



Privatization, market competition, international attractiveness, management tenure and hotel performance: Evidence from Slovenia

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ABSTRACT

This paper tests several hypothesis related to the impact of privatization, market competition, management tenure and international attractiveness on the cost efficiency of tourist hotels. We measure efficiency using the innovative Bayesian frontier methodology. The data involve a sample of Slovenian hotels which operate in a highly dynamic environment. From the results, it is clear that hotel efficiency is positively related to privatization and international attractiveness, and negatively related to longer management tenure. No significant link, on the other hand, is found between market competition and hotel efficiency. Further discussions of these findings and related managerial implications are provided.

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1. Introduction

The hospitality industry of recent years is often described as competitive, global and technologically driven. It is common today to find international hotel brands and local hotels competing fiercely for a slice in a market pie that rarely varies in size and often saturated. The competition problem even worsened with the current economic crisis which affected consumer confidence and led to a sharp decline in occupancy and capital investments. At the strategic level, hotels have now little alternatives but to consider cut in prices, more focused promotion, customer loyalty schemes and bundling. While consumers are the main beneficiary of such situation, hotels have to survive higher operational expenses/fixed assets and lower revenues and profit.

In the literature, it is well established that within a fierce market competition and low profit margin, performance improvements and cost containments become necessary (Ros, 1999). Several recent studies (Barros and Alves, 2004; Sigala et al., 2004; Barros, 2005) have reinforced the need for high performance in the hotel industry. Most of the recent studies have also focused on elevating the level of accuracy in modeling the performance of hotels, mainly by introducing more robust performance methodologies such as the data envelopment analysis (DEA) or stochastic frontier (SF) methods. Some examples of DEA and SF studies now cover several key international hotel industries including Taiwan, the UK, the

US, Portugal and Australia. Traditionally, studies on hotel performance have adapted the simple ratio approach, which in contrast to the DEA and SF methods, is unable to account for the multiple input/output complexities of hotel operations.

In the present paper, we aim to introduce a further extension to the existing literature by offering more accurate insights into the performance determinants of hotels. Most existing studies in the literature tend to focus on the estimation of efficiency without providing an in-depth analysis into the factors that explain the source of variations in hotel efficiency. The sole focus on efficiency makes the study limited to one sample or one geographic area of analysis. The methodology used in this study also provides an innovation to the existing literature. We introduce the Bayesian methodology which has several advantages over the maximum likelihood (ML), traditionally used to estimate the SF approach. For instance a key advantage of the Bayesian approach is that it allows the inclusion of “prior” information about parameters in inferences. With Bayesian, the results are also usually presented in terms of probability density function (pdfs), making it thus possible to make probability statements about the parameters, hypotheses and models.

In testing our hypotheses we use a sample of Slovenian hotels. There are several interesting characteristics of the Slovenian hotel industry that allow us to test our desired hypotheses. The country is known for its rich tourism history and quickly developing hospitality industry. On average, the tourism generates around 5.5 percent of the country GDP and 4.8 percent of the employment (Zagoršek et al., 2008). The hospitality industry became an important economic driver, especially post the privatization period when new private owners initiated major operational investments. With Slovenian entrance to the European Union (EU) in the year 2004, the hospitality industry also gained access to EU funds for financing

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infrastructural projects in the tourism industry. In the next section, we provide a more detailed overview of the Slovenian hotel industry. This is followed by the literature review, methodology, data characteristics/hypotheses, results, discussions and concluding remarks.

2. The Slovenian hotel industry

Slovenia is an Alpine and Mediterranean country located in the North-East of the Adriatic Sea. It has a wide variety of tourism products such as mountain tourism, ski tourism, sun and beach, spa tourism, city and cultural tourism, rural tourism and gambling. The country is small (2 million inhabitants) and receives around 2.8 million visitors per year, with 64 percent being foreigners (SORS, 2009). Slovenian tourism is one of the most important sectors of the national economy. In 2006, the tourism GDP reached EUR 1679 m, representing 5.5 percent of total national GDP (Zagoršek et al., 2008).

The country's total hotel capacity is about 33,000 beds, with more than half (55 percent) of the capacity is spread around the seaside and mountain resorts. The average hotel size is about 170 beds or 80 rooms (SORS, 2009; Slovenian Chamber of Commerce, 2009). The average yearly hotel occupancy rate is around 50 percent (SORS, 2009) and is below the EU 15 average, which is around 60 percent (Eurostat, 2009).

The hospitality industry in this country witnessed an important restructuring since the completion of the privatization process in the year 2000, when new owners, mainly domestic companies started to invest in the refurbishment of rooms and the development of new products such as conference and wellness or thermal facilities. Following Slovenia's entry to the European Union (EU) in 2004, tourism firms also earned access to EU funding programs (primarily structural and cohesion funds) through the European Regional Development Fund. In total, 96 infrastructural projects were funded, costing up to 97 million EUR. Since firms had to finance at least 50 percent of the investments from their own funds, the total value of tourism investments was around 357.5 million EUR (Ministry of Economy, 2009).

