

# CHAPTER 1: INTRODUCTION

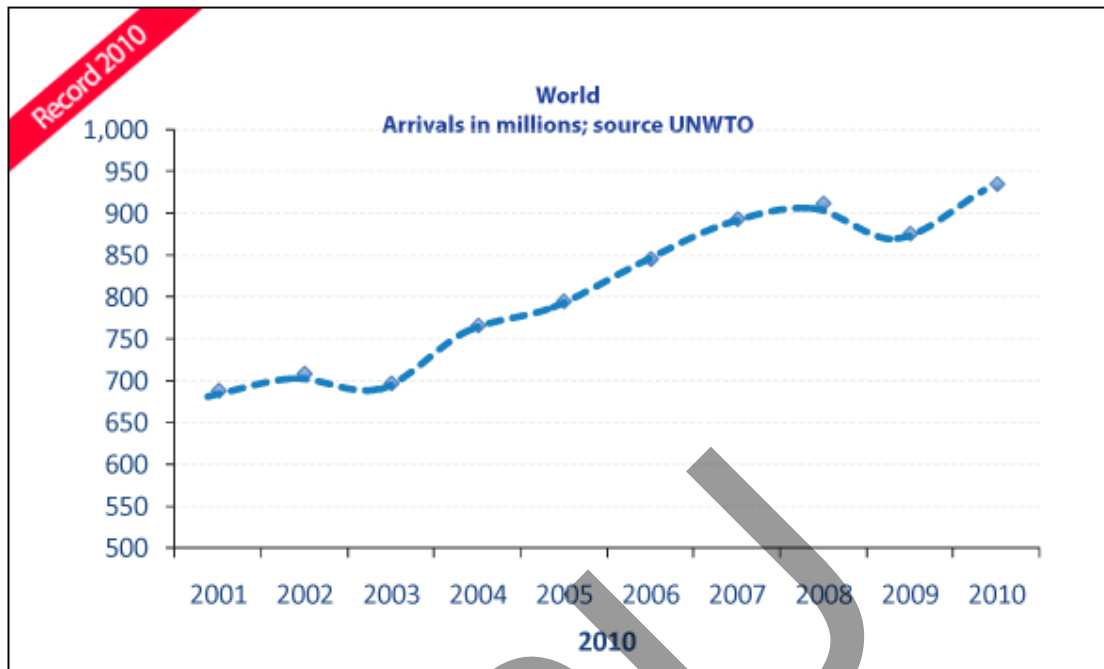
## Introduction

This chapter aims to provide the background of this research. Firstly, the chapter introduces the impact of an economic crisis on different levels ranging from the global and Asia Pacific tourism industry to Thailand and Phuket's tourism industry. The research objectives, research definitions, research frames, research limitations, and research justifications will then be discussed.

### The Impact of Economic Crisis on Global Tourism

Over recent decades, tourism has experienced continued growth and has become one of the fastest growing economic sectors in the world. Nowadays, the business volume of tourism equals or even surpasses that of oil exports, food products or automobiles. Moreover, tourism has become one of the major players in international commerce, and at the same time represents one of the main income sources for many developing countries. Such a growth goes hand-in-hand with increasing diversification and competition among destinations (World Tourism Organization 2011).

**Figure 1: World tourist arrivals**



Source: Pacific Asia Travel Association (2011)

However, global tourism has been severely affected by the current financial and economic downturn. According to the United Nations World Tourism Organization (UNWTO) data, international tourism started to decline during the second quarter of 2008, becoming one of the latest sectors to feel the effects of the global recession. Moreover, while financial institutions around the world confirm the intensity of the crisis through various indicators, the negative trend in international tourist arrivals intensified during the first half of 2009 in line with the prevailing financial situation (Papatheodorou, Rosselló & Xiao 2010).

It is reasonable to assume that projected tourism growth may suffer from an economic downturn. Moreover, massive prolonged increases in fuel prices, with few short-term options (at least for airlines), as well as other 'mega crises' will have a fundamental downward effect on international travel (World Tourism Organization 2008). Such a statement was endorsed by the World Travel & Tourism Council (2008) who stated that the world's tourism outlook in 2008 and beyond is likely to be negatively affected by high oil prices, fear of recession in the US, increasing deficits, and a weaker dollar.

