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Price Competition in Five-Star Hotel Industry

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Abstract

Purpose – To analyze the characteristics of price competition in five-star hotel industry in DIY.

Method – Descriptive qualitative method in order to know the detail about price competition. In-depth interviews with market players as well as government and other stakeholders are conducted. To get the full picture, this study also interviewed to PHRI (Indonesian Hotel Union). The SCP theory (structure-conduct-performance) becomes the guidance of interview and analysis.

Findings – The results of this study indicate that the hotel market is loose oligopoly or close to the monopolistic nature, competition is quite strict considering frequent over supply within one year, and pricing strategy becomes more important. Every hotel often changes their price strategy to follow certain conditions in the market. In differentiating its products, each hotel implements different themes to attract the attention of the guests. In five-star hotels at DIY, price strategy has low impact to the customers' satisfaction except for Eastparc Hotel.

Implication – This study implicates that the behavior of five-star hotels in DIY will make the competition become soft and create tacit collusion. This is not good news for below three-star rank hotels.

Originality – This study contributes to the price competition study especially in five-star hotel market.

Abstrak

Tujuan – Menganalisis karakteristik persaingan harga pada industri hotel bintang lima di DIY.

Metode – Metode kualitatif deskriptif untuk mengetahui secara detail tentang persaingan harga. Wawancara mendalam dengan pelaku pasar serta pemerintah dan pemangku kepentingan lainnya dilakukan. Untuk mendapatkan gambaran yang utuh, penelitian ini juga mewawancarai PHRI (Persatuan Hotel Indonesia). Teori SCP (struktur-perilaku-kinerja) menjadi pedoman wawancara dan analisis.

Temuan – Hasil penelitian ini menunjukkan bahwa pasar perhotelan bersifat oligopoli longgar atau mendekati sifat monopolistik, persaingan cukup ketat mengingat sering terjadi over supply dalam satu tahun, dan strategi penetapan harga menjadi lebih penting. Setiap hotel sering mengubah strategi harga mereka untuk mengikuti kondisi tertentu di pasar. Dalam membedakan produknya, setiap hotel menerapkan tema yang berbeda untuk menarik perhatian para tamu. Di hotel bintang lima di DIY, strategi harga berdampak rendah terhadap kepuasan pelanggan kecuali Hotel Eastparc.

Implikasi – Studi ini berimplikasi bahwa perilaku hotel bintang lima di DIY akan membuat kompetisi menjadi lunak dan menciptakan *tacit collusion*. Ini bukan kabar baik untuk hotel peringkat bintang tiga atau lebih rendah.

Orisinalitas – Studi ini berkontribusi pada studi persaingan harga terutama di pasar hotel bintang lima.

Introduction

DIY (Daerah Istimewa Yogyakarta), one of the main tourist destinations of Indonesia has built various infrastructure including hotels. Hotel, an accommodation for tourists, is necessary for supporting tourism sector to be a leading sector. In line with such opinion, DIY is very concerned in providing hotel to strengthen tourism industry. According to the data, the number of tourists coming to DIY increased from 3.2 million people in 2012 become 4.06 million people by 2015. Based on the data from BPS, tourists using hotel increased their contribution from 24.4% (2012) to 41.9% (2015) . It means, more tourists go to DIY will increase the use of the hotel for lodging. The need for hotels in DIY is higher than the number of tourists. Due to increasing regional revenue from the tourism sector, the DIY government supports the construction of hotels in order to increase the supply of hotels.

During 2009-2015, there has been an increase of hotel room availability (Nugraha, 2017). The increase of rooms on the average of hotels per year is greater than the increase of room numbers on the average in non-star hotels per year (17.6% compared to 2.3%). Larger estimated demand for hotels compare to non-hotels demand shows the optimistic future that hotel business has bright prospects in DIY.

Along with the increase of hotel room availability, it did not show the improvement of occupancy rate of starred-hotel rooms. The average of occupancy rate for all starred-hotels is 52.9% where the average occupancy rate of five-star hotels is 56.45% of the capacity (Nugraha, 2017). Five-star hotels have slightly better occupancy rates than other starred hotels. The number of occupancy rate is the average number. If the occupancy rate is divided into two, high season and low season, the average occupancy rate in high season is almost 100% while in low season, occupancy rate is only between 40% and 50% (Nugraha, 2017).

