

Price determinants of individual hotels: evidence from Milan

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Abstract

Purpose – This article aims to identify average room rate (ARR) determinants of individual firms located in a destination.

Design/methodology/approach – The sample is composed of 72 individual firms, operating in the 3-5 star category; data were collected using financial statements and questionnaires. Independent variables are searched along “what” (product) and “where” (location) dimensions.

Findings – The empirical findings identify four main significant and relevant determinants related to the “what” positioning – number of rooms, number of employees, number of employees per room, years since the last refurbishment – and confirm the relevance of location, and especially the centrality inside the destination.

Practical implications – Empirical findings show the relevance of strong advantage (disadvantage) of location (where) that might compensate disadvantage (advantage) in the strategic positioning (what). Inside the determinants, the results suggest the importance of a broad commercial policy, able to differentiate the served targets, in order to optimise occupancy and, if possible, prices.

Originality/value – The paper suggests the usefulness of taking into greater account the link between destination and local firms as an important determinant of performance and explores what are key success factors for individual (not affiliated) firms.

Keywords Hotels, What and where, Location, Performance, Hospitality services, Prices, Italy

Paper type Research paper

1. Introduction

What are the factors that determine firms' performance? This fascinating research question has generated many studies in the field of strategic management (Lenz, 1981; Schmalensee, 1985; Capon *et al.*, 1990; Rumelt, 1991; Hawawini *et al.*, 2003). Two main broad causes have been identified:

1. external factors, primarily related to sectors and markets, that appear in the seminal work of Schmalensee (1985); and
2. internal factors, or “firm effects” or “firm strategy”, which tend to play a more important role in subsequent studies (McGahan and Porter, 1997; Hawawini *et al.*, 2003).

Research into determining factors has also had numerous applications in the tourism sector. In a previous literature review paper, 180 contributions were identified. Researchers in the field of hospitality show a strong focus on internal factors (firm effects) (Blayney, 2009; Claver-Cortés *et al.*, 2007a, b; Israeli, 2002; Jogaratnam and Tse, 2006; Phillips and Sipahioglu, 2004; Yeung and Lau, 2005). Inside this wide corpus of contributions, two gaps have been identified.

The first is related to the level of analysis. Studies are focused prevalently at the national or continental level (Chung and Kalnins, 2001; Gursoy and Swanger, 2007; Reichel and Haber,

2005), ignoring the effects originated by the destination context. By contrast results in the field of destination management suggest the relevance of local context especially in influencing the main attracted targets, designing a quite similar “market orientation” for local firms (Jeffrey and Barden, 2000a, b). Other authors describe the destination as a “business unit” (Bieger, 1997) or the primary level where competition occurs in tourism markets (Go and Govers, 2000; Ritchie and Crouch, 2000; Enright and Newton, 2004). In synthesis, on the one hand the influence generated by destination positioning is expected to be relevant for local firm performances, but, on the other hand, previous studies tend to ignore this relationship.

The second gap is more related to the type of hotel firm analysed. Many studies suggest a different business model exists between “affiliated” and “non-affiliated” hotel units (Damonte *et al.*, 1997; Kim and Kim, 2005; Meidan and Lee, 1982; Yeung and Lau, 2005). This distinction has been widely used especially after the publication of the research carried out by Baum and Ingram (1998). These authors clearly demonstrated that affiliated hotels present a reduced risk of failure as compared to individual hotels. The possibility of sharing organisational knowledge makes this business model more effective (Baum and Ingram, 1998), but in many contexts, affiliated hotels are marginal and the prevalent business model is represented by individual firms. Surprisingly, studies focusing on individual hotels are quite rare.

The present paper is part of this debate (performance determinants) and suggests the usefulness of taking into greater account the link between destination and local firms as an important determinant of performances, as well as exploring what the key success factors are for individual (not affiliated) firms.

2. Literature review

2.1 Performance in the field of hospitality management

Many studies have used the hotel industry to search determining factors of performance, exploring the link with strategy (Claver-Cortés *et al.*, 2007a, b; Gursoy and Swanger, 2007; Israeli, 2002; Lee and Jang, 2007) and functions such as marketing (Jeffrey and Barden, 2000a, b; Koenig and Bischoff, 2005; Sin *et al.*, 2005), production (Barros, 2004; Chen, 2007; Sigala, 2004), and organisation (Alleyne *et al.*, 2006; Chand and Katou, 2007).

