

ANNEX 8 - TOURISM SECTOR

Situation Analysis

1. Tourism is the main industry in the Maldives, with total receipts estimated at about \$478 million in 2004. The industry contributes approximately 31% to the GDP directly but an estimated 60-70% when indirect impacts are considered. The tourism industry, directly and indirectly, also accounts for a high portion of Government revenues. Lease payments from hotel projects were \$48 million in 2004 with bed and departure taxes contributing \$41 million and custom duties estimated at another \$46 million. Just these three items account for \$135 million and this excludes taxes generated from other sources such as landing fees, telecommunication taxes, other company royalties, etc.

2. The hotel sector alone accounts for 17,000 jobs out of an economically active population of about 88,000 and when consideration is given to other tourism businesses and multiplier effects, the tourism industry is likely responsible for over 25,000 jobs. It should be noted that some 40% of jobs in the hotel sector are filled by expatriates, detracting from the economic benefits to the Maldivian economy.

3. Several years ago the government decided to focus on high end tourism with potentially lower volumes but higher spend tourists instead of pursuing a mass tourism approach. The rationale was to maximize the economic impacts and minimize the potential negative impacts often associated with the industry, particularly given the Maldives' small size and fragile ecosystem. This sustainable approach has worked well in terms of encouraging boutique style luxury resort development and attracting high spend tourists, maximizing revenues generated by the industry for both government and private sector investors while maintaining environmental and social sustainability. While there is still a mix of properties to cater to a variety of markets, the Maldives now hosts some of the world's top resorts. Visitor satisfaction is reflected in a relatively high repeat rate of 20-30% and investor satisfaction is reflected in relatively high rates of return for most projects and increasing interest from a number of the world top hotel chains to establish a presence in the Maldives. While Government has set the overall policies and direction for tourism, the sector has been very private sector driven.

4. Tourism has been the main driver behind the country's strong economic growth over the past several years. Arrivals increased from 430,000 in 1999 to 615,000 in 2004, an annual growth rate of over 7%, despite the global slowdown in travel after 9/11, the weak global economy and the outbreak of SARS which devastated several other tourism destinations in Asia. 2004 had been a banner year for the Maldives with bed night demand up some 12% over 2003 and bed occupancy running at about 85%, impressive for any destination. The largest markets for the Maldives are Italy (20%), UK (17%), Germany (11%), France (10%) and Japan (7%).

5. The impact from the tsunami has been significant on the sector and can be divided into the direct and indirect impacts: 1) Direct: damage to the tourism infrastructure and other related businesses, and 2) loss of revenue from the downturn in tourist arrivals, both to the private sector and Government and the impact on those working directly or indirectly for the industry:

6. *Direct Impacts; Damage to Tourism Infrastructure* The tsunami caused 3 fatalities and a number of seriously injured among foreign tourists. Of the country's 87 resorts, 21 sustained considerable damage and are closed. By the time the tsunami hit, there was a registered total of 17,476 resort hotel beds, 1,700 beds on safaris and 427 beds in guesthouses. Before the tsunami hit a number of these beds were not operational for various reasons such as undergoing rebuilding and refurbishment work. Currently the total number of beds out of operation stands at 5042 (about 30%) about it is expected that 3,800 will likely re-open over the next few weeks or months while 1,200 have sustained more serious damage and will remain closed for all of 2005. Another five resorts (874 rooms) were under construction or renovation with plans

to open at some point during '05. Therefore, by the end of '05 the bed inventory, even without the 5 badly damaged resorts, should return to late '04 figures with supply growth resumed in '06 as some of the more severely damaged resorts re-open. In addition to resorts, there are over 100 safari vessels (1700 beds) and 24 guest houses (360 beds). There is a likelihood of the possibility of increase in physical damages and numbers of beds likely to be out of operation due to other effects of soil erosion, changes to water table and result of unsafe structures . This can be declared only after a detailed structural damage assessment of each building in the resorts is completed.

7. For the damaged resorts, preliminary estimates of the cost to rebuild are around \$100 million. While some of the physical damage will be covered by insurance, not all the insurance assessments have been undertaken as yet and it would appear that in many cases there were limits for natural disasters which fall short of replacement cost, insurance caps and other clauses which limit the amount of insurance payment received. Replacement values stated in various policies may also be undervalued. One estimate is that in the final analysis maybe 50% of the physical damage will be covered by insurance. Most policies also cover business interruption while a resort is not operating, however, they will generally not cover cash flow losses related to market conditions or the overall decline in visitor arrivals once the hotel is operational.

