



Pestana Hotel Group: North America Expansion

Bernardo Vieira

Dissertation written under the supervision of Professor Nuno Cardeal.

Dissertation submitted in partial fulfilment of requirements for the MSc in Management with specialization in Strategic Marketing, at the Universidade Católica Portuguesa, December 2022.

Abstract

Title: Pestana Hotel Group: North America Expansion

Author: Bernardo Vieira

Pestana Hotel Group, the largest Portuguese hotel chain, celebrated in 2022 five decades of success in the hospitality sector. After years of solidifying its presence in Portugal, the company expanded its business outside Portuguese borders.

For a long time, the company wanted to expand its U.S. operations, given the market's attractiveness. In 2012, it announced its entry in Miami, and only in 2020 did it start the expansion process in New York City, through a unique entry mode – ground lease contracts.

This dissertation aims to present students, through a pedagogical format, a real-life example of the process and challenges hotel companies face when pursuing an internationalization strategy in the U.S. market. Additionally, it addresses relevant frameworks on internationalization strategies, where students can apply what they learn in class and discuss the company current and future expansion strategy in U.S. market.

To analyze the internationalization strategy of the company, primary and secondary data were gathered. For primary data, interviews with key contacts from the company were documented. As for secondary data was used Pestana reports, industry case studies, books, and online sources. The findings that motivated the company to reinforce its presence in U.S. is the market potential, the average daily rate, and strategic tourism destination.

Keywords: Internationalization strategies; tourism sector; hospitality.

Resumo

Título: Pestana Hotel Group: Expansão na América do Norte

Autor: Bernardo Vieira

O PHG, a maior cadeia hoteleira portuguesa, celebrou em 2022 cinco décadas de sucesso no setor hoteleiro. Depois de anos a solidificar a sua presença em Portugal, a empresa começou a expandir os seus negócios fora das fronteiras portuguesas.

Por muito tempo, a empresa quis expandir sua operação nos Estados Unidos, dada a atratividade do mercado. Em 2012, anunciou a sua entrada, em Miami e só em 2020 iniciou o processo de expansão em Nova York, por meio de um modo de entrada único – contratos de locação de terrenos.

Esta dissertação tem como objetivo apresentar aos alunos, através de um formato pedagógico, um exemplo da vida real do processo e desafios que as empresas hoteleiras enfrentam quando prosseguem uma estratégia de internacionalização no mercado norte-americano. Adicionalmente, aborda modelos relevantes sobre estratégias de internacionalização, onde os alunos podem aplicar o que aprenderam em sala de aula e discutir a estratégia de expansão atual e futura da empresa no mercado americano.

Para analisar a estratégia de internacionalização da empresa, foram recolhidos dados primários e secundários. Para dados primários, foram documentadas entrevistas com contactos estratégicos da empresa. Quanto aos dados secundários foram utilizados relatórios da empresa, estudos da indústria, livros e fontes online.

As descobertas que motivaram a empresa a reforçar sua presença nos Estados Unidos são o potencial de mercado, o índice diário de preço e o destino estratégico do turismo.

Keywords: Estratégias de internacionalização; sector do turismo; hotelaria.

Acknowledgements

I would like to express my deepest gratitude to those who encouraged and guided me during this long process:

To my thesis advisor, Professor Nuno Cardeal who was always available to provide feedback despite the geographic distance.

To my friends who always encourage me to complete my dissertation.

To Pestana Hotel Group, particularly to José Carlos Fernandes and Tomás Gonçalves. Without their invaluable information, this dissertation wouldn't be possible.

Finally, I want to thank my parents, brother, and wife for their unconditional love and support.

List of Abbreviations

U.S.	United States
PHG	Pestana Hotel Group
UNWTO	United Nations World Tourism Organizations
IMF	International Monetary Fund
FDI	Foreign Direct Investment
CRM	Customer Relationship Management
GDP	Gross Domestic Product
ILO	International Labor Organization
NYC	New York City
LA	Los Angeles
GRI	Global Review Index
RGI	Revenue Generated Index
RevPar	Revenue Generated per Available Room
ADR	Average Daily Rate
OOC	Occupancy Rate
CR7	Cristiano Ronaldo 7
P/L	Profit & Loss
MICE	Meetings, incentives, conferences & exhibitions
OTA	Online Travel Agency
ROI	Return on Investment

List of Figures

Exhibit 1: Evolution of Pestana Group in terms of the number of rooms and ranking.

