



# When demand drops and prices rise. Tourist packages in the Balearic Islands during the economic crisis<sup>☆</sup>



Joaquín Alegre<sup>1</sup>, Maria Sard<sup>\*</sup>

Department of Applied Economics, University of the Balearic Islands, Edificio Jovellanos-Campus UIB, Crta. Valldemossa Km. 7.5, 07122 Palma de Mallorca, Illes Balears, Spain

## HIGHLIGHTS

- Three price indexes of tourist packages have been applied.
- The reaction to the crisis of the tourist sector is analysed.
- The paper highlights the tour operators' market strategies during the crisis.

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## ABSTRACT

The aim of this paper is to analyse the effects of the crisis on the prices of package holidays to the Balearic Islands sold by a sample of British and German tour operators. Three alternative price indexes are calculated. The results show that tour operators have reacted by using market strategies other than pricing, aimed at boosting their revenue even though they do not push up the number of tourists, thus protecting the tour operators' financial yield.

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## 1. Introduction

The beginning of the current world economic crisis can be traced back to 2007, with the United States' subprime mortgage crisis. Due to economic globalization, what was initially a financial crisis turned into a world recession. Tourism has not remained unaffected by the crisis. According to the World Tourism Organization (UNWTO, 2010), the economic crisis resulted in a 4% drop in international tourist arrivals and a 6% decrease in international tourism revenues in 2009. Some initial analyses of the impact of the crisis on international tourism demand (Page, Song, & Wu, 2012; Papatheodorou, Rosselló, & Xiao, 2010; Ritchie, Amaya Molinar, & Frechtling, 2010; Smeral, 2009; Song & Lin, 2010) coincided in pointing toward a recovery in the number of international tourists in 2010. The UNWTO forecast a swift recovery in international

tourist arrivals for 2010 of between 3% and 4% and, in 2011, a growth of almost 5% could be observed in the volume of international tourism, consolidating the 2010 rebound (UNWTO, 2011).

However, although globally it can be said that there has been a recovery in international tourism demand, the negative effect of the crisis varies a great deal among regions and sub-regions. International tourism in advanced economies has been far more badly hit than in emerging ones (UNWTO & ILO, 2013, p. xii). This negative effect has also been less acute for regions with more diversified issuing markets to the detriment of those more dependent on Europe and North America (UNWTO & ILO, 2013).

Although not all European countries are in recession, most are still suffering from the effects of the crisis. Despite economic reforms and restructuring, there are high unemployment rates, low levels of consumption, cutbacks in family income and strong uncertainty about the value of family assets and future pensions. In such conditions, many households tend to forgo trips or else they opt for a different kind, leading not only to a drop in the tourism participation rate but also in tourism spending (Alegre, Mateo, & Pou, 2013; European Commission, 2013; Nigg, 2011; Reinhardt, 2011; Smeral, 2009).

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<sup>\*</sup> Corresponding author. Tel.: +34 971172785; fax: +34 971 172389.

E-mail addresses: [joaquin.alegre@uib.es](mailto:joaquin.alegre@uib.es) (J. Alegre), [maria.sard@uib.es](mailto:maria.sard@uib.es) (M. Sard).

<sup>1</sup> Tel.: +34 971 172826.

The negative effect of the current economic crisis on tourism demand has been analysed by different authors (Dwyer, Forsyth, Spurr, & Vanho, 2006; Page et al., 2012; Papatheodorou et al., 2010; Ritchie et al., 2010; Smeral, 2010; Song & Lin, 2010; Wang, 2014). However, little attention has been paid in relevant literature to pricing management by tour operators during the crisis. This paper tries to fill this gap by analysing the evolution of price indexes for a major tourist destination for European tourism. More specifically, the behaviour of these prices is analysed at one of the Mediterranean's leading sun and sand destinations, the Balearic Islands, focussing on the two main issuing countries for tourism there: Germany and the UK. In 2012, the Balearics received 10.3 million international tourists, 67% of whom were Germans or Britons (Conselleria de Turismo, 2013).

Despite the growth in non-package holidays, tourist packages are still fundamentally important holiday products for many destinations. One of the main consequences of the crisis is the increase in the number of tourists that book a package holiday. Specifically, according to the European Commission (Eurobarometer, 2009, 2013), in 2008, 16% of European tourists booked their travel fare or accommodation through a travel agency and 19% opted for a package holiday. In 2012, 33% of all European tourists went on at least one (non-all-inclusive) package holiday and 26% went on at least one all-inclusive holiday. At sun and sand destinations like the Balearics, package holidays continue to be the type of product with the highest demand. Indeed, in 2012, 66.6% of German tourists and 68.2% of British ones stayed at a Balearic hotel as part of a package holiday (Conselleria de Turismo, 2013).