8. *Indirect Impacts; Decline in Tourist Arrivals* The country was at the height of the peak tourism season when the tsunami hit. While only a portion of the country's resorts were damaged, due to the ongoing publicity of the badly affected areas, all resorts are suffering. Trip and flight cancellations have been significant and bed occupancies are now ranging from 30-40% for the opened resorts (20-30% based on a full inventory of 17,000 beds) where these are more typically over 90% at this time of the year. This suggests that room night demand is down somewhere between 65-75% and seems to match airport arrivals which were 5,625 for the first 11 days of January '05 compared to 20,308 for the first 11 days of January '04. With low load factors, both scheduled and charter flights have been reduced. Cancellations are starting to decline and some new reservations are starting to come in, albeit slowly. Discussions with some of the larger hotel operators suggest that travel should start to pick up in February and more earnestly in March.

Economic Impact

9. Private sector tourism businesses and companies that support the tourism sector indirectly are suffering from the physical damage to their properties and other assets, to the extent that damage was sustained, but even more so from the loss of income from the downturn in arrivals. To counter heavy overhead expenses it can be expected that employee redundancy measures will be taken by resorts. Many resorts have already reduced staff numbers in response to low occupancy, while some have decided to retain full staff under the assumption that business will return to normal levels shortly. Facing the risk or reality of at least temporary unemployment, some staff have chosen to return to home islands. Even if staff remain on the payroll, however, well over 50% of their income is typically derived from the 10% service charge. The annex attached to this report was prepared by UNDP and provides a list of companies that have been affected with the downturn as well as smaller businesses and individual working in the informal sector that may be affected. The status of the employees in the 5 resorts that are completely devastated and out of operation is not yet known.

10. The negative impacts on the economy from the downturn in tourism will depend on how quickly visitor numbers rebound. Recent experience indicates that the travel industry is fairly resilient with most crises prompting an initial setback in arrivals but fairly quick rebounds. In Egypt, which experienced several incidents of violent attacks against tourists, the pattern has been an initial sharp drop in arrivals but visitor numbers rebounding within 1-2 years. The recent earthquake in Turkey also resulted in a drop in arrivals followed by sharp rebound in one year and the situation was similar for the bombing of a Bali

nightclub. Obviously, any further earthquake or tsunami activity in the Maldives, health epidemics etc., would hamper the recovery process, but barring such events, the industry should start to rebound fairly quickly, assuming that appropriate marketing/communication campaigns are undertaken to bring tourists back. The fact that loss of life from the tsunami was relatively small compared to other tsunami-hit tourist destinations should aid the recovery time as well as the fact that the Maldives is a very unique destination and not easily compared to or replaced by other competitive destinations.

11. Aside from the losses to private tourism businesses, two scenarios are set out below to estimate the impact of the downturn to the economy. These numbers are based on a financial model developed within the Ministry of Tourism which is not yet finalized and are considered preliminary. The first scenario (a) assumes a gradual rebound in bed night demand with a full rebound to pre-tsunami projections by July and average bed occupancy of 67% for the year, based on available inventory. A more pessimistic scenario (b) assumes 50% bed occupancy for the year. Both scenarios assume a slight discount in room rates. While the table below gives an approximate assessment of the revenue loss due to fall in tourism, an assessment of the direct income loss of resort owners and their employees is yet to done to estimate the full impact of this setback.

	2004	2005 (a)	2005 (b)
Average bed occupancy (%)	85%	67%	50%
Gross receipts from tourism* (US\$m)	\$415	\$190	\$160
Estimated loss		(\$225)	(\$255)
Tax revenue (bed & departure tax) (US\$m)	\$41	\$34	\$28
Estimated loss		(\$8)	(\$14)
Customs duty on tourism goods (US\$m)	\$43	\$29	\$24
Estimated loss		\$14	\$19
Loss of lease rent if waived for rooms out of inventory (US\$m)		\$3.4	\$3.4

*includes direct and indirect effects and multipliers

Short Term Recommended Actions

1. Marketing/PR Campaign

12. Rationale: To minimize financial damage associated with the downturn in tourism, First and foremost there is a need to increase confidence that the Maldives is a safe place to visit and bringing tourists back. The international press coverage on the tsunami's damage to the country and the inference in some cases that it would be insensitive or disrespectful to travel to the county for a holiday is clearly a deterrent in bringing travelers back. The message that it is safe to travel here, that the tourism industry is up and operating with most resorts unaffected and that visitors are very much welcome needs to be clearly communicated to the travel trade and to tourists directly. It is recommended that \$2 million be added to the current destination marketing budget.

13. Suggested activities include:

- Detailed media strategy
- Focused efforts targeted at travel trade, particularly tour operators from major markets, travel writers, travel publications, airlines
- Working with embassies to ensure travel advisories are lifted as appropriate and that accurate information is available
- Focused marketing on former visitors

- Strong attendance at upcoming travel trade shows (BIT, ITB, etc.)
- Develop incentive programs for tourists to visit (free nights or meals, special gifts) rather than straight discounting or rooms

14. **Responsibility:** The Maldives Tourism Promotion Board (MTPB), funded primarily by Government with some income from the private sector, is quite capable of managing these marketing efforts in conjunction with the Ministry of Tourism (MoT), Maldives Association of Tourism Industry (MATI) and the Tourism Promotion Advisory Council; the Pacific Asia Travel Association (PATA), an effective regional organization with a focus of tourism marketing and vast experience in crisis situations, may also be able to provide some useful assistance.