Rising oil prices is one of the major negative factors that affects the tourism industry. It should be pointed out that rising oil prices does not only affect the price of airfare tickets, but also affects the tourism industry overall. The level of impact depends on various factors including the particular segment of the industry; how reliant on tourism cities and destinations are; and most critical of all, how much oil prices will rise. Airlines, cruise lines, and bus lines all need fuel to operate; hotels, resorts, and restaurants need energy to heat and cool their buildings; and families traveling by car are beginning to limit their normal traveling (Wilkening 2011b). Among the hardest hit sectors in the tourism industry is airlines.

In the airline industry, airports reported a slowing passenger traffic growth trend in June 2008, with worldwide growth at a modest 2 percent. High oil and jet fuel prices, stock market turbulences, inflation and an uncertain economic outlook took their toll on air traffic in June, also impacting half year figures. Compared with those in June 2007, the two largest international markets Europe and Asia-Pacific regions reported only 2.4 and 0 % increases respectively in 2008, whereas Africa and Middle East both increased by 13 %, followed by Latin America & Caribbean region at 7 %, North America at 5.4%. Asia Pacific international traffic contracted mainly due to China, Taiwan and Japan. Bangkok (+5.1%), Singapore (+2.9%), Kuala Lumpur (+6.5%) and Hong Kong (+5.5%) still showed moderate growth, but were significantly down from previous levels (Airports Council International 2008).

In the first half of 2009, airlines across regions struggled to cut capacity to match steep declines in demand. As fast as airlines have been cutting capacity, for most it has not been fast enough to match the sharp fall in passenger traffic. First half numbers for the major operators in the Americas, Europe and Asia demonstrate the extent to which passenger traffic has fallen and load factors are down. In addition, increased competition has resulted in falling yields and fares, and there has been a drop-off in the premium travel sector, making it clear why the airline sector is in crisis (Dunn 2009).

Like the airline industry, the hotel industry has also been affected by the economic crisis. The average price of a hotel room around the world fell by 17 percent in the first six months of 2009. Hotel room rates in June 2009 were more than one sixth lower than they were the year before and room rates were just one percent above the January 2004 level. The 17 percent fall in room rates was driven by price drops across every continent (Travel Moles 2009). In addition, average room rates have decreased in 3 and 4 star hotels as clients

downgrade star ratings in purchasing accommodation. This has led to budget hotels battling to maintain their share of the corporate market (Jarrett 2009).

