THE ECONOMIC CRISIS DOES NOT INFLUENCE PRICING STRATEGIES OF SPANISH LUXURY HOTELS

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1. The situation in Spain after the fall of Lehman Brothers

The year 2007 and the fall of the US-investment bank Lehman Brothers is generally considered to mark the beginning of a global financial crisis. It started with a liquidity crisis in the banking system resulting from the sale of complexly structured financial products based on lower-quality subprime mortgages. In the beginning, the subprime crisis did not reach Spain because of the structure of its banking system. Spanish banks are mostly retail banks relying on a large number of domestic customers. Thus, its banks had abstained from purchasing structured mortgage products. However, during the crisis, the Spanish economy suffered, due to its side effects, namely, the lack of liquidity in the global banking system, the changing perception of risk, the deterioration of the housing markets (in the US but also severely in Spain) and the subsequent global recession.[1] In particular, the altered perception of risk and reduced lending led to tumbling house prices, which translated into layoffs in the construction industry that continue until today. The Spanish construction industry contributed 12 % to GNP in 2007 and 2008, a number that fell to 10 % in 2010.[2] Within Europe, Spain was one of the countries that suffered most from the crisis, due to its severe housing bubble.[3]

The rise in unemployment further aggravated the difficult situation of the Spanish economy.[4] The crisis affected the tourism sector when unemployed people reduced their spending. Spanish hotels rely heavily on domestic tourism for business and leisure. In 2009, 58% of all hotel overnight stays were Spanish residents, a percentage that has remained stable over the past several decades.[5] International and domestic tourism contributes significantly to the national income.[6] However, due to the recession following the 2008 financial crisis, international tourism to Spain declined, and spending by international as well as domestic tourists deteriorated.[7]

2. Why should a luxury hotel's pricing strategy be affected by an economic crisis?

Pricing strategies can be classified as either strategic (long-term orientation) or tactical (short-term).[8] Hotels are large scale investments with fixed capacities (number of rooms) that cannot be altered in the short term. They have a high degree of fixed costs and cannot change their location in order to benefit from better economic conditions elsewhere. Neither can their service be stored, nor can they rely on exporting it to other countries that are not hit by a crisis.[9] Since they possess inflexible, location-bound capabilities, they find it difficult to adjust to a changed environment.[10] Thus, they have to detect unused capacities and react tactically, i.e. by offering last-minute rebates.

1 Alvarez, J. A. (2008): La banca española ante la actual crisis financiera, In: Revista de estabilidad financiera, 13, p. 23-28.

2 Instituto Nacional de Estadística (2013): Inebase, Contabilidad Nacional de España; Producto interior bruto a precios de mercado y sus componentes, http://www.ine.es/inebmenu/indice.htm

3 Alvarez, J. A. (2008): La banca española ante la actual crisis financiera, „Revista de estabilidad financiera", 13, p. 23-28. Taylor, J. B. (2009): The financial crisis and the policy responses: an empiric analysis of what went wrong: NBER Working Paper 14631, Cambridge, MA: National Bureau of Economic Research.

4 OECD (2009): Overcoming challenges in employment, housing and education would help put Spain back on the road to recovery. OECD Observer, 270/271, p. 79-80.

5 Instituto de Estudios Turísticos (2010): Familitur Informe Annual 009. Movimientos turísticos de los españoles (Familitur), Madrid.

6 Instituto de Estudios Turísticos (2011). Balance del Turismo. Año 2010; Instituto Nacional de Estadística (2010). Contabilidad Regional de España. Base 2000.

7 Instituto de Estudios Turísticos (2010). Frontur y Egatur: Año 2009.

8 Freyer, W. (2009): Tourismus-Marketing. Marktorientiertes Management im Mikro- und Makrobereich der Tourismuswirtschaft. 6th ed., Munich.

9 Meffert, H.; Bruhn, M. (2006): Dienstleistungsmarketing. Grundlagen - Konzepte – Methoden. 5th ed., Wiesbaden.

10 Lee, S.-H.; Beamish, P. W.; Lee, H.-U.; and Park, J.-H. (2009): Strategic choice during economic crisis: Domestic market position, organizational capabilities and export flexibility. In: JWB, 44, pp. 1-15.