To measure performance, researchers tend to use the well-known classification worked out by Venkatraman and Ramanujam (1986). These authors proposed a tri-partition of performances, distinguishing between the financial, operational and organisational dimensions. The financial dimension includes mainly accounting measurements able to appreciate margins and company profitability. The operating dimension measures the firm's ability to gain trust from its clients and, in this sense, it is an important determinant of financial success. Lastly, the organisational dimension measures the satisfaction achieved by the various company stakeholders, usually employees and shareholders.

The use of the operational dimension has found wide application in hospitality firms due to the existence of official statistics related to occupancy and price and the diffusion in hotel firms of some operational indices, like the revenue per available rooms (RevPAR).

Inside this growing research activity, two strategic decisions taken at foundation play a central role:

1. what product to sell; and
2. where to locate (Baum and Haveman, 1997).

Choice of location and of product characteristics are particularly critical for hotels because the costs of relocating and changing product characteristics are high.

2.2 What product to sell?

What product to sell is a key decision that each hotel should take. To operationalise this concept, the literature mainly suggests the following variables:

- size;
- quality level;
- period of founding and refurbishment;
- services delivered; and
- market orientation (or commercial mix).

Many studies suppose a positive relationship between firm size, economies of scale and performance (Israeli, 2002; Barros, 2004; Pine and Phillips, 2005; Chen and Tseng, 2005; Barros and Mascarenhas, 2005; Claver-Cortés *et al.*, 2006, 2007a, b; Rodríguez and Cruz, 2007). Empirical findings demonstrate the ability of firm size to generate direct and positive ties with performances.

Quality is used as a determinant in a large number of studies. Empirical findings suggest a direct and positive relationship with performance (Ingram and Roberts, 2000; Israeli, 2002; Pine and Phillips, 2005; Danziger *et al.*, 2006; Briggs *et al.*, 2007; Chand and Katou, 2007). Tsang and Yip (2009) demonstrate that only high star-ranking joint venture hotels contribute to heightened demand, creating agglomeration effects. Quality is usually operationalised using official star classification or the number of employees per room.

Founding is a potential important variable in researching determinants of performance. When entrepreneurs found firms, they observe existing companies; Ingram and Baum (1997a) introduce the idea of "vicarious learning" that is time- and location-specific. Entrepreneurs observe existing hotels and benchmark them to decide the key characteristics of the firms. "In the 1920s hotels were slow to recognise the market opportunity presented by auto travelers, and failed to make necessary changes such as providing garage space and making it possible for guests to register without walk-in through a formal lobby in dirty road clothes" (Ingram and Baum, 1997b, p. 80).

The relevance of vicarious learning is very important for individual firms that cannot take advantage of previous experiences developed by the chain in the same or in other destinations (Baum and Mezias, 1992). But paradigms and best practices evolve over time (Urtasun and Gutiérrez, 2006). For this reason newcomers can have an additional advantages with respect to incumbents. The latter can modify their offer by refurbishing it, reducing or nullifying disadvantages or taking advantage of new solutions.

Services delivered capture the breadth of supply. The literature review shows relatively few studies using this variable (Claver-Cortés *et al.*, 2006, 2007a, b; Urtasun and Gutiérrez, 2006). This could appear surprising. However, many studies use size as a proxy of services delivered. Baum and Haveman (1997, p. 314) write: "Size is closely tied to the scope and scale of a hotel's services. Large hotels can offer a wider range of services (dining, recreational, and personal) and can cater to a greater variety of clients (e.g. business travelers, corporate meetings, conferences, tourists, tour groups) simultaneously". The scale and scope of services delivered can be measured by counting the number of total services offered or using dummy variables focusing on key services.