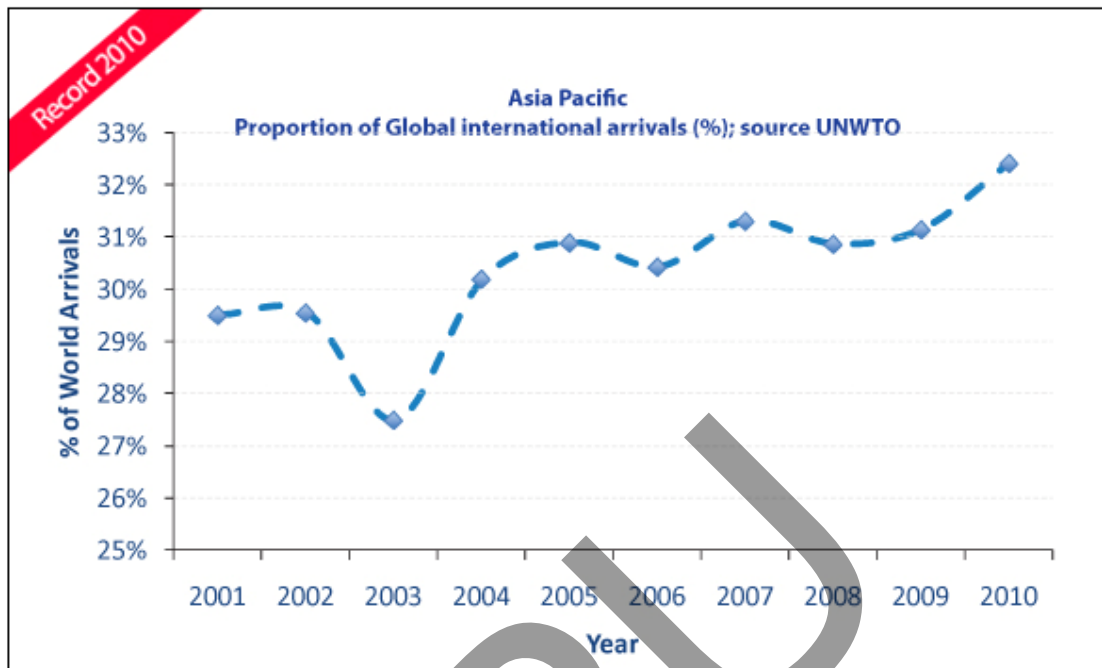
Asian hotel rates, which had been holding up better than those in the U.S. or Europe, tumbled in the first half of 2009 dropping an average of 17 percent compared to the same period one year earlier. Sydney saw the average price for a hotel room fall from US\$175 to US\$122, a 30 per cent decline, in the first six months of 2009. In New Zealand, Auckland saw the biggest drop with a 40 per cent dip in rates from US\$139 to US\$84. As demand fell, hoteliers closed floors and cut back both services and prices, creating a market with a distinctly promotional character that is likely to endure for some time (Travel Moles 2009).

In order to cope with the global economic crisis, many countries have developed stimulus measures within their fiscal and monetary packages to mitigate the effects of the crisis on tourism, realizing that the sector can be a key driver of economic recovery. Some destinations are reducing taxes and improving travel facilitation, recognizing that it is now crucial to remove all obstacles to tourism, especially taxation and over regulation. Others have developed financial systems to support tourism enterprises, maintain/increase employment in the sector and develop infrastructure. These initiatives are supported and encouraged by the World Tourism Organization (UNWTO) (World Tourism Organization 2009).

#### The Impact of Economic Crisis on Tourism in Asia Pacific

The Asia Pacific region remains notable as one of the fastest growing tourism regions; since 1990, international tourist arrivals to Asia and the Pacific have grown at an average annual rate of 7.1%. Not surprisingly, tourism in this region has become the motor propelling global tourism in general, gradually changing the world tourism scenario (Pacific Asia Travel Association 2007). The significant increase in the market share of Asia Pacific in terms of international visitor arrivals is illustrated in Figure 2 below.

**Figure 2: Asia Pacific as % of global international visitor arrivals (IVAs)**



Source: Pacific Asia Travel Association (2011)

The Asia Pacific region (Asia, the Pacific, and North America) now accounts for close to one-third of global international arrivals (Pacific Asia Travel Association 2011). With international travelers projected to almost double by 2020, the most significant increases are expected to take place in markets such as China, India and destinations in South-East Asia. The Gulf States and emerging destinations in Eastern Europe complete this picture, followed by Latin American destinations and finally African markets (World Tourism Organization 2008).

Asia Pacific travel and tourism is facing a serious economic crisis due to a combination factors including US currency depreciation, rising local costs and new fuel surcharges. This is because the economic crisis has spread to all regions of the world, despite the fact that this crisis was triggered by events in the United States housing market. In fact, the crisis represents a serious setback for the tourism industry because it is taking place at a time when the tourism business has been making progress in economic performance (Badr, Zakareya & Saleh 2009).

Since 2005, the US dollar has depreciated by between 14% and 21% against six major Asia Pacific currencies, making some parts of Asia an increasingly expensive choice for US travelers. This in part is fuelling a shift in destination choice even within the region. At the same time, inflationary pressures across the region have been pushing local costs upwards. For example, since 2006, average daily rates at 5-star hotels in six major Asia Pacific cities have jumped by between 10% and 39%, as measured in local currencies, and as oil prices have hit record levels, fuel surcharges have increased substantially (Pacific Asia Travel Association 2008).

