendees. However most meetings hosted by the Nelum involve small numbers of participants, are short in duration, and attract only participants already resident in Colombo.

The Nelum's posted rate for a double room, European Plan is US\$50 a day, and its negotiated rate for actual 5-7 day stays is US\$30-35 a day. The Nelum management thinks that its rates are as high as they can go, and that cost increases cannot be passed on to guests. In March of 2000 the Sri Lankan government imposed a 12.5% value added tax on hotel accommodation (hotels had previously been exempt), and none of the Colombo hotels were able to pass the cost increase through to tour operators.

Sixty-four percent of *The Hotel Nelum's* revenue comes from room rental, 29 percent from food and beverage, less than one percent from bar sales and 7 percent from laundry services, telephone charges, and secretarial and business center. Restaurant revenue includes the Palmyrah Restaurant, and revenue from receptions, seminars and conferences, and banquets. The average for 3, 4 and 5 star hotels in Colombo is 57 percent of total revenue coming from room rental, and 22 percent from food and beverage.

The Nelum's good service arises from corporate culture, rather than from a formal training program. Department heads are in charge of training new staff, and for maintaining quality control. Staff members are told "look after guests, and you will be looked after and rewarded." There is an ongoing training program for department heads. All employees are recruited from outside the hotel industry, with the exception of specialized positions such as chefs.

The Nelum offers one quite unusual staff benefit. They maintain staff quarters about 100 meters from the hotel, where staff from outside Colombo can stay during the week. Many staff from outside the city live in these quarters 25 days per month, saving bus and train fare and making it easier to report for early shifts.

² There is apparently a government regulation that hotels must make toiletries and toothbrushes available to patrons. So the Nelum's jewelry boutique devotes a little barely-visible space to toiletries and pocket books, and the remainder to moderately priced (but very high markup) jewellery.

Because the hotel does not seek guests from the local market, it does no local advertising or promotion at all. In particular, the Nelum does not follow the common hotel practice of placing advertisements in local business magazines, and covering the cost by barter – usually for complementary hotel rooms or restaurant meals.

The hotel employs two local sales people to call on local businesses and governmental and non-governmental organizations, asking these organizations to book the hotel for business visitors from outside Sri Lanka. It is in dealing with these organizations that what turns out to be a very narrow price spread between three and five star hotels becomes most critical.

The Nelum Hotel has one of the highest occupancy rates in Colombo, with average room occupancy of 94 percent during the year. Sixty percent of hotel guests come from south and southeast Asia, the balance from Europe, the U.K. and from Sri Lankans returning to the island for a visit. Guests from developed nations are seen as desirable in that they are less price sensitive than those from developing nations. Developed-nation business travelers spend money entertaining in the restaurant and lounge, use room service frequently, and use the fax, telex and long distance telephone services, all of which produce high profit margins for the hotel.

Guest loyalty is high. At any given time, about 15 percent of guests have previously stayed at the hotel at least once. Management thinks that about 70 percent of first-time guests will return to the Nelum when they return to Sri Lanka.

Management thinks that the six main sources of guests are:

1. Shipping companies;
2. Non-governmental organizations (including those holding meetings at the hotel);
3. Banks;
4. Business organizations;
5. Government organizations; and
6. Advertising companies.

In the 2010 accounting year, Nelum City Hotels Limited showed profits of just over Rs 200 million, but most of this was from share transactions in other companies. The profit from hotel operations was such as to show a return on invested capital of about 15 percent, below the Sri Lankan inflation rate of 16 percent and well below the 20 percent return offered by short term government securities.

On balance, *The Hotel Nelum* is far from being a 5 star hotel – its rooms are smaller, it lacks luxury amenities, its common areas are far less elegant. *The Hotel Nelum* is a good 3 star hotel with a reasonable location and a high level of personalized service.

Segmentation of the Hotel Industry

Travelers view the hotel industry as having geographic or activity-based segments – city center, beach, suburban, and airport locations, and as being budget, mid-range, executive-stay hotels (usually 3 stars), or luxury hotels (4 and 5 stars). Hotels are given their “star” ratings by an agency of the government.

In Colombo, budget locations would include the Central YMCA on Bristol St. in Colombo 1, which offers dormitory rooms for Rs 900 per person, and about a hundred small guesthouses. An example would be Mrs. Jayani Sayakkara’s house at 280 Chelsea Gardens in Colombo 3, which offers two rooms with separate entrances, attached bath, fan and net for Rs 2550 per night. Mid-range hotels would include the *Hotel Mira* at Kumaran Ratnam Rd, offering singles/doubles with bath for Rs 2400 with air conditioning Rs 600 extra, and the *Hotel Ruby* on Galle Road in Colombo 6, with air conditioned single or double rooms for Rs 3500.