Exhibit 2: Pestana Group operation per Continent.

Exhibit 3: World GDP growth rate from over the last 10 years - 2012 – 2022.

Exhibit 4: Monthly evolution per international tourist arrival 2019 – 2022.

Exhibit 5: Top five industries impacted by Covid-19.

Exhibit 6: U.S. International arrivals from 2000-2021 | Impact on sales and employment in 2020.

Exhibit 7: International visitor spending in U.S. 2019-2021.

Exhibit 8: Top 10 U.S. Arrivals in 2021.

Exhibit 9: Market size of the hotel and motel sector in the United States from 2012 to 2021, with a forecast for 2022(in billion U.S. dollars).

Exhibit 10: Number of hotel jobs in the United States from 2018 to 2021, with a forecast for 2022 (in millions).

Exhibit 11: Selected cities with the most expensive hotel rates in the United States as of June 2022 (in U.S. dollars).

Exhibit 12: Summary of Pestana U.S. units.

Exhibit 13: Pestana U.S. operations.

List of Tables

Table 1: Entry modes and control.

Table 2: The CAGE distance framework.

Table 3: Porter's five forces model.

Table 4: Porter's generic strategies.

Table of Contents

<u>I. CASE STUDY</u>	1
1. INTRODUCTION	1
2. PESTANA GROUP	2
2.1. ABOUT.....	2
2.2. HISTORY.....	4
2.3. PORTUGUESE MARKET	4
2.4. INTERNATIONALIZATION	5
2.5. PARTNERSHIPS	6
3. THE HOSPITALITY INDUSTRY	6
3.1. US MARKET	9
3.1.1. Tourism in US – Market Overview	10
3.1.2. Hospitality in US – Market Overview	12
3.2. PESTANA US OPERATIONS.....	15
3.2.1. Entry Mode	16
3.2.2. Challenges.....	18
3.2.3. Competitors.....	19
3.2.4. Future Strategic Plans	20
<u>II. RESEARCH NOTE</u>	21
1. ENTRY MODE	21
2. CAGE	22
3. PORTER’S FIVE FORCES	23
4. COMPETITIVE ADVANTAGE	25
<u>III. TEACHING NOTE</u>	26
1. INTRODUCTION	26
2. SYNOPSIS	26
3. TEACHING OBJECTIVES	27
4. SUGGESTED ASSIGNMENT QUESTIONS	27
5. ANALYSIS AND DISCUSSION	27
<u>IV. CONCLUSION AND LIMITATIONS</u>	33
<u>V. REFERENCES</u>	35

I. Case Study

This is a pedagogical case study of a Portuguese hospitality group that recently reinforced its internationalization program within the United States. The purpose of this dissertation is to offer students the opportunity to learn from this case by applying concepts and frameworks discussed in the research and teaching notes.

For the research, interviews were conducted with two contacts from the company, José Carlos Fernandes, Director of U.S. Operations, and Tomás Gonçalves, - Development, Research & Valuation Manager - responsible for identifying, analyzing, and conducting expansion plans.

The case study structure is as follows: a general introduction to Pestana Hotel Group, its history, domestic and international operation. Followed by a chapter addressing an overview of the tourism and hospitality sector and a chapter dedicated to the operation of Pestana U.S. Finally, the research note, framework, and concepts are introduced followed by the teaching notes.

Research Questions

This dissertation is focused on answering the following questions:

- Analyze the attractiveness of the industry Pestana operates in.
- What was the entry mode strategy adopted by Pestana Hotel Group in U.S. market? How do they differ between Miami and New York City operations? What are the advantages and disadvantages of those strategies?
- Imagine working for the Business and Development Department of Pestana Hotel Group. Would you continue to invest in U.S. market and expand its operations? Please apply CAGE framework concepts.

1. Introduction

The year 2022 will be very a particular year for the family business Pestana Hotel Group (PHG). The Group celebrates five decades of success in the tourism industry. Currently managing over 100 hotels, the Group's success was achieved through a robust business model that combines ownership, leasing, and managing with high operational efficiency.

The company capacity to consistently maintain high profitability levels, even during periods of economic downturns, is only possible due to the unique asset portfolio and efficient business model led by top management.