Steadily rising oil prices since 2001 continue to exert upward pressure on price levels worldwide. Despite tighter monetary policies in many countries in the region since 2005, there has been an increase in the Asian and Pacific region's average inflation rate, from 2.8 per cent in 2005 to 3.5 per cent in 2006. Therefore, many oil-importing economies such as Malaysia, Thailand, Nepal and Pakistan are experiencing increases in oil prices, which then caused inflation rates to nearly double between 2004 and 2006 (United Nations ESCAP 2008).

Like other countries in Asia Pacific, Thailand has also been affected by the economic crisis, and the impact will be discussed below.

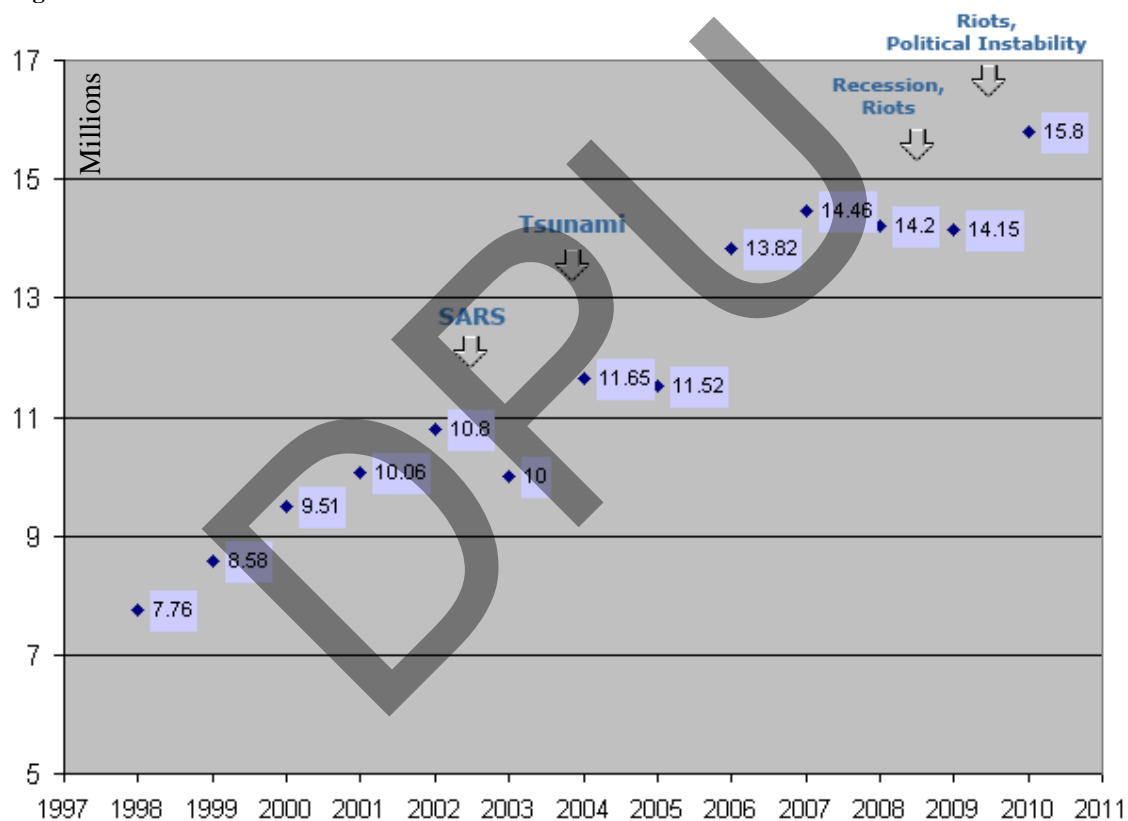
### The Impact of Economic Crisis on Tourism in Thailand

There is no doubt that tourism is a major export service of Thailand (Vogt & Wittayakorn 1998), accounting for around 6 to 7 percent of the country's national GDP (EIU ViewsWire 2003). Moreover, growth in Thailand's tourism industry in recent years has been the result of numerous strengths including a rich cultural heritage and historical tourist destinations (Rittichainuwat, Qu & Brown 2001), a tradition of hospitality (Koumelis 2004; National Identity Board 2000), strong natural attractions, and value for money (Rogers 2003, p. 276). Evidently, the tourism industry is a crucial component of the Thai economy (Brassett, L. & Watson 2010).