In a seminal work using daily occupancy data, Jeffrey and Barden (2000a, p. 185) used market orientation as an independent variable: "It measures the proportion of leisure guests to business and conference guests". Market orientation, in their study, "produces a level of explained variance of 65%" (Jeffrey and Barden, 2000a, p. 185). Further studies, using similar samples (Jeffrey and Barden, 2000b; Jeffrey *et al.*, 2002) confirmed the same results. Market orientation is used in many other works (Sargeant and Mohamad, 1999; Gray *et al.*, 2000; Capiez and Kaya, 2004; Tse *et al.*, 2005; Sin *et al.*, 2005; Cizmar and Weber, 2000; Gu and Ryan, 2008; Tajeddini, 2009; Qu *et al.*, 2005), but the concept of market orientation refers "as organizational-wide information gathering and dissemination, and a quick

response to current and future customer needs and preferences” (Sin *et al.*, 2005, p. 563). For the purpose of this paper, market orientation is more related to the concept of commercial mix, following the interesting results of Jeffrey and Barden. The independent variable is operationalised using the commercial mix relevant for the specific destination examined.

2.3 Where to locate?

The importance of “where” (location) is well known in the hospitality sector. Baum and Mezas (1992, p. 585) write: “the location and pricing of a hotel have substantive long-term consequences for the success of the establishment [...] Among the most frequently mentioned criteria in a traveler’s decision to purchase accommodation are: i) location (destination or city as well as specific address within the area); ii) price; iii) services; iv) facilities; and v) image [...] Those familiar with the hotel industry often argue that the three most important factors for success, as with restaurants and real estate, are location, location, and location”.

At the local level, location is operationalised using a spatial segmentation related to the main blocks or avenues of the destination. Some researchers use a “street-avenue grid” (Baum and Mezas, 1992, p. 589; Baum and Haveman, 1997, p. 319), or location coordinates and subjective geographic areas (Urtasun and Gutiérrez, 2006, p. 389), while Ingram and Inman (1996, p. 646) use proximity to relevant attractions.

2.4 Research model

Following insights taken from the literature review, the present study aims to test some hypotheses related to the what-where perspective. Table I summarises the expected relationships and signs.

Size, both in term of rooms (*H1*) or employees (*H2*), is expected to be positive (+) related to price. Big hotels offer more additional services and therefore command higher prices.

Quality, measured using the average number of employees per room (*H3*), should have a positive relationship (+) with price.

Founding is expected to be related negatively (–) to results. This dimension has been operationalised using two variables:

1. the number of years since founding (*H4*); and
2. the number of years since the last refurbishment (*H5*).

If the hotel was founded made many years ago, the building and the main services would have been with customer needs in mind that are significantly different from current needs. In contrast, a reduced number of years since the last refurbishment permits the facilities to be more aligned with the needs of current clients.

Table I Research model

<i>Strategic decisions</i>	<i>Variables</i>	<i>Independent variables</i>	<i>Hypotheses</i>	<i>Sign of expected relationship</i>
1. What product to sell	Size	Rooms	<i>H1</i>	+
		Employees	<i>H2</i>	+
	Quality	Employees per room	<i>H3</i>	+
	Founding	Founding (years)	<i>H4</i>	–
		Refurbishment (years)	<i>H5</i>	–
		Congress facilities	<i>H6</i>	+
	Market orientation	Exhibitors	<i>H7</i>	–
2. Where to locate	Location	Centrality	<i>H8</i>	+

Note: Dependent variable: average room rate (ARR)

Breadth of service has been operationalised by checking the presence of congress facilities (*H6*). Congress services allow hotels to attract new clientele segments, reducing seasonality and increasing sales. Therefore, the impact on ARR is expected to be positive (+).

The last variable for the “what” perspective is market orientation. Milan is the second-ranked European destination for exhibition facilities. The relationship with price is expected to be negatively related (–), because firms focusing excessively on exhibitors (*H7*) increase their seasonality and reduce their occupancy.

Finally, the location (*H8*) was measured considering the centrality of the hotel. The relationship is expected to be positive (+).

3. Methodology

To analyse the link existing between the competitive positioning of the destination and the performance of hotel firms, a multiple case study methodology was used (Yin, 1994), applied to the city of Milan.