With those investments, hotel quality also improved significantly over time. Currently, more than 90 percent of all hotel properties in Slovenia operate at the three, four or five-star level (SORS, 2009). That being said, the Slovene hotel industry is still behind on several aspects, including brand recognition and internationalization (Konečnik, 2007). None of the newly established hotel chains, for instance, managed so far to develop an international hotel brand. Only few hotel companies invested outside Slovenia and only few foreign hotel chains are present in the Slovenian market. The industry also suffers from the skill shortage in middle and top managers (Sibila Lebe, 2009), probably due to the low wages and the absence of training programs. A recent negative trend includes the ongoing economic crisis which affected the average room price of several Slovenian hotels.

The Slovenian hotel industry is thus at an exciting developing stage. Investors have financed their investments in most cases from debts in order to improve their properties, and currently, they are watching closely their occupancy, average room rate, and returns on investments. At the government level, more aggressive strategies are also being formulated to provide further competitive advantages to the sector. In the last few years, the government launched a program for knowledge improvement schemes in the hospitality industry. In the field of marketing, two strategic documents were developed, focusing on improving the hotel guest's satisfaction, and on introducing the "Customer Relationship Management" scheme. The government also prepared a manual for the development of efficient environmental practices in hotels. The last

document launched in 2009 provided a framework for measuring the performance of Slovenian hotels based on the triple bottom line approach.

3. Literature overview

The modern literature on the performance measurement of hotels has focused on the use of multi-inputs and outputs methodologies such as the DEA and SF methods. Both these methods measure the efficiency of a particular firm by assessing its distance from a frontier technology of best practices (i.e. a frontier that represents fully efficient firms). The literature on the DEA method is significantly larger. Some leading studies include Bell and Morey (1995), Morey and Dittman (1995), Brown and Ragsdale (2002), Hwang and Chang (2003), Reynolds (2003), Barros and Alves (2004), Sigala et al. (2004), Barros (2005), Chiang et al. (2004), Barros and Mascarenhas (2005), Wang et al. (2006a,b), Reynolds and Thomson (2007), Yu and Lee (2009), Barros and Dieke (2008) and Barros et al. (2009). However, there are fewer papers in the existing body of literature that used the SF method. This is despite its known statistical advantage over the DEA method.

In fact, while the SF method is a statistical method, DEA measures efficiency using linear programming techniques, and thus has no account for measurement error. This is sometimes problematic seeing that measurement errors and uncertainty are common in observed data. Some examples of SF studies in the hotel literature include Anderson et al. (1999), Anderson and Fok (1999) who estimated the managerial efficiency of U.S. hotels, Barros (2004, 2006) who employed the same method on a sample of Portuguese hotels, and Chen (2007) who employed the SF method to measure the efficiency of Taiwanese hotels.

Several recent studies have provided a more comprehensive review on the modern efficiency studies in the area (Barros and Dieke, 2008; Hu et al., 2010; Barros et al., 2009), and thus we do not intend to reiterate these reviews here. However, a clear trend that can be noticed is the lack of published papers that analyze the efficiency of hotels with the use of the Bayesian approach. Most studies have also adapted the DEA method which suffers from statistical limitations. More importantly, the focus of the present literature is on the efficiency analysis of the hotel industry without providing an in-depth analysis into the factors that lead to efficiency variations between each individual hotel. In the next sections we provide more details about the methodology and data collected.

4. Methodology: the Bayesian stochastic frontier model

In this study, we follow the stochastic frontier method to test our desired hypotheses. The original literature on this method appeared in several studies and thus we do not intend to reiterate it here (for more details see Coelli et al., 2005). The model can be simply expressed as follows:

$$y_{it} = \beta_0 + x'_{it}\beta + u_{it} + v_{it}, \quad i = 1, \dots, N, \quad t = 1, \dots, T \quad (1)$$

y_{it} is the log of total cost of a particular hotel i at period t and x_i is a vector of $K \geq 1$ explanatory variables, β is a vector of coefficients, v_{it} is an i.i.d. Normal error term with mean zero and constant variance, assumed to be independent of u_i . Several distributions have been proposed for u_i , with the most common are the exponential, half normal, or truncated normal. The cost efficiency r of the i th club can be expressed as $r_i = \exp(-u_i)$, $0 \leq r \leq 1$.

The methodological innovation of this paper is that it adopts the Bayesian methodology to estimate the model in (1), while all previous studies in the area have followed the maximum likelihood approach. The main advantage of the Bayesian approach over the maximum likelihood method is that it allows the inclusion of

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