This situation indicates a tight competition in the hospitality business especially during low season. At this time, hotel managers work hard to set and execute their proper strategy in order to survive from this stressful condition. The behavior of market players in the hospitality industry is very interesting to observe. This study focuses on the behavior of five-star hotel industry in price competition. It chooses five-star hotel industry because the players are few so it is easier to design the research under low budget study. In addition, this study concentrates on price competition rather to non-price competition, because the behavior of five-star hotels price competition is more dynamic. The easiness of changing strategy in pricing causes this study is interested to observe the behavior of the hotel managers in price competition. Relating to the lack of data available by the Indonesian statistics agency for the hospitality industry, this study used a qualitative approach by using intensive interviews in order to find the required data. This investigation relies on the interviews to all business actors along with the Indonesian hotel union (PHRI).

Research on price competition in the hospitality industry has been widely observed. A consumer in choosing a hotel based on price always compares the price of the destination hotel with reference hotel prices which is considered market leader (Jacobson and Obermiller, 1990). Consumers tend to look for the cheapest hotel rates on the quality of hotels that are already referred. However, other studies have shown that low tariff oriented consumers should not be important to consider (Blinder et al, 1998). They are unreliable when low season is coming. Loyal customers are much more reliable in low season. Because of that, discount strategies are not effective to increase hotel revenues in low season. Usually, consumers feel unsafe if they change hotels which they commonly come to because they are afraid the quality will be worse than they have known. Hayes and Huffman study (1995) describes this situation as risk adverse consumers who are not comfortable with the new of the product offered. Consumers feel unpleasant with the offer of another hotel even though the price is cheaper. For hotel managers, the situation is better because the price reduction does not increase the number of hotel guests significantly, so the discount strategy for hotels has the limitation in time and quantity.

Actually, what is the demand elasticity for hotel services? The results are different for each region, whether it's another location with the same country or another country. Hiemstra and Ismail (1990) estimate the elasticity of hotel demand in the United States. Hotels with low tariffs have elasticity of -0.35 and -0.57 for hotels with high tariff. The elasticity value may change according to

its location. Canina and Carvell (2005) conclude that the price elasticity for hotel tariffs in 22 major cities in the United States is -0.14. But if the hotels are categorized into 5 categories from the most expensive to the cheapest, the value of price elasticity varies irregularly. Price elasticity for the most expensive hotels is -0.15 which then decreases along with the decrease of tariff, ie -0.11 and zero. But the next cheaper tariff has higher elasticity, -0.21 and -0.31 (the cheapest tariff). The conclusion of the Canina and Carvell (2005) research is the price elasticity of hotels in the United States is inelastic.

The inelastic hotel demand in the United States shows that, the hotel has become a part of people's life in the United States. In traveling, Americans are more comfortable to stay in hotels than to stay with their relatives despite being in the same city. With the situation, a massive discount strategy to attract guests is not appropriate. Price competition becomes less dynamic. The managers of the hotel, especially low tariff hotels, just run how to meet all the minimum requirements that must be fulfilled by the hotel in order to avoid the penalty from hotel regulators.

Similar results are shown by Becerra et al (2013) on the factors influencing hotel rates in Spain. Price competition is not too tight in every category of hotel, from one-star to five-star hotel. Hotel managers in Spain prefer non-pricing strategies by highlighting their product advantages such as being close to the beach, close to historic or historic locations. Therefore, an excessive discount strategy will not be applied to attract more guests.

Research Methods

The studies mentioned before use an amazing amount of data because the statistical institutions of western countries where the study took place provide sufficient data to generate many research. Different conditions exist in Indonesia. Complete hotel data is rare. Existing data does not cover the behavior of hotel managers in the face of competition. Due to data limitations, this study uses qualitative methods to explain the phenomenon of price competition in the hotel industry in DIY. The type of qualitative method that will be conducted is descriptive qualitative (Leksono, 2015) where the results will illustrate the objective conditions of price competition in hotel industry in DIY.

The category of hotels to be researched is five-star hotels. The categorization is based on certificates issued by the Business Certificate Institution (BCI) of Tourism Bhakti Mandiri and BCI of Tourism Adi Karya Wisata. In the certificate, there is a hotel that is not certified five stars in BCI Bhakti Mandiri but is certified by BCI Adi Karya Wisata, vice versa. Therefore, respondents of five-star hotels are defined as five-star hotel certified hotels by one of the BCIs mentioned above. There are eight five-star hotels that have been certified and will be the object of research. The analysis tool to be used is structure-conduct-performance analysis (SCP) (Lipczynski et.al, 2005). This analytical tool is powerful enough in describing the condition of an industry, especially in price competition. Because using qualitative methods, intensive interviews are the backbone of this research. The resource persons to be interviewed are the people who represent the eight hotels plus the PHRI representatives who are considered to have important information that may be hidden by the hotel manager.