The decision to analyse a single destination is justified by considering the complexity of the information to be collected and the processing to be carried out to get to know in detail the location, functioning and performances of an aggregate made up of several hundred firms and thousands of players. This methodological choice has found confirmations in numerous previous studies centered on product analysis (Murphy *et al.*, 2000), competitiveness of destinations (Ritchie and Crouch, 2000; Enright and Newton, 2004; Claver-Cortés *et al.*, 2007a, b), and in the performance of firms based in a destination (Urtasun and Gutiérrez, 2006; Ham *et al.*, 2005; Tse *et al.*, 2005; Chiang *et al.*, 2004; Espino-Rodríguez and Padrón-Robaina, 2004; Chung, 2000; Baum and Ingram, 1998; Ingram and Baum, 1997a; Ingram and Inman, 1996; Baum and Mezias, 1992).

3.1 Sample and procedure

The sample is constructed starting from the population of local firms obliged to publish financial statements. One- and two-star structures were excluded, according to previous studies (Claver-Cortés *et al.*, 2006, 2007a, b; Emeksiz *et al.*, 2006); furthermore, according to Italian legislation, they are almost always not obliged to publish financial statements. The “financial statements population” counts 129 firms, but the financial results of eight firms were not available when data was recorded. All the firms were supplied with a questionnaire, and a final sample of 72 firms was obtained, with a redemption of 59.5 per cent in rooms.

The sample has a good stratification if read according to the details identified previously (Table II).

The financial statement made it possible to gather financial information for the last five years (2002-2006). For Italian legislation accounting income in the public financial statement is not subdivided per business unit or department. In the calculation of ARR, income relating to F&B and to any collateral services such as SPA or congress centres is therefore included.

The questionnaire data made it possible to obtain information concerning occupancy, seasonality (measured on a monthly basis), dimension, number of staff, foundation and last

Table II Descriptive statistics					
	<i>Number</i>	<i>Minimum</i>	<i>Maximum</i>	<i>Mean</i>	<i>SD</i>
Rooms	72	27.000	188.000	71.958	36.641
Employees	72	6.000	100.000	19.417	14.132
Employees_rooms	72	1.000	7.000	3.736	1.289
Refurbishment	72	0.000	26.000	3.722	5.195
Founding_years	72	0.000	57.000	22.597	15.059
Exhibitors	72	0.030	0.778	0.360	0.176
Centrality	72	0.000	1.000	0.264	0.444
Valid <i>n</i> (listwise)	72				

refurbishment, services offered, locations. The questionnaires administered by an interviewer between the end of January and the beginning of February 2007 and contain information about the results for 2006.

3.2 Statistical analysis

Table III presents the correlation matrix of the eight independent variables.

The data show correlations among some determinants, mainly generated by size (number of rooms and number of employees); in both cases there are some significant relationships.

Focusing on rooms, this variable is positively tied to the number of employees, foundation in years, and the presence of congress facilities. In other words, big hotels in Milan have more personnel, were founded many years ago, and have developed congress services. These results appear reasonable.

The number of employees is negatively related with the number of employees per room, while is positively linked with the presence of congress facilities and centrality. Concerning employees per room, big hotels appear to be more efficient, and in fact are able to reduce the number of personnel per room. Concerning congress facilities, hotels with an higher absolute value of personnel present a strong fixed-costs structure. For this reason they would be more sensible to develop additional services (congress facilities) that are able to attract new segments and to increase sales. Finally, the relationship with centrality is determined by the presence of some big structure in the centre of Milan.

In order to analyse the problems of multicollinearity, two tests were performed. The first was the variance inflation factor (VIF); the maximum value found in the sample was 2.7, which is lower than the maximum value of 3 suggested by Hair *et al.* (2005). The second is the condition index; the highest value of 18.4 is lower than the value of 30 suggested by Belsley *et al.* (2004). The two indexes suggest the absence of multicollinearity.

Heteroscedacity was controlled using the White test, verifying the null hypothesis of homoscedasticity. The value obtained is not statistically significant, and so it is possible to affirm the validity of the model.

4. Results

A regression analysis was performed (Table IV) using the ARR as the dependent variable. The model obtained was statistically significant ($p = 0.000$) and able to explain 63.6 per cent of the average room rate variance.