Kimes[11] points out the difficulties in maintaining price positioning during the 2008 financial crisis. Hotels had to rely on various price and non-price strategies in order to keep income stable. Price strategies included bundling of services (i.e. overnight stay + spa treatment), unbundling of rooms (i.e. list a charge for the room only and charge amenities separately), use of opaque distribution channels (i.e. discounts for internet offers) as well as offering targeted rate cuts to specific market segments (i.e. special company rates, special rates for local residents). As a result of the crisis, revenue managers reported an overall decline in revenues. Research of previous economic crises indicates that hotels suffer from the identical negative impacts, regardless of their positioning or location.[12]

Williams and Spencer[13] researched the impact of the 2008 financial crisis on the tourism industry of Jamaica. They concluded that even though advertising campaigns and increased marketing efforts were launched by the government, the biggest effect came from the subsequent devaluation that made travel to Jamaica cheaper for tourists from hard-currency countries. Therefore, costs for the individual tourist, reflected in prices, are the only issue that matters in order to influence demand after a crisis. This finding is in line with research undertaken by **De Sausmarez**.[14] She analyzed the response to the Asian financial crisis by the Malaysian government and the Malaysian tourism industries. In Malaysia, efforts were aimed at increasing domestic as well as international demand. Domestic tourists were attracted to city hotels by special weekend packages. Hotels bundled several services together to offer a bargain. All these sources indicate that a crisis should be reflected in a hotel's pricing strategy.

3. Why should a luxury hotel's pricing strategy not be affected by an economic crisis?

Luxury hotels are positioned in the premium segment which is reflected in their pricing. They offer a superior service at a higher price. The pricing is part of their value proposition and a change in pricing will negatively affect the value perceived by the client. Thus, price wars are scarce in luxury segments or luxury industries.[15] Since the price forms an important element of the luxury hotel's value proposition, competition takes place on the service level. Thus, a luxury hotel's demand reacts with inelasticity to price changes. This is due to certain special effects that influence price-sensitivity of demand. The "unique value effect" states that price-sensitivity of demand falls the more exclusive the product offered is. A second effect is the "price-quality" effect. It states that a high price for complex products reflects higher quality in the eyes of the consumer. Also of importance for luxury hotels is the "business expenditure" effect that describes the decreased price-sensitivity of business travelers (since their costs are borne by the company). The last effect characterizing price-elasticity of demand in the luxury hotel segment is the "sunk investment effect". It means that customers are willing to pay more for the service if they know that the hotel has already adapted to their needs (i.e. special service needs in the case of business events).[16] In combination, these effects enable luxury hotels to keep their prices constant even in crisis situations.

A survey undertaken for the Leading Hotels of the World Group by **Barsky**[17] indicates that a

11 Kimes, S. E. (2009): Hotel revenue Management in an Economic Downturn: Results of an International Study (No. 12). Ithaca, NY 14853: Cornell University - School of Hotel Administration (from www.chr.cornell.edu).

12 Okumus, F.; Karamustafa, K. (2005): Impact of an economic crisis: Evidence from Turkey. In: Ann. Tour. Res., 32(4), pp. 942-961.

13 Williams, D. A.; Spencer, A.(2010): Advertising and Tourist Arrivals: Evidence from Jamaica. In: THR, 10(4), pp. 359-366.

14 Sausmarez, N. de (2004).Malaysia's response to the Asian financial crisis. In: Journal of Travel & Tourism Marketing 15, pp. 217–231

15 Simon, H.; Fassnacht, M. (2009): Preismanagement, 3rd ed., Wiesbaden.

16 Kotler, P.; Bowen, J.; and Makens, J. (2010). Marketing for hospitality and tourism, 5th ed., New Jersey.

17 Barsky, J. (2009). Luxury hotels and recession: a view from around the world. CA: Market Metrix.

recession affects luxury hotels less than hotels belonging to other categories. Luxury travelers are more prone to changing their destination before choosing a lower class accommodation. In addition, a prior investigation by the same author reached a similar conclusion. **Barsky and Nash**[18] state that worldwide, during the 2008 recession following the financial crisis, branded luxury hotels were more able to maintain their prices than other hotels. This may be because their target group (high net worth individuals) continued to grow despite the crisis.[19] The findings in a study by **Taylor and Enz**[20] confirm this research. In a survey of the responses of general managers to the attacks of September 11th, 2001 in the US, the authors note that high-quality, high-end hotels are less likely to cut prices in response to a crisis but instead increase and redirect marketing efforts and cut costs by laying off employees or reducing their hours worked to stay profitable. In addition, seasonality and inflation impact pricing strategies much more than sporadic critical events. Even though these results have been researched after a crisis resulting from a terrorist attack, the consequences can still be transferred to an economic crisis. **Henderson**[21] distinguishes between six different types of crises affecting the tourism industry: economic, political, socio-cultural, environmental, technological or commercial crises that are caused by either external or internal factors or both. Although they cannot be stopped, their impacts are very similar and can be limited by effective crisis management. Thus, findings from literature researching i.e. terrorist attacks can be related to those researching economic crisis. All the above describe authors conclude that a financial crisis should have no impact on the pricing strategies of luxury hotels.

18 Barsky, J.; Nash, L. (2008).Are luxury hotels recession proof? In: HMM, (June), p. 14.

19 Capgemini& Merrill Lynch Wealth Management (2011). World Wealth Report, http://www.ml.com/media/114235.pdf

20 Taylor, M. S.; Enz, C. A. (2002). Voices from the Field: GM's Responses to the Events of September 11, 2001. In: CHRAQ, (1), pp. 7-20.

