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Low-cost travel and tourism expenditures

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ABSTRACT

Tourists' perception of saving money with the cheaper air fares offered by low-cost carriers may encourage them to spend more money at their destinations. This paper aims to test the following hypothesis: "Low-cost travel savings from tourists' place of origin are transferred, at least partially, to higher tourism expenditures at the destination". A system of simultaneous equations is estimated using the 3SLS method, distinguishing between tourism expenditure at the origin and at the destination. The methodology may be applied to any destination and for different policy assessments. The results for the case of Canary Islands show that the hypothesis holds for most tourist profiles, with savings-transfer ratios that range between 10.3% and 46.1%.

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Introduction

One key to success in the tourism sector as an economic growth generator is the capacity to provide added value. Amongst other aspects, tourism expenditures are an essential factor to measure the gross added value of tourism destinations. However, tourism expenditures are disbursed not only at the destination but also in the country of residence. This decomposition is not trivial in terms of added value. For instance, tour operators located at origin provide an open door for channelling tourists while also, as deserved, detracting from part of the destination's potential added value. Generally speaking, the result of the negotiations between tour operators and hotel management determines the share of the added value between the origin country and the destination.

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Arguments against empowering tour operators are usually stated by both hotel managers and local government.

Nevertheless, the structure of the tourism market has changed and continues to change dramatically. Traditionally, most tourists opted for comprehensive packages, which were paid for through travel agencies. The advent of Internet has shortened the 'distance' between origins and destinations, which has opened up new alternatives to tourists, allowing for more customised services. There has been a shift towards breaking down tourism packages so that travel, accommodation, meals, and excursions can be booked separately. Under this new market structure, tourism service products can be distributed either by direct sales on the Internet or by cheaper Internet intermediaries.

It should be noted, however, that this success depends on tourists' confidence in the system. The production costs of tourist products arranged on the Internet are likely to decrease, which implies either lower prices and or higher profits, depending on market competition. In any event, lower prices increase consumer surplus and higher profits increase producer surplus, resulting in increased social welfare. Moreover, a lower price implies an increase in the number of tourists, even when that price decrease is homogeneous for all destinations. Hence because of either a higher number of tourists or higher profits, added value at the destination is expected to increase.

Controversial discussions have arisen concerning the convenience of the new market structure. Special attention has been focused on the presence of low-cost carriers (LCCs), which recently have increased as a result of this new situation. Tourism destination policymakers wonder about the consequences of this situation for the market overall and the best strategy for addressing those consequences, which are numerous. First, the presence of LCCs may attract new tourists to a destination because those tourists are able to afford to travel at lower prices. This competitiveness gain is more or less effective, depending on how alternative destinations cope with the situation. Second, the airline market is also affected by LCC entrance. Flagship companies are likely to lose market share and may even stop flying to the destination altogether. This development could affect the profile of the tourists at the destination. Such a market-share redistribution has an impact on tourism expenditures at the destination. Third, tourism budget constraints are distributed among travel, accommodation, meals and other expenditures. It is interesting to explore how the presence of LCCs may contribute to a redistribution of these budgets. Household savings from cheaper travel tickets may be transferred—either fully or partially—to higher tourism expenditures at the destination. The purpose of this paper is to test and quantify the following hypothesis:

Hypothesis. *Low-cost travel savings from tourists' place of origin are transferred, at least partially, to higher tourism expenditures at their destination.*

Testing this hypothesis is relevant to understanding one key impact that the presence of LCCs has on tourism markets. Quantifying this impact is relevant for policymaking, especially for understanding the degree of support that LCCs should receive from destinations. The current literature has focused on the traffic generated by LCCs and on market-share redistribution, but has not addressed the issue raised by this paper's hypothesis.

It should be noted that this paper develops a methodology that allows for determining expenditure differences among different tourist profiles. This methodology can be applied to multiple analyses, such as understanding expenditure differences by nationality, the purpose of the visit, activities undertaken or any type of variable that can describe tourist profiles of interest. More precisely, the definition of the tourist profiles in this paper is based on LCCs' tourists vs. non-LCCs' tourists, distinguishing the types of tourist packages and the categories of accommodation. To estimate these expenditure differences, an econometric analysis is carried out. That said, our econometric analysis cannot focus exclusively on tourism expenditures disbursed at the destination because to do so will bias the analysis by ignoring the expenditures disbursed at the origin. For that reason, the methodology is based on a simultaneous system of equations, which can simultaneously address expenditures at the origin and expenditures at the destination. Amongst the alternative methods of estimation considered, the method estimated by three-stages least squares (3SLS) has been chosen.

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