The Hotel Nelum competes in a category above these, which includes six 5-star hotels and a number of 3-star executive stay hotels. There are several five star hotels in Colombo Fort or close to it (15 minutes north of the Nelum), typically with elegant spacious public rooms, large swimming pools, shops, several restaurants, and full air conditioning. Among the five star hotels are; the *Colombo Hilton* (387 rooms), the *Galadari Hotel* (446 rooms), *Cinamon Lake Side* (358 rooms), the *Taj Samudra* (400 rooms), and the *Cinamon Grand* (600 rooms).

Quoted or "rack" prices (which at this level of hotel are quoted in U.S. dollars) range from US\$145 to US\$170 for a standard single room, US\$185 to US\$215 for a standard double room, and US\$190 to US\$300 for a luxury double. But the negotiated prices can be lower than that.

All of the four and five star hotels have year-round occupancy rates of 55 percent or less, except for the Galle Face, which is at 75-80 percent.

There are several other hotels in the Nelum's 3-star category and which target business clientele. One is the *Hotel Jana*, in Colombo 5. Rack rates at the Jana are \$US35-US\$40 standard single or double, and US\$55-US\$60 for a more luxurious double, and negotiated rates in the US\$35 to US\$40 range, sometimes including breakfast for clients with longer stays

Government Efforts at Hotel-Rate Price Fixing

There have been continuing government efforts to fix prices in 5-star hotels in Colombo by raising rack rates and/or minimizing discounts. The government's logic in attempting to price fix is that competitive discounting does not attract more tourists, but simply lowers the total number of tourist dollars available for hotels, for their employees (whose share the 10% gratuity charge) and for government itself, which receives the goods and services tax.

The government had more success in negotiating lowered room rates, when it convinced 5-star hotels to offer extremely low rates to package tours bringing British cricket enthusiasts to Sri Lanka for tournaments.³ The government's logic was that having 9,000 British fans in Sri Lanka for the matches would show the world that fears about tourist safety were unfounded. Five star hotels bought into the plan, and offered rooms to package tours at special discounted rates.

Sri Lankan economy and tourism industry today

A political solution is sought for the Sri Lanka's North and East situation resulting in war free situation in the country during the past 3 years. Traveling to tourist destinations and normal business activities takes place in the former war prone areas today. There is much hope that this peaceful situation will continue further.

The economic situation in the country has improved recently. The government has been able to maintain the inflation rate below 10% for a considerable period and the growth rate has been around 7.5% for the last 3 years. Sri Lanka has been able to maintain this impressive growth momentum despite the fact that all the major economies in the world facing severe economic hardships.

Peak arrival months are November through March, with January the highest with a seasonal index of 143. Lowest arrivals are in May, with a seasonal index of 69. Average duration of stay is 10.4 days.

³ As a result, most tickets to the matches were also sold to tour packagers, thus making it difficult or impossible for Sri Lankan cricket fans to attend the matches.

Ninety-nine percent of arrivals are through Bandaranaike International Airport, Colombo, with the remaining one- percent by sea through Colombo Harbour.

The main motivation for travel is pleasure (88%), with travel for "private or official" business purposes 5.2%, and travel to visit friends and for religious purposes or sport accounting for the balance.

Further, Sri Lankan tourism industry is now interested in the MICE (meetings, incentives, conferences, and exhibitions) sector. A promotional campaign planned to promote Sri Lanka as one of the Asia's latest destinations for MICE travelers will be launched within the next couple of days. Given the high yields generated by the travel and tourism sector, MICE travelers spend six times more than normal leisure travelers, so the economic gains are far greater for the country. Another significant factor is these travelers invariably return with family or friends.

Rise in tourist arrivals-International tourist arrivals increased by 4.5% in the first four months for 2011, according to the latest issue of the UNWTO World Tourism Barometer. Between January and April 2011, destinations worldwide recorded 268 million international tourist arrivals, some 12 million more compared to the 256 million registered in the same period in 2010.