2. Encourage Rebuilding Efforts/Support Cash Flow Shortfalls

15. **Rationale:** The repair or rebuilding of damaged resorts and other businesses serving the tourism industry directly or indirectly will help to speed the recovery process. To reduce the financial burden on hotel owners, duty-free importation of materials required for rebuilding is recommended. Many companies will likely face working capital or cash flow shortfalls due both to the decline in on going business plus the likely increase in accounts receivable from tour operators. There may be money available from aid organizations to channel through banks and other financial institutions for on-lending to tourism and other companies although appropriate vehicles and manpower will be required to administrate. The Maldives National Chamber of Commerce and Industry (MNCCI) has developed an interesting scheme to assist small and medium scale businesses and has already collected over \$500,000. IFC is also in initial discussions with some of the larger companies to support rebuilding and/or debt restructuring. **Responsibility:** Ministry of Finance, MoT, MNCCI, private and public sector financial institutions,

3. Consider Temporary Waiver or Partial Waiver of Lease Payments

16. **Rationale:** To ease the financial burden of resorts, the annual lease payment should be temporarily waived. These lease payments represent a high fixed cost for the hotel operation and will be difficult for hotels to pay if the hotel is closed for repairs/reconstruction. Even for hotels which are operating, significantly reduced cash flows from lower occupancies and possibly discounted room rates will stretch financial resources unless they have a fairly sizable amount of cash or other liquid assets. A rough estimate of the cost to Government to waive lease payments while beds are not in operation, based on an average lease payment per bed of \$2,800/yr (\$8 per bed/day) would be \$3.3 million. It is understood that some lease agreements do have a clause waiving payments in the event of closure due to natural disaster. **Responsibility:** Ministry of Finance, Ministry of Tourism

4. Limit New Supply in Short Term

17. **Rationale:** Depending on how quickly tourism rebounds and at what magnitude, there may be a short-medium term oversupply of resort rooms viz a viz room night demand. Government may want to consider slowing down the leasing process for the 11 new islands/resorts that were bid on in 2004 (approximately 1600 beds) until there is a clear picture that tourism arrivals are fully back on course. **Responsibility:** MoT

5. Assessment of Possible Structural Damage

Rationale: Ensure that resorts in operation are structurally sound and safe for occupancy

Rationale: Any accident at a resort resulting from structural problems would add considerable damage to the Maldives's image and credibility as a tourism destination. To the extent that

resorts were badly hit and have not yet been evaluated by a structural engineer, these assessments should be undertaken ASAP.

Long Term Actions

1. Assess Impact on Marine Life

18. Rationale: The impact of the tsunami on fish, coral reefs, etc., should be fully assessed. Aside from the importance of the marine environment from an environmental perspective, premier diving is a key attraction and selling point for the Maldives. It is critical to assess the impact, if any, to communicate this message to the travel trade, dive associations etc. and, to the extent that damage may have occurred, take remedial actions. The effect of global warming on the Maldives has long been a concern and the impact of this potential threat to the industry should be studied as well. Responsibility: Ministry of Environment, MoT; possible GEF finance

2. Develop a Crisis Management Plan and Committee for Tourism-Related Crisis Rationale

19. The tourism industry is vulnerable to numerous risk factors from natural disasters, climate change, terrorism, health scares, changes in flight schedules, violence against tourists to political problems and economic downturns in source markets. It behooves every destination to develop a crisis management plan to better understand and manage risks and ensure better preparation for handling the wide variety of crises. PATA has also had vast experience in this area and may be able to provide assistance. Responsibility: Ministry of Tourism, MATI, Ministry of Health, National Security, other Government emergency units, PATA

3. Provide Technical Assistance on Insurance

20. Objective: The tsunami crisis brought insurance problems within the industry to the fore with respect to coverage lapses, caps, undervalued assets, etc. and it would appear that the complexities of insurance are not fully understood. It would be useful for hotel owners to receive training and advice on insurance matters and this may more practically be approached at the industry level.

4. Develop an on-going Financial/Accounting System to track impacts of tourism on the economy

21. Rationale: Government should develop a Tourism Satellite Accounting System (TSA) to more accurately track the economic impact of the tourism sector on the economy. Alternatively, the Planning Department of the MoT has already drafted a model, which achieves many of the same objectives and this could be refined/finalized for ongoing tracking.

5. Improve value added associated with the industry

Rationale: While the economic benefits of tourism are already significant, these could be strengthened with focused efforts to ensure that more related economic activities stay within the country. This has long been recognized as an important issue and actions taken but these efforts should be strengthened, including training and hiring more local staff in the industry, particularly women, and improving/developing better linkages between tourism and the rest of the economy, particularly agriculture.