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## Research paper

## Role of tourism price in attracting international tourists: The case of Japanese inbound tourism from South Korea

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## ABSTRACT

Tourism price has been extensively used to predict tourism demand. However, there is no agreement on the proper indicators of its components. Use of different price indicators may be the reason for researchers' apparently inconsistent results. The purpose of this study was to identify proper price indicators for the demand model of Japanese inbound tourism from South Korea. After comparing six models, each with different price indicators, the model with relative price and exchange rate but without transport cost was identified as the best model in which relative price, exchange rate, and per capita income were found to be significant.

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## 1. Introduction

International tourism has experienced sustained expansion over the past six decades, substantially contributing to the world economy. International tourist arrivals reached the unprecedented milestone of 1 billion in 2013 and generated US\$476 billion in expenditures (World Tourism Organization, 2014). Accordingly, many researchers have conducted studies on international tourism flows and their major determinants (Carey, 1991; Chatziantoniou, Filis, Eeckels, & Apostolakis, 2013; De Vita & Kyaw, 2013; Garín-Muñoz, 2006; Law, Goh, & Pine, 2004; Lee, 1996; Wang, 2009).

Tourism demand forecasting is important for effective use of limited resources in both private and public sectors (Lee, Var, & Blaine, 1996; Song & Witt, 2006). Since many tourism products such as airline seats and hotel rooms are perishable, efficient planning based on accurate estimation of demand is critical for successful tourism businesses. An inability to meet demand often leads to business failure in the tourism industry (Song & Witt, 2006). For the public sector, tourism forecasting provides a basis for planning investments in tourism infrastructure such as airports and highways (Lee, Song, & Mjelde, 2008). Since such large-scale infrastructure projects require considerable public funds over the long term, the expected return on investment (ROI) should be spelled out in the planning stages, and ROI is in large part

determined by forecasting tourism demand. Accordingly, accurate demand estimation is essential when appraising investment plans' economic feasibility (Song & Witt, 2006).

Recognizing the importance of tourism demand forecasting, the econometric approach has been widely adopted to predict tourism demand (Song & Li, 2008). In econometric studies of tourism demand, per capita income, tourism price, promotional efforts, and external shocks have been identified as important determinants of tourism demand (Li, Song, & Witt, 2005; Lim, 1999; Song & Li, 2008). However, results regarding the effects of price variables (e.g. relative prices, exchange rates, transport cost) on international tourism demand vary widely. Some inconsistent results may be attributable to use of different variables as a proxy for the same tourism price factor. This inconsistent use of price variables suggests that more research needs to be done to identify the price variables that best represent international tourism price.

Given that previous empirical studies yielding the inconclusive results on price effect have been conducted in the context of different countries, proper price variables may be different from destination to destination. Indeed, tourists' responses to changes in explanatory variables are country-specific and therefore the variables' elasticity varies by destinations (Crouch, 1995; Dwyer, Forsyth, & Rao, 2000; Gil-Pareja, Llorca-Vivero, & Martínez-Serrano, 2007). Moreover, recent changes in economic circumstances such as currency depreciation resulting from unconventional monetary policy (US, Eurozone, Japan), shifts in exchange rate policy (Switzerland, Singapore, China), and drastic drops in oil

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prices triggered by expanded supplies of shale gas may substantially influence the cost of travel to the countries changing international tourism demand. Thus, choosing the proper price variables for the tourist destinations examined could be critical to the accurate estimation of tourism demand for those destinations.

The aim of this study is to address the selection of proper tourism price variables in identifying underlying factors in tourism demand model. Specifically, this study estimates and compares several demand models of Japanese inbound tourism from South Korea (hereafter Korea), each of which includes different price variables. Japanese inbound tourism from Korea was chosen for the following reasons: (1) Korea is the largest tourism market for Japan; and (2) price variables have a clear effect on tourism demand, as shown by the fact that the Japanese yen (JPY) has depreciated against the Korean won (KRW) from the fourth quarter of 2011 to the third quarter of 2014. The findings of this study contribute to a better understanding of price variables when forecasting international tourism demand for a specific country. In addition, because the Japanese government intends to increase its annual tourist arrivals to 20 million by 2020 when Japan hosts the Tokyo Olympics (Ong, 2014), identifying determinants of tourism demand for Japan is of great importance for both policymakers and tourism practitioners.

## 2. Literature review

Tourism demand studies fall into two categories: qualitative and quantitative (Peng, Song, & Witt, 2012). Quantitative demand studies are dominant in the tourism demand literature (Song & Turner, 2006) and two forecasting approaches are the most commonly used: time-series and econometric (Song & Li, 2008). The time-series approach is useful in that estimation procedures are relatively simple and only one data series is needed for estimation (Peng et al., 2012). In this approach, demand forecasting is performed by analyzing the patterns of past demand movements and then, from that, predicting future movements (Song & Li, 2008). On the other hand, the econometric approach predicts tourism demand based on the causal relationship between dependent (e.g. tourists) and explanatory (e.g. income) variables with sound theoretical basis (Peng et al., 2012). The empirical usefulness of this approach lies in identifying which factors contribute most to tourism demand (Lee et al., 1996; Song, Witt, and Li, 2009).