21 Henderson, J. C. (2007). Tourism Crises: Causes, Consequences and Management. Oxford: Butterworth-Heinemann.

4. How did different Spanish luxury hotels react to the economic crisis?

Given the importance of tourism for Spain, an exploratory case study was conducted in order to detect an impact (if any) of the financial crisis on three Spanish luxury hotels: the Ritz in Madrid, a superior destination for business clients, the Kempinski Bahía Marbella Estepona on the Costa del Sol and the Hotel Botanico& The Oriental Spa Garden on Canary Islands, dedicated to holiday tourism. All hotels are located in regions that are highly valued by foreign and domestic tourists alike.[22] Additionally, statistics show that luxury hotels were hardest hit by the financial crisis in Spain. In 2009, revenue per available room (RevPAR) and average daily rate (ADR) declined most in the 5* segment, occupancy fell to 43.3 %.[23]

The study was conducted between July 29th 2009 and July 28th 2010. For one year following the financial crisis, prices quoted for standard rooms were noted. Quotations were asked for three different periods: same night, in a fortnight, in a month. All quotations were taken from internet search engines. Different patterns were detected when analyzing the data. On the one hand, during certain seasons prices at the Ritz and the Kempinski fell if the arrival date was in the future (i.e. indication of special rebates for early booking – a tactical pricing strategy). On the other hand, prices in all three hotels rose prior to special events (i.e. indication of tactical pricing). In addition, patterns were found that indicate seasonal pricing (high season – low season).

22 Instituto de Estudios Turísticos (2010):Frontur / Egatur Informe anual 2009. Movimientos turísticos en fronteras (Frontur) / Encuesta de gasto turístico (Egatur), Madrid; Instituto de Estudios Turísticos (2010):Familitur Informe Annual 009. Movimientos turísticos de los españoles (Familitur), Madrid.

23 Instituto Nacional de Estadística de España: Encuesta de ocupación hotelera 2009. Datos Nacionales por categorías. Oferta. Grado de ocupación por plazas y por categoría y meses. Cinco estrellas de oro; Instituto Nacional de Estadística de España: Encuesta de ocupación en alojamientos turísticos. Indicadores de Rentabilidaddel Sector Hotelero.

Apart from price variations, the Ritz as well as the Kempinski layed off workers; also both hotels were closed (or fully booked)[24] for several weeks during the low season – a strategy described by **Kimes**[25] as frequently being used in the luxury hotel segment in order to reduce costs. Whereas the Ritz increased prices overall by 2 € over the period investigated (price range from 185 € – 572 €, increase amounting to less than 1%), the Kempinski reduced them by 27 € (price range between 188 € and 530 €, decrease between 5 and 15%) and the Botánico by approximately 4 € (prices ranging from 168 € and 280 €, decrease of maximum 2 %).

5. Can an influence of the financial crisis be detected?

Obviously, given the small sample size and the limited observation period, the conclusions can only be exploratory. The data from the three hotels show that all hotels seem to employ seasonal pricing as well as – to a certain degree – rebates for early bookings. Whereas the two holiday hotels decreased prices over the period observed, the business hotel increased prices. This could indicate different price sensitivity of tourists and business travelers. However, an observation of the competitive structure in the certain regions show, that for the time period observed, competition in Madrid and the Canaries increased (new hotels opened), whereas it decreased in Costa del Sol (hotel closures in the luxury segment).[26] The prices of the luxury hotels do not reflect the changed competitive situation.

Looking at the data, it seems that the economic crisis does not in the short term affect pricing strategies of the observed Spanish luxury hotels. Other factors apparently have a larger influence on pricing strategies. Those could be for instance ownership structure (chain vs. privately owned), client structure (business vs. holiday) or yield management strategies. Additionally, as observed by other researchers, it might be that before luxury hotels change their pricing they would rather rely on other strategies, cost reductions through closure periods, lay-offs, outsourcing or the like. They could also simply hide the price changes they undertook. If prices are only lowered for contracted rates, those changes would not show in the sample researched.

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24 Pricing data were collected from internet booking engines. Thus, no distinction can be made between time periods where the hotel is fully booked or closed. Both periods appear in the booking engine as "not available".

25 Kimes, S. E. (2009): Hotel revenue Management in an Economic Downturn: Results of an International Study (No. 12). Ithaca, NY 14853: Cornell University - School of Hotel Administration (from www.chr.cornell.edu).

26 Instituto Nacional de Estadística de España: Encuesta de ocupación hotelera 2008/2009/2010. Datos por Comunidades Autónomas y Total Nacional. Oferta. Establecimientos abiertos estimados por comunidades autónomas, categoría y meses. Cincoestrellas de oro.