Nonetheless, the tourism industry in Thailand has been challenged in recent years by a number of distinct crises, including the SARS epidemic (2003); the bird or avian flu (2004);

and the tsunami which struck the region (December 26, 2004). The anti-government protest during August-December 2008 also affected Thailand's tourism industry heavily, as international tourists avoided traveling to Thailand due to the fear of political turmoil (The Seoul Times 2008). Thailand's latest crisis is an impact from the global economic crisis, also known as the recession starting from the year 2008 (Bank of Thailand 2010). The figure below illustrates international tourist arrivals in Thailand between 1997 and 2011, with indications of crisis-affected periods.

**Figure 3: International tourist arrival to Thailand**



Source: Thai Websites (2011)

During an economic crisis, or recession, tourism operators in Thailand have been advised to focus more on regional and domestic markets, as it is difficult to attract tourists from Europe or the US during a recession (Chinmaneevong 2009). In turn, the Thai government set out to promote domestic tourism in order to compensate for losses incurred from the decline in foreign tourism revenue. In December 2008, the government in

collaboration with the private sector, including hotel and airline operators, organized a Thai Travel Fair to promote domestic tourism during both peak and off-peak periods. The policy aimed to rescue the tourism sector and to shelter other related industries and employment. Although the price-cutting strategy reduced the average daily expenditure of Thai tourists, it helped to increase the quantity and frequency of domestic travel. The price cutting strategy benefited Thailand's tourism industry (Bank of Thailand 2010).

However, the revenue gained from domestic tourists was not as high as that from overseas tourists. Compared with overseas tourists, domestic tourists (mostly Thais) spend much less per day and their trips are shorter, on average two and a half days. In 2007 for example, there were reportedly over 83 million in-country travel trips. This generated 380 billion baht in revenue. The average daily expenditure was around 1,770 baht per person versus 4,120 baht per person for international tourism (Thai Websites 2011).

Moreover, foreign tourists generally spent a large proportion of their budget on accommodation and air transportation, whereas Thai tourists normally stayed at mid-to low-end hotels and traveled by ground transportation. The total impact, therefore, would depend on the direct purchases or shocks that are imposed, and the indirect impact, which results from the industry's backward and forward linkages. Clearly, the same amount of spending in the domestic market by Thai tourists did not yield the same income as the spending of foreign tourists, given the differences in the structure of spending (Bank of Thailand 2010).

To sum up, the gains from domestic tourism would not entirely offset the losses from foreign tourism, given the different patterns of spending. More importantly, encouraging Thai people to spend more on tourism would be a daunting task, given the current fragility of the domestic economy. Thailand's tourism industry still relies on spending by foreign tourists to help boost the overall economy and support the current account. As a result, it is critical that the government enforces policies to stimulate the tourism industry and restore foreign tourist confidence (Bank of Thailand 2010).



### The Impact of Economic Crisis on Tourism in Phuket

One of the most popular tourist destinations in Thailand is Phuket. Phuket is Thailand's largest island and is often dubbed as 'the pearl of the Andaman', or 'the pearl of the south'. Its natural resources, rocky peninsular, limestone cliffs, white powdery beaches, tranquil broad bays and tropical in-land forests contribute to making it the South's wealthiest, busiest, most visited and most popular island and province (Tourism Authority of Thailand 2010).

Phuket is considered as an international tourist destination which attracts a number of tourists from all over the world. According to C9 Hotelworks (2010b), Phuket's top 5 source markets are the following:.