Regions around the world recorded strong year-on-year growth, led by South America (up 17 per cent), South Asia (up 14 per cent) and South-East Asia (up 10 per cent). A large number of countries around the world reported positive results in the first months of 2010. Of the 77 destinations reporting data for this period, 60 showed positive figures, of which 24 posted double-digit growth including Estonia, Israel, Hong Kong (China), Macao (China), Japan, Taiwan (PR of China), Indonesia, Singapore, Vietnam, Guam, India, Nepal, Sri Lanka, US Virgin Islands, Nicaragua, Ecuador, Kenya, Seychelles, Morocco, Egypt and Saudi Arabia. So the increase in tourists is visible in many other countries as well.

Therefore, the mechanism for Sri Lanka is to get a competitive advantage by promoting the industry by adopting better strategies including proper research in the field as well as developing the cluster areas for tourist attraction by promoting our Sri Lankan identity.

Diversified strategies and sustainability

It is important to understand from which countries Sri Lanka have more tourists arriving. Figures released by Sri Lanka's Tourism Authority confirmed that 68,830 Indians visited Sri Lanka between January and May 2011, up 54.5 per cent over the same period in 2010.

However, even though the numbers are increasing, there should be a system to increase spending in Sri Lanka and to increase the staying time in the country. Numbers will not tell you the story. As an example, most of the Indians are coming to Sri Lanka by looking at cheap accommodation and shopping, but the tourist coming from Russia will spend millions to enjoy his holiday (different objectives). The country can also target different segments like international business conferences, etc.

In 2010, Malaysia welcomed 1.3 million international business event visitors, contributing an estimated EUR 4 billion (US\$ 6 billion) to the economy. The meetings hosted include the Asian Pacific Digestive Week (2,661 delegates), 6th World Islamic Economic Forum (2,000 delegates) and the 2nd Global Model United Nations Conference (1,000 delegates). Such diversified strategies can be very important for the sustainability of the tourism.

Options to be considered

So the long-term room pricing situation in which the Nelum finds itself is one in which guesthouses, some offering air conditioned rooms and breakfast, charge as much as US\$30, the Nelum charges about US\$35, four star hotels charge as little as US\$40-US\$45 and five star hotels as little as US\$50. The problem is that in focusing on the business market, most of the Nelum's referrals come from local business, governmental and non-governmental organizations, who are aware of the price structures, and often chose to give their visitors "5-star" treatment for a few rupees more. By comparison, in most cities, a three star hotel would charge twice what a guesthouse does.

The Nelum has high occupancy rates but isn't making a reasonable return on investment on operations. Because of its high occupancy rate the Nelum would not benefit much from lowering its posted rates, and it certainly can't raise them. It is well positioned to profit at such time as the nation's civil unrest is over and tourists return, but that may be many years in the future.

Questions

Assume that you have been appointed as a consultant for already established leading multinational which is seeking possibilities of setting up a hotel in Sri Lanka. Your task should be,

- i. Identify core competencies for The Nelum. (8 Marks)
- ii. Conduct a SWOT analysis for the Business. (10 Marks)
- iii. Explain with justifications the most viable strategy, using M.E. Porters Generic model in order to achieve competitive advantage (12 Marks)
- iv. Analyse your answer to above, using McKinsey 7s model for the company to transform the business. (10 Marks)

(Total 40 marks)

Question 2

Briefly discuss the Ansoff product/market growth matrix using one of the service organizations of your choice. Critically analyze the benefits and constraints for each of the strategy directions proposed as per the matrix. (20 Marks)

Question 3

"Michael E. Porter has identified five competitive forces that shape every industry and every market. All forces find out the intensity of competition and the profitability and attractiveness of an industry. The objective of corporate strategy should be to modify these competitive forces in a way that improves the position of the organization."

Comment. Critically discuss five competitive forces with examples . (20 Marks)

Question 4

Explain any FOUR of the following concepts with suitable examples.

- i) VRIN framework for analyzing competitive advantage.
- ii) Functional level and corporate level strategies
- iii) Blue Ocean strategy
- iv) BCG Matrix for analyzing business portfolio
- v) Strategic groups

(20 Marks)

Question 5

“Balance Scorecard method evaluates financial as well as financial performance”

- i) Explain the elements of balance score card method. (5 marks)
- ii) What is the strategic implication of Balance scorecard method? Explain. (15 marks)

Question 6

“Mergers and Acquisition is the most common means of entry into new markets”-John Kay.

- i) Explain the differences between mergers and acquisitions (10 Marks)
- ii) What are the strategic implications for Mergers and acquisitions? Explain. (10 marks)

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