Results and Discussion

From nine sources of the plan to be interviewed, only six are finally willing to be interviewed. They are Phoenix Hotel, Royal Ambarukmo Hotel, Eastparc Hotel, Sheraton Mustika Ratu Hotel, Hyatt Regency Hotel, and PHRI (Indonesian Hotel Union). The rejection of the interview was due to high activities of the hotel managers who did not consider this interview is important. Until the end of this study should make a report, there are three hotels that do not reply to the request to be interviewed. The sources who were willing to be interviewed, their responses varied. Some of them enthusiastically provided a lot of information and the others reluctantly answer the question and need extra effort to obtain the required information. Overall interview processes were going well.

Five-star hotels in DIY spread over two administrative areas namely in the municipality of Yogyakarta and in the district of Sleman. They are Tentrem Hotel, Royal Ambarukmo Hotel, Phoenix Hotel, Hyatt Regency Hotel, Melia Purosani Hotel, Grand Aston Hotel, Eastparc Hotel,

and Sheraton Mustika Hotel. From the name can be seen which is part of the chain hotels and which are not from chain hotels. The three hotels that are not part of the chain hotel happen to be regarded as the top four in the set of five-star hotels in DIY. Based on the number of beds available, the order of hotels from the largest number of beds to the least presented in Table 1.

Table 1. Rooms and Beds at Five-Star Hotels at DIY

Hotel	Room	Bed
Tentrem Hotel	273	546
Melia Purosani Hotel	280	399
Hyatt Regency Hotel	269	368
Sheraton Mustika Hotel	246	365
Royal Ambarrukmo Hotel	247	325
Eastparc Hotel	193	255
Phoenix Hotel	144	218
Grand Aston Hotel	141	183

Source: Five Star Hotel Directory at DIY 2016

If the availability of the beds is considered to represent the market share of the hotel, the leader of the five-star hotel industry is Tentrem Hotel followed by Melia Purosani Hotel and Hyatt Regency Hotel. If the four large hotel beds are calculated, then the CR4 is about 60%. This means that the five-star hotel market structure in DIY is loose oligopoly or close to monopolistic. The power of top four is slightly higher than the bottom four. However, this assumption is not entirely correct because additional data is required in the form of real average occupancy rate per year. A hotel usually resents sharing the occupancy rate data due to hiding real performance. Therefore, data of the structure of five-star hotel market comes from interviews. Most of the sources agree that Tentrem Hotel is the leader in five-star hotel industry. Next ranks are Royal Ambarukmo Hotel, Hyatt Regency Hotel, and Phoenix Hotel. The rest is unclear position. However, all sources agree that Sheraton Mustika Ratu Hotel is in the lowest position.

All participants in the industry are divided into two groups. The first group which is on the top consist with four hotels rely on their strong brand. The second group hotels still struggle with their own uniqueness and still count on the price strategy to attract guests. Both groups do not mind increasing the tariff significantly during high/peak season. However, during long low season, they turn the strategy into complicated price strategy. Basically, for five-star hotel, massive discount strategy is not possible. There are some high operational costs that hotel should take for maintaining five-star quality of services.

There are three types of customers for the hotels. Guests come from travel agents, from corporate or government institutions, and FIT (free independent travelers). Guests from travel agents usually find the best price among five-star hotels. They are sensitive to price. Guest from corporate or government institutions typically loyal customers and special tariff for them are applied. FIT (free independent travelers) are the guests who never make reservation to stay at the hotel. They are businesspeople who always travel, a family who constantly stay at their favorite hotel, and people who enjoy staying at the hotel for special purposes, e.g., an author writing his novel or his book.

Hotels provide limited discount for travel-agent guests. The meaning of limitation is low certain discount and rooms limitation. The low rank hotels provide big shares of rooms for such guests. They believe that many guests are responsive to price. They want five-star hotel services but with the lowest price. The guests do not appreciate the uniqueness of the hotel and the detail of the services. However, the hotels do not offer big discount due to high operational cost. For top rank hotels, only limited quantity of rooms is provided for these guests. The top hotels still confidence that their loyal customer much larger than the number of price responsive guests. This situation is supported by the research of Hiemstra et al (1990), Canina et.al (2005), and Becerra et.al (2013).

Corporate and/or government institution guests are ideal guests for five-star hotels. They are loyal and the numbers are huge. For such customers, hotels usually give special price and also special services in every condition, low season and high season. Hotels commonly accept the

negotiation for price and services in order to maintain the relationship to the institutions. Every reservation from them followed by large number of guests, therefore, the cost for each guest can be reduced and the revenue increase dramatically. Nevertheless, they come irregularly so that it is not easy to predict their reservation. Besides, frequently, the relationship between hotels and the institutions depends on the regime of the leader of the institutions. When the leaders are replaced, the next leaders probably prefer to other five-star hotels or locations.