**Table 1: Phuket's top 5 source markets**

<b>Rank</b>	<b>Top Source Markets</b>	<b>Top Asian Markets</b>	<b>Top Growth Market</b>
1	Australia	China	China
2	Sweden	Japan	Korea
3	Russia	Korea	Australia
4	China	Malaysia	Middle East
5	United Kingdom	Singapore	Russia

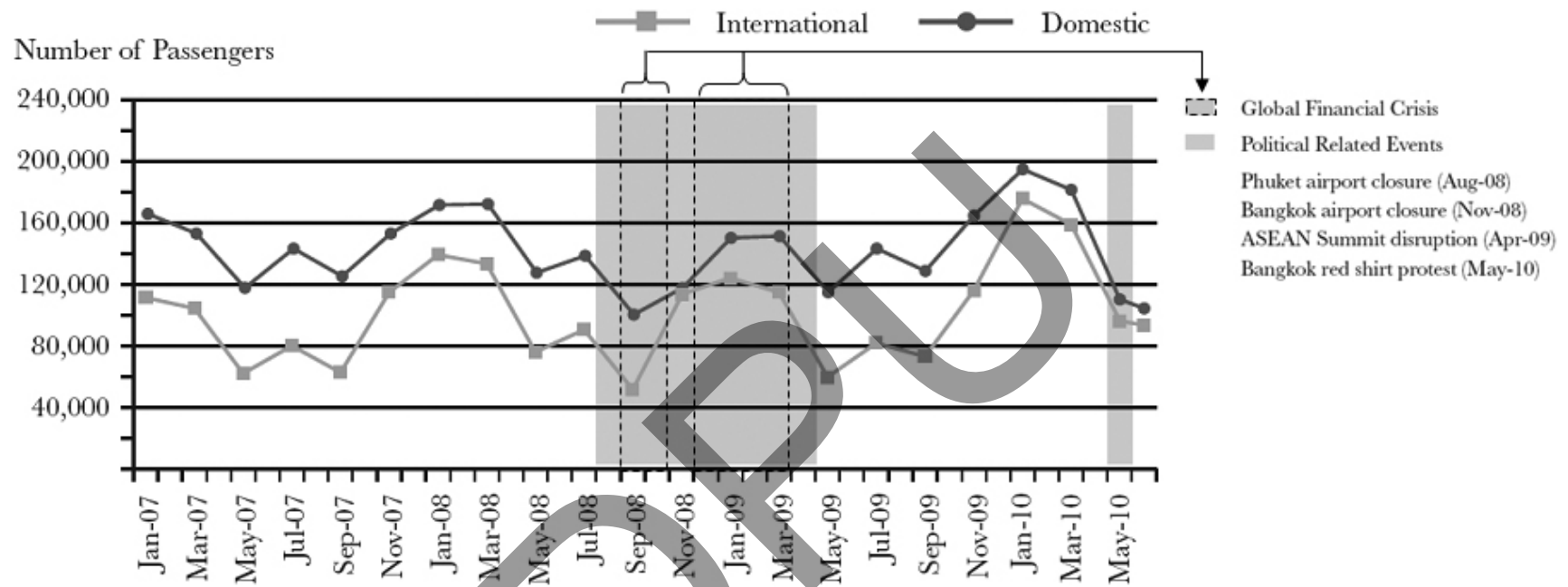
Source: C9 Hotelworks (2010b)

Like other tourism destinations in Thailand, Phuket has been affected by the economic crisis, which deters some travelers particularly from long-haul markets (Theparat 2008). Although Phuket has recovered from the 2004 tsunami, and such a recovery has been endorsed by The Tourism Authority of Thailand's statistics of a full physical recovery for the tourist business, the current global economic crisis, however, sent visitor numbers plunging once again (The Age 2009). This statement has been supported by the Phuket Tourist Association which stated that the number of tourists coming to the Andaman coast in 2009 fell slightly owing to the current global economic downturn (MCOT 2009). As hotels are a crucial part in Phuket's tourism industry, Phuket hotels inevitably have been affected by the economic crisis.

In turn, Phuket hotels have suffered a blow to key metrics, revenue per available room (RevPAR) and average room rates (ADR). Wide scale discounting of 20% led to losses in 2009 of approximately US\$300 million in room revenue. In fact, Phuket's annual visitor arrivals of 2.9 million in 2009 are only equivalent to those in 2007 level (C9 Hotelworks 2010a) as shown in the figure below.