### 2.1. Price factors affecting international tourism demand

In econometric tourism demand studies, several economic factors have been found to be significant determinants of international tourism demand (Prideaux, 2005). Based on classic economic demand theory (i.e. the higher the prices of goods and services, the lower the demand for those products), tourism price has been commonly used in demand models as a primary determinant (Hui & Yuen, 1998; Uzama, 2009). According to Crouch (1994), Witt and Witt (1995), and Webber (2001), tourism price consists of living cost plus transport cost. Living cost, in turn, has two components: prices of tourism goods and services in the destination country and exchange rates.

In general, prices of tourism goods and services have a negative relationship with tourism demand. The relationship may be sensitive to changes in domestic tourism prices in the origin country and therefore many demand models include prices of destination tourism products relative to the origin country in order to consider the cross-price effect (Loeb, 1982; Tan, McCahon, & Miller, 2002). Because price information of tourism goods and services is generally unavailable, consumer price index (CPI) has commonly been used as a proxy for relative prices (Akis, 1998; Lee, 1996; Morley,

1994; Muchpondwa & Pumhidzai, 2011). Furthermore, actual prices of a destination's tourism products have not been found to be clearly superior to CPI in accounting for tourism demand (Martin and Witt, 1988). Although CPI is most commonly used for relative prices (Akis, 1998), Gil-Pareja et al. (2007) included purchasing power parity in their demand model instead of CPI and Garín-Muñoz (2006) developed her own tourism price index.

Many studies have proved that tourism demand is significantly responsive to changes in relative prices (Eilat & Einav, 2004; Hiemstra & Wong, 2002; Patsouratis, Frangouli, & Anastasopoulos, 2005; Qu & Lam, 1997; Webber, 2001). For example, Webber (2001) identified the determinants of tourism demand for Australia in eight tourism markets using Engle and Granger's procedure and Johansen's procedure. The results showed that relative prices had a significantly negative effect on tourist arrivals from six of the eight countries, all but Malaysia and the U.K. Hiemstra and Wong (2002) investigated the outbound tourism from seven major countries to Hong Kong between 1990 and 1998. In the study, autoregressive estimation was employed for seven tourism demand models and relative prices were included only in the demand model for Australia–Hong Kong. The results of the study provided clear evidence of a significant effect of relative prices on tourist arrivals from Australia to Hong Kong. On the other hand, Muchpondwa and Pimhidzai (2011) found no link between relative prices and tourism demand. Lee et al. (1996) showed that the significant effects of relative prices on international tourism demand varied depending on the origin country to country indicating mixed results.

Exchange rates, the other indicator of living cost, have also been frequently examined in tourism demand studies (e.g., De Vita & Kyaw, 2013; Di Matteo & Di Matteo, 1996; Dritsakis & Gialitaki, 2004; Edward, 1995; Wang, 2009; Yap, 2011). When the currency of a country devalues, its tourism becomes more price competitive and therefore travel demand for the country is likely to increase (De Vita & Kyaw, 2013). Conversely, as the value of a country's currency rises, the decreased price competitiveness of its tourism results in a reduction in inbound tourism (De Vita, 2014). However, this view has not always been borne out in international tourism markets. Some researchers (e.g. Di Matteo & Di Matteo, 1996; Eilat & Einav, 2004; Hiemstra & Wong, 2002; Roselló-Villalonga, Aguiló-Pérez, & Riera, 2005; Wang, 2009) have found evidence that exchange rates have a significant effect on tourism demand, while others (e.g. Hui & Yuen, 1998; Muchpondwa, Pimhidzai, 2011; Webber, 2001) failed to find such evidence. In addition, Lee (1996) developed several demand models for inbound tourism to Korea and the results of exchange rate were inconsistent. These results indicate that the effects of exchange rates are asymmetric across countries and even across different markets in a single country.

It has generally been held that relative prices and exchange rates should be considered in tourism demand models, but it remains controversial whether these two components of living cost should be examined separately or combined as effective relative prices (Durberry and Sinclair, 2003; Gray, 1966; Tan et al., 2002). According to Song and Witt (2000), price changes in a destination country can be calibrated by movements in exchange rate. Therefore, the destination price level that potential foreign tourists pay attention to is relative prices adjusted by exchange rates. Based on this argument, many researchers (e.g. Chang, Khamkaew, & McAleer, 2010; Divisekera, 2003; Garín-Muñoz, 2006; Kliman, 1981) convert relative prices into the currency of an origin country in tourism demand equations. Numerous studies (e.g. De Vita, 2014; Divisekera, 2003; Durberry & Sinclair, 2003; Hiemstra & Wong, 2002) have argued for the significance of effective relative prices. Tan et al. (2002) concluded that effective relative prices were a better measure of living costs for Malaysian and Indonesian tourism. In contrast, Eilat and Einav (2004) and O'Hagan and

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