Free independent travelers (FIT) are the second favorite guest for the hotels. They are loyal, however, it is not in large number. The relationship of both can last very long. They tend to be loyal because, for them, other hotel probably more inconvenient than their favorite hotel. Hotels usually offer higher price compare to the price for travel agent guests but better services in order to compensate higher cost for the customers.

The problem for five-star hotels happens when low season comes. The manager should set the price strategy in order to survive from low numbers of customers. From the interviews suggest that main strategy is yielding. Yielding is a hotel terminology for differentiating price from high season and low season. Of course, hotels fix high price for high season (or inelastic demand) and low price for low season (or more elastic demand). From microeconomic reference, this kind of strategy named peak-load pricing. The percentage difference from high price and low price depends on the rank of the hotel. Top rank hotels set the difference from high price and low price is about maximum 25%. They believe loyal customers still ask to stay at the hotel. If they do not stay, usually customers ask for MICE (meetings, incentives, conference, exhibitions) services. Incomes from MICE are considered as big as incomes from of the guests staying. Even though income of top rank hotels from guests decreases, income from MICE business compensates it. For low rank hotels, in certain time, they give big discounts in low season. However, they maintain the loyal customers by offering special price for certain customers. Each loyal customer has different tariff and this in economic textbook is known as first degree discrimination price (Nicholson et.al, 2008). Not only low rank hotel use this strategy, high rank hotels also apply this strategy. Other situation happens such as the customers have also MICE activities in the hotel. From the MICE activities, the customers usually bring their own guests who stay at the hotel related to the MICE activities. The hotel apply special low tariff to the customers which is difference to the tariff for other normal guests. This is what microeconomic terminology as third degree price discrimination. So, to face the low season, hotels use complicated scheme of price strategy.

At the certain period, price war cannot be prevented and the price offered makes PHRI concern. For that reason, PHRI ask for agreement to all five-star hotels to have lower and upper limit tariff in order to avoid big loss for the industry. However, the hotels secretly break the agreement because of lack of control and difficult to obey. The price setting agreement is also for limiting new entrants. Though, it is hard to prevent new entrants to come in the industry. In fact, price setting agreement is failed to apply.

Table 2. Reviews on Five-Star Hotel at DIY, March 2016-February 2017 (%)

	Tentrem Hotel	Royal Ambarrukmo Hotel	Hyatt Regency Hotel	Grand Aston Hotel	Phoenix Hotel	Melia Purosani Hotel	Eastparc Hotel	Sheraton Mustika Hotel
Excellent	66.44	57.67	53.61	48.30	60.73	37.10	73.1	40.44
Very good	26.42	34.60	32.96	40.6	30.66	46.46	22.34	36.85
Average	4.71	5.68	10.29	7.64	6.63	11.39	3.27	13.96
Poor	1.53	1.27	2.29	1.83	1.25	3.66	0.79	5.04
Terrible	0.87	0.76	0.83	1.54	0.7	1.38	0.39	3.68
Total reviews (people)	912	1179	1438	1033	3196	1229	1007	1031

Sources: Tripadvisor.com

The consequence of price strategy for the five-star hotel industry is on the welfare of customers. Many of them still satisfy with the hotel services. This study uses tripadvisor.com reviews for all hotels. Israeli (2002) use some internet surveys including tripadvisor.com to evaluate the service of the hotels. According to Table 2, top rank hotels still have best reviews from their

customers. More of 50% of the customers who agree to give the review evaluate them as excellent. The rest, the reviews for excellence are less than 50% except for Eastparc Hotel. This hotel uses low price strategy consistently and enjoys the place in the low rank hotels. Probably, the customers feel good worth of money if they stay at this hotel. Moreover, one of the eight hotel is most likely to exit from the industry due to mismanagement.

Conclusion and Implications

Price strategy for five-star hotel at DIY is still relevant because actually the type of the competition is monopolistic competition. Because of the high and low season, the hotels apply peak-load pricing. The detail of peak-load pricing strategy is complicated because hotels apply different strategies in different situation under peak-load pricing. The details of price strategy are first degree price discrimination, third degree price discrimination, and agreement price. They discriminate the price for loyal customers and low tariff seeker customers. Even though for loyal customers are employed higher price, the services are more excellent for them. The agreement price is ineffective due to lack of control and difficult to obey. From the survey of customers reviews of five-star hotels in DIY, four top rank hotels are excellent but not for the low rank hotels except for Eastparc Hotel. The effect of price strategy in low season does not affect the customers' perception about five-star hotel. They satisfy the services to the 4 top rank hotels but does not to the 3 bottom rank hotels. Eastparc Hotel is the only hotel from for below rank hotels which obtain high review form the customers. Customers probably feel worth of money staying at Eastparc Hotel compared to other the members of four below rank hotels.

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