Table III Correlation matrix

		1	2	3	4	5	6	7	8
1. Rooms	Pearson correlation	1.000							
	Significance (two-tailed)								
2. Employees	Pearson correlation	0.618**	1.000						
	Significance (two-tailed)	0.000							
3. Employees per room	Pearson correlation	0.140	-0.453**	1.000					
	Significance (two-tailed)	0.241	0.000						
4. Founding in years	Pearson correlation	0.313**	0.184	-0.048	1.000				
	Significance (two-tailed)	0.007	0.121	0.691					
5. Refurbishment	Pearson correlation	0.39	0.181	-0.135	0.020	1.000			
	Significance (two-tailed)	0.742	0.128	0.258	0.869				
6. Congress	Pearson correlation	0.506**	0.384**	0.108	0.066	0.112	1.000		
	Significance (two-tailed)	0.000	0.001	0.365	0.580	0.351			
7. Exhibitors	Pearson correlation	-0.124	-0.126	0.016	-0.020	0.82	0.139	1.000	
	Significance (two-tailed)	0.299	0.290	0.893	0.867	0.495	0.243		
8. Centrality	Pearson correlation	0.079	0.324**	-0.344**	0.121	0.051	0.032	0.003	1.000
	Significance (two-tailed)	0.507	0.006	0.003	0.309	0.673	0.791	0.979	

Notes: **Correlation is significant at the 0.01 level (2-tailed); $n = 72$

Table IV Regression model

	Unstandardised coefficients		Standardised coefficients		t	Significance
	B	SE	β			
(Constant)	-13.600	36.343			-0.374	0.709
Rooms	-1.552	0.306	-0.626		-5.071	0.000
Employees	7.315	0.853	1.138		8.576	0.000
Employees_rooms	32.041	7.323	0.455		4.376	0.000
Founding_years	-0.647	0.464	-0.107		-1.396	0.168
Refurbishment	3.423	1.289	0.196		2.656	0.010
Congress	-2.064	17.475	-0.010		-0.118	0.906
Exhibitors	-36.642	38.812	-0.071		-0.944	0.349
Centrality	42.176	16.025	0.206		2.632	0.011

Notes: Dependent variable: ARR. Adjusted $R^2 = 0.636$

The columns B and β (standardised coefficients) in Table IV show the sign of the relationships between ARR and the independent variables. The last column (Significance) shows whether or not the results are significant (italic values, $p < 0.05$). Figure 1 summarises the significant results.

Between “what” variables, the model shows that:

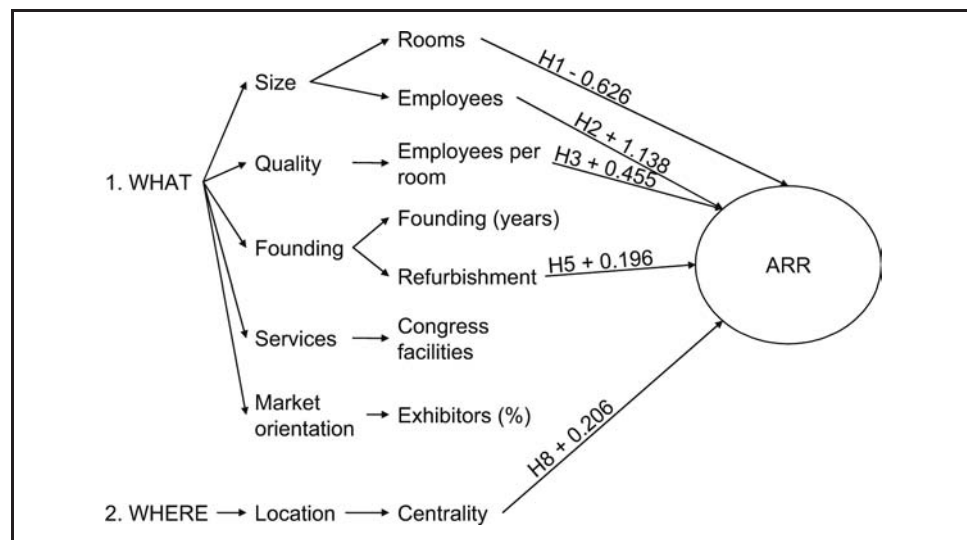
- the number of rooms is negatively related to results (-0.626);
- the number of employees is positively related to ARR (1.138);
- the number of employees per room is positively related to average price; and
- refurbishment is positively related to the dependent variable (0.196).