In its capacity as an intermediary between tourism demand and supply, the tour operator sector has become a key element in management of the crisis, with a capacity to help minimize the damage and boost the recovery of the demand (Rosenthal & Pijnenburg, 1990; de Sausmarez, 2007). When faced with a drop in demand, tour operators might be expected to respond by cutting the prices of some of their holidays and promoting package holidays that are more attractive in price terms. Nonetheless, the role that prices play in a crisis situation is complicated. Smeral and Song (2013) claim that tourist behaviour is asymmetrical across the economic cycle, with possible variations in its price elasticities depending on the stage of the business cycle. Factors such as loss aversion, liquidity constraints, and varying expectations regarding income and job security might account for consumers' different sensitivities to price variations (Nicolau, 2008; Smeral & Song, 2013). Likewise, restructuring of consumption by households, particularly for precautionary reasons, can imply forgoing unnecessary goods, thus increasing consumers' insensitivity to price reductions (Smeral, 2009, 2010).

The European tour operator market is a controversial one (Aguiló, Alegre, & Sard, 2003). With mass tourism, large tour operator companies have been formed that are able to exert substantial market pressure, both in terms of the production process of holiday packages and in the final price structure of their products. Europe's leading tour operators are capable of exerting oligopsonistic pressure on producers of holiday packages, particularly the hotel sector, in order to bring down prices (Aguiló et al., 2003; Papatheodorou, 2003; Papatheodorou et al., 2010). In addition, given their relationship with travel agencies and their role as an agent in issuing markets, they have acquired a high level of oligopolistic power over the final demand, allowing them to charge prices above marginal costs (Aguiló et al., 2003). This market power should make it easier for tour operators to manage their holiday products, smoothing drops in demand.

The main objective of this study is to analyse the evolution of prices of holiday packages to the Balearics sold by major German and British tour operators during the crisis. The prices of tour

operator packages for different years can be obtained from their travel brochures, but it is impossible to track the evolution of prices for individual products due to the high volume and variety of packages. The alternative is to draw up some kind of index that summarizes this primary data. A relatively standard methodology can be used to meet this goal (Alegre, Cladera, & Sard, 2012; ILO et al., 2004). In this study, a decision was taken to build two types of indexes, taking a yearly timeframe as a reference: a hedonic price and chained Laspeyres index. With a hedonic price index, the evolution of prices can be monitored, neutralizing the effect of the variability of the packages' main characteristics. The hedonic price method relates the price of a package holiday to its characteristics and then estimates the evolution of prices for a uniform product (Triplett, 2004). Two versions were calculated for this kind of index: a direct fixed-base version, where the coefficients that capture the effect of the characteristics are held constant across the whole period, and a rolling chained version, where the coefficients vary across time. The chained Laspeyres index reflects the methodology habitually used for this kind of index, aggregating simple indexes for individual packages using the category of hotel, type of board and tourist resort as a basic way of classifying the package. Although most official statistics offices draw up Laspeyres indexes, hedonic indexes are beginning to be used for some specific products, like cars, computers or housing (Bover & Velilla, 2001; Hill, 2011). Two types of indexes were calculated because *a priori* they offer two different perspectives. Due to the way in which it was constructed, the hedonic price index offered an image of the evolution of prices under the assumption that the same uniform product was offered across time. The chained index, on the other hand, is sensitive to the products' changing characteristics, with the incorporation of modifications to the aggregate product in the price evolution (Alegre et al., 2012).

In addition to calculating the price indexes, this paper also reflects on tourism demand responses when faced with an economic crisis and the role played by tour operators in this context. For this reason, this article is not just limited to outlining the methodology and estimated results of the indexes. The following section analyses consumer responses to the current crisis. Following that, the macroeconomic context of the issuing markets under analysis (the German and British markets) is outlined. The third section analyses tour operator strategies, with particular reference to the European market and sun and sand segment, while the fourth section briefly explains the methodology used to construct the indexes. Lastly, the obtained results are analysed and the main conclusions presented. Due to difficulties in gathering information from the datasets for the prices and characteristics of the packages, the analysis was limited to up to 2010, although the results are not conditioned by this fact.

## 2. Tourism demand and the economic crisis

Research into the links between economic crises and tourism has focused on three main periods (Hall, 2010, 2013): the economic crisis in Western Europe and North America in the early 1980s (Bodson & Stafford, 1988; Boerjan & Vanhove, 1984; Ostrowski, 1985; World Tourism Organization, 1988); the late 90s recession (Akal, 2005; Henderson, 1999a, 1999b; Hing, McCabe, Lewis, & Leiper, 1998; Leiper & Hing, 1998; Okumus, Altinay, & Arasli, 2005; Okumus & Karamustafa, 2005; Stafford & Sarasin, 2003; Wang, 2009) and the 2008 world crisis, a period in which the depth and breadth of the depression have made the tourism sector being regarded in certain countries as a solution to the crisis (Alonso-Almeida & Bremser, 2013; Baležentis, Kriščiukaitienė, Baležentis, & Garland, 2012; Barda & Sardianou, 2013; Chon, Li, Lin, & Gao, 2010; Cohen & Neal, 2010; Li, Blake, & Cooper, 2010; O'Brien, 2012; Otero-Giráldez, Álvarez-Díaz, & González-Gómez,

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