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Figure 4: Visitor arrivals at Phuket International Airport



Source: C9 Hotelworks (2011)

As illustrated in the figure above, visitor arrivals at Phuket International Airport during the economic crisis period are significantly lower than the number of visitor arrivals during the same month a year ago. In addition, bottom lines have been hit as hoteliers attempted to induce demand and meet increasing consumer pressure for lower rates. Virtually every chain scale tier was affected with the exception of the budget and economy segment. In summary, 2.9 million tourists visited Phuket in 2009 with an island-wide average occupancy of 64%. This means average rates and revenue per occupied room have dropped by 20% and 22% respectively compared to 2008 (C9 Hotelworks 2010a).

### Summary of a Research Background

The economic crisis has affected international tourism demand worldwide, and Phuket is no exception (The Age 2009). Such a crisis has caused a sharp drop in tourist arrivals, and this is the major reason why the demand in Phuket hotel rooms has declined recently. Therefore, it is crucial for management at Phuket hotels to identify the best practices or 'critical success factors' of economic crisis management. In order to do so, they will first need to understand local negative factors affecting Phuket hotels, and examine the impacts of the economic crisis as global negative factors that affect Phuket hotels.

Using Phuket as a case study, it is envisaged that the findings of this research would provide both rich and substantively meaningful understanding of crisis management during an economic crisis, which will not only provide an academic contribution to existing tourism literature, but also provide managerial implications to tourism suppliers so that they can instigate an effective strategy which can be applied in an economic crisis situation.

In order to meet such needs, this research has developed the following research objectives:

## Research Objectives

Objectives of this research are:

1. To examine local negative factors affecting Phuket hotels.
2. To examine economic crisis as a global negative factor affecting Phuket hotels.
3. To investigate the critical success factors (CSFs) of crisis management implemented by Phuket hotels during an economic crisis.

## Research Definitions

- **Crisis:** An adverse incident with an unpredictable outcome (Bland 1998; Campbell 1999; Coombs 1999; Coombs & Holladay 2002; Ruff & Aziz 2003).
- **Crisis management:** A systematic effort by organizational members to avert crises, or to effectively manage those that do occur (King III 2002).
- **Critical success factor (CSF):** The limited number of areas in which results, if they are satisfactory, will ensure successful performance for the organization (Rockart 1979, p. 85).
- **Economic crisis:** a long-term economic state characterized by unemployment and low prices and low levels of trade and investment (Princeton University 2011).
- **Risk:** Any unintended or unexpected outcome of a decision or course of action (Wharton 1992, p. 5).

## Research Frame

In order to accomplish the research objectives, only recent economic crises from the year 2008 onwards will be covered in the study, whilst target populations are hotels in Phuket that have a room rate of at least 133 USD (approx 4,280 Baht) per night.

## **Research Limitations**

Although data have been collected only by interviewing executives at Phuket hotels with a room rate of at least 133 USD (approx 4,280 Baht) per night, it is envisaged that selected hotels in Phuket will be able to provide sufficient insightful information in regard to the crisis management approaches used during crisis situations.

## **Research Justifications**

This research primarily focuses on the impact of an economic crisis on Phuket hotels and how such a crisis can be managed from a hotel's perspective. Results from this research will enable tourism stakeholders, such as hotels, tourism authorities, tourism organizations, and tourism associations, to have a better understanding toward crisis management in order to be 'proactive' rather than 'reactive' when an economic crisis hits the tourism industry.

Moreover, it is envisaged that this study will provide a variety of key outcomes and specific deliverables to the tourism industry. The study will review the literature in this field and offer a series of recommendations which may be considered and implemented by various tourism bodies, not only in Phuket but also in Thailand.

## **Summary**

This chapter has laid the foundations for this research and presented its key concerns, research considerations, and research focus. It has supplied background to the research by illustrating the significance of the tourism industry, particularly hotel businesses, in Phuket and how it has been affected by recent economic crises. Taken together, this forms the basis for the research objectives which underpin this inquiry.

Literature in regard to crisis management in the tourism industry will be reviewed in Chapter 2.