

Sustainability of Hotels: Evidence from Tourism Industry in Sri Lanka

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Abstract: The present study explores the sustainability level of the Sri Lankan hotels in the tourism industry. It was observed that the return on equity has been decreasing in the hotel companies though there is an increasing trend in the tourist arrivals in Sri Lanka (Weerasinghe et al., 2019). This unanswered problem raises the question of whether the hotels in the tourism industry are heading towards bankruptcy. This study used secondary data from the annual reports of 34 listed hotels, which are registered in the Colombo Stock Exchange during the last five years (2015-2019). This study applied the Altman's original Z score model (1968) which is the most accurate and reliable in forecasting the sustainability of the firms by using ratio analysis method. The finding of the study reveals that 91% of the hotels are in the distress zone, 9% safe zone and none in the gray zone. The present study is significant since it sheds the light, through the empirical evidence on the scary financial environment, which signals the hotels in the tourism industry in Sri Lanka, about the doubt of going concern..

Keywords: Sustainability, Bankruptcy, Altman Z score, Hotels, Sri Lanka.

I. Introduction

Going concern concept is the major pillar in accounting when preparing financial statements. With regards to this, when the hotels are working towards maximizing their profits, the concentration on the macro-economic changes in the financial market is vital.

Although, many bankruptcy models were presented in the past five decades (Aloy and Pratheepan, 2015), Altman Z score model is still considered to be the best model to predict the level of bankruptcy. The results generated from the Altman Z-score model can be used with the reasonable success of a high level of reliability and accuracy (Diakomihalis, 2012). Altman Z score model consists of five financial ratios covering the analysis of assets and the liabilities of the firm. Many researchers have used this model as an indicator to measure the

financial well-being of companies (Meeampol et al., 2014).

When focusing on the Hospitality and Tourism industry, it is significant to predict the risk level of bankruptcy since, in countries like Sri Lanka, the main aim is the generation of income. Identifying the level of risk in such kind of industries at the earliest, will help in maintaining the stability of the economy. However, it is argued that, though studies are available in other sectors like banking, it is hard to find such studies in hotels sector in Sri Lanka (Nagendrakumar and Rameez, 2008).

II. Objective

The objective of this study is to explore the sustainability level of hotels in Tourism industry in Sri Lanka.

III. Methodology

The study has adopted the quantitative approach which measures the sustainability level of the hotels which are listed in the Colombo Stock Exchange (CSE) completely relying on secondary data that was extracted from the annual reports of the listed hotels. Although there are 38 hotels listed in the CSE under Hotels and Travels sector, only 34 are included in the sample due to lack of information provided in the annual reports. Altman's original Z score model is used to analyze the sustainability level of the hotels in Sri Lanka. The study presents a brief interpretation of the Altman's Original Z-Score Model (Altman, 1968).

The model,

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.060X_4 + 0.999X_5$$

X_1 = Working Capital / Total Assets, X_2 = Retained Earnings / Total Assets,

X_3 = Earnings before Interest and Taxes / Total Assets,

X_4 = Market Value of Equity / Total Liabilities, X_5 = Sales / Total Assets

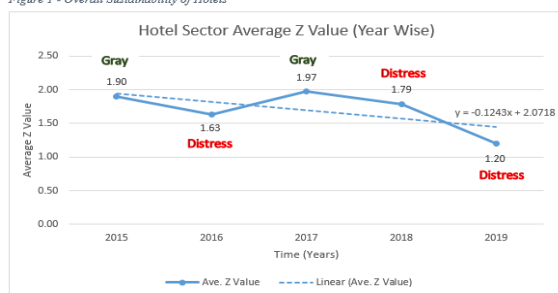
Zones of Discrimination

$Z > 2.99$ - Safe Zone, $1.81 < Z < 2.99$ - Gray Zone, $Z < 1.81$ - Distress Zone

IV. Findings and Results

The study found that, 31 hotels are under the distress zone (91%) which signals that they are very likely to be bankrupt in the very near future. Further, the findings posit that the rest of 9% of the Sri Lankan hotels are financially safe and none were recorded under the gray zone.

Figure 1 - Overall Sustainability of Hotels



Source: Survey Data

Fig.1. Overall Sustainability of Hotels

Figure 1 illustrates the overall sustainability standing of hotels in Sri Lanka based on their yearly average Z value. Moreover, the graph depicts that, within the survey period the hotels (Overall phenomenon) have not been in the safe zone. The highest Z value recorded by the hotels during the survey period is 1.97 in 2017, and notably it was under gray zone. Initially also, in 2015, hotels have been operating in the gray zone with a Z value of 1.90. However, the study found a significant declination in 2016, recording a Z value of 1.63. As a result, the Sri Lankan hotels have again fallen into the distress zone. During 2016-2017 Sri Lanka had a hope for a growth in hotels since the Z value trend has been robustly increasing. However, from 2018, consecutive declination of Z value was recorded which leads the hotels to a danger zone. If this trend continues, without any positive interventions of the government and the management, the Sri Lankan hotels will be stagnated or collapsed.

V. Discussion

The study found that all the hotels are in the distress zone, except ASHP04, BRBH07 and FORH30. About 94% of the entire hotels remained in the same zone while 6% of the hotels changed their zones within the time period under consideration (2015-2019). The hotels like ANHP03, CEHC08, CILH09 and PAGH22 got Z score value below 0.1. Furthermore, 12.9% of the hotels in the distress zone have high propensity of being bankrupt. HNKH18 which is in the distress zone takes the nearest average Z score value of 1.80 to the gray zone. Thus, the respective management of the hotels should take corrective actions to make the hotels appear in the gray zone. The above is made possible since the retained earnings of HNKH18 have been nil over the past five years, and the management can raise the sustainability standing simply by increasing the retained earnings.

HNKH18 was the only hotel that was in the gray zone in 2015. However, it got shifted to the safe zone in 2016 with Z score value of 4.03. Moreover, after 2016, consecutively for three years (2017-2019) Z score value trend is declining and, Z score

value of 0.17 was recorded in 2019. As a result, from the average Z score values none of the hotels have fallen to the gray zone over the past five-years. Although, the ASHP04 and FORH30 were in the safe zone, their Z scores were gradually decreasing over the last five-year. BRBH07 has been in the safe zone from 2015 to 2018, however, the Z score value dropped to 0.17 leading the company to the distress zone. Finally, the study found that sustainability of the Sri Lankan hotels will become questionable and most of the hotels will lose their going concern in the very near future.

VI. Conclusion

The current study empirically proved that the propensity of being bankrupt is very high in the Sri Lankan tourism industry. Further, the study concludes that 31 Sri Lankan hotels are in the distress zone, while three are in the safer zone and none are in the gray zone. Thus, it is concluded that 91% of the Sri Lankan hotels are in danger of losing sustainability in the foreseeable future indicating a warning through Altman's original Z score model to the stakeholders. The study, further suggests the prospective researchers to explore on how to overcome the issues in hand.

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