Concerning the “where” variable, centrality is positively related to results (0.206).

Interesting, the empirical findings suggest a diverse sign (as supposed in Table I) in the relationship between the independent variables and ARR in $H1$ (rooms) and $H5$ (refurbishment).

5. Discussion

The results show five significant determinants of performance.

Figure 1 Significant results

1. Concerning size, the number of rooms is negatively related to ARR, suggesting diseconomies of scale. It is important to remember that the sample is composed only of individual hotels; therefore the effectiveness of the non-affiliated business model reduces increasing the number of rooms available. In other words, the evidence from Milan suggests the importance of considering the corporate governance structure (affiliated or individual) in order to capture the relevance of a specific success determinant.
2. In contrast, the number of employees is positively related to performance, showing that employees are not a proxy of rooms, and that employees tend to generate value in terms of price.
3. The number of employees per room is able to increase the average room rate. This means that this indicator is more a proxy of quality than a measure of efficiency. Hotels with a higher number of employees per room present an increased level of service and therefore command higher prices.
4. Refurbishment was assumed to be negatively related to results, showing that recent re-structures increase prices. The empirical findings do not confirm the sign. The positive relationship suggests a lag time effect: a new refurbishment requires time to be perceived and to generate positive effects on ARR.
5. Finally, centrality is able to increase the value of price, as supposed. It is interesting to note that centrally located hotels are not correlated with dimension (number of rooms), founding, refurbishment, breadth of facilities or market orientation. The only two significant correlations (Table III) the number of employees (0.324) and the number of employees per room (-0.344). The location advantage is so relevant that it is able to generate a positive rent independently of specific strategic positioning (size, founding, refurbishment, breadth of facilities and market orientation).

Concerning the remaining hypotheses (*H4*, *H6* and *H7*), the results are not significant, so is impossible to form conclusions about the relationship with ARR. Surprisingly, the presence of congress facilities is not significantly related to price.

6. Conclusions

The present study makes it possible to draw some conclusions at the theoretical and empirical levels.

At the theoretical level, the findings suggest the importance of linking the identification of determinants with the local context (destination) and positioning inside the city (location). As showed in the literature review, previous works tend to focus exclusively on national samples, without exploring independent "destination-based" variables. The case of Milan indicates the relevance of some local variables, such as the commercial mix and location. Market orientation is often designed and managed more at the destination level rather than the firm level. Starting from the destination helps researchers to have a widening knowledge of some structural traits that tend to characterise the sample, such as seasonalities and occupancy. Furthermore, the evidences confirm the relevance of corporate governance structure and especially some radical differences in success determinants between affiliated and individual hotel units.

At the empirical level, the study suggests some interesting implications both for existing hotel and for start-ups. For existing firms, the empirical findings show the relevance of a strong advantage (disadvantage) of location (where) that might compensate disadvantages (advantages) in strategic positioning (what). Inside the determinants, the results suggest the importance of a broad commercial policy that is able to differentiate the targets served in order to optimise occupancy and, if possible, prices.

Finally, concerning start-ups, the findings confirm the old rules of the hotel game, significantly summarised in the three success factors of a hotel unit: location, location and location.

7. Limitations

The article has three main limitations:

1. it is based on data from one destination;
2. it uses information related to one year; and
3. it operationalises the location variable using only one dummy (centrality versus non-centrality).

Concerning the first point, the decision to analyse one destination is principally tied to the relevant work necessary to know the local context, develop the primary (interviews) and secondary (financial statements) data, and understand the main strategic and managerial practices used by local firms and leading companies (Fiera Milano, 2008).

The empirical findings are based on one year (i.e. 2006). This decision was mainly tied to the difficulties in recording data related to sales volume (rooms sold per single hotel unit). The fragmented structure of the supply necessitated intensive field research and dealing with the problems of confidential data.

Finally, the division of Milan into street blocks is based on public segmentation. In this article, a distinction is developed between hotels located downtown and elsewhere. A wider sample would make it possible to analyse the location effects in greater detail.

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