Currently in over 16 countries, the company’s goal is to continue strengthening the domestic market and accelerate investment in the international market. In recent years the Group turned his attention to U.S. market. After opening in 2012 the Pestana Miami South Beach hotel, an art deco hotel, the Group intended to find further business opportunities on the East Coast, specifically in New York. Finally, in 2020, the Group opened two hotels in the city – Pestana Park Avenue and Pestana CR7 Times Square. The timing could not be worst, a few months later, the hotels closed when the country and the world dived into a global pandemic crisis. It was hard times for the Group as a whole, but due to their healthy financial situation and top management capacity to deal with adversity they were able to turn around.

Currently, all businesses are back in operation, and the U.S. market thriving.

2. Pestana Group

2.1. About

PHG is considered the largest multinational Group of Portuguese origin in the hospitality and tourism sector (exhibit 1), with more than €262M of revenue in 2021. In 2022 the Group will celebrate five decades of success in a very competitive industry. Pestana is currently present in the European, American, and African continents (exhibit 2), managing over 100 hotels and more than 12,000 rooms (exhibit 1). Every year the Group greets around 3,5 million guests from all around the world.

Exhibit 1: Evolution of Pestana Group in terms of the number of rooms and ranking.



Source: Pestana Group website

Exhibit 2: Pestana Group operation per Continent.

EUROPE	NORTH AMERICA	SOUTH AND CENTRAL AMERICA	AFRICA
PORTUGAL	UNITED STATES OF AMERICA	BRAZIL	MOROCCO
SPAIN		ARGENTINA	CAPE VERDE
ENGLAND		URUGUAI	MOZAMBIQUE
GERMANY		VENEZUELA	SAO TOME AND PRINCIPE
NETHERLANDS			SOUTH AFRICA

Source: Pestana Group website

Even though hospitality is considered its primary business, the Group also operates in other areas such as tourism real estate, casinos, vacation clubs, golf, and beer company.

In hospitality, the Group has four brands: Pestana Hotels & Resorts, Pestana Collection Hotels, Pestana Pousadas de Portugal, and Pestana CR7 Lifestyle Hotels each with a different value proposition.

Pestana Hotels & Resorts portfolio combines more than fifty sophisticated resorts and smart urban locations of four- and five-star hotels located across three continents.

The super-premium value proposition relies on its Collection Hotels, combining an exclusive collection of seven properties in prime locations across Europe. All properties are luxurious buildings and monuments, classified as hidden treasures that offer unique experiences to their guests.

Pestana Pousadas de Portugal resulted in a concession by the Portuguese Government to Pestana Group, in 2003. This portfolio results in thirty-four national treasures managed by the Group, offering the ultimate Portuguese experience in some of the country's most historical and iconic properties.

Finally, Pestana CR7 Lifestyle Hotels, the company's most recent brand, results from the partnership between Pestana's hotelier expertise and Cristiano Ronaldo (CR7) lifestyle. With this partnership the Group wants to target a younger audience by offering an exclusive and unique value proposition, with each hotel being in exceptional locations with unique designs and decorations. There are five hotels of this brand, located in Funchal, Lisbon, Madrid, New York, and, more recently Marrakech. The Group announced a plan to open two more unique hotels, one in Paris and one in Manchester.

2.2. History

PHG started with its first hotel in Madeira Island, back in 1972, the Carlton Madeira¹, owned by Manuel Pestana and his brother José and managed by the Sheraton Hotel Chain. With that opening the brothers founded M & J Pestana – Sociedade de Turismo da Madeira and began the activities that would shape the future of Pestana Hotel Group. A few years later, José Pestana sold his shares to his brother, Manuel, who became the enterprise's sole owner. After 1974, the Group struggled with financial difficulties due to socioeconomic factors influenced by post revolution. The country had been ruled for several years by a dictatorship regime. Soon after the revolution, the country went through a socioeconomic crisis characterized by political and social instability, high inflation, and rising interest rates.

These economic conditions also had a significant impact on the hospitality sector, with a significant drop in demand.

During that period of political and economic turmoil, many hotels, Pestana included, faced bankruptcy due to organizational and financial difficulties. For Manuel, it would be inconceivable to admit failure, so he trusted his son's, Dionísio, expertise to save the family business.

In 1976, after completing university studies in business management, Dionisio, accepts his father's challenge to take over the operation in Madeira. The goal was simple: try to make the hotel viable. It was a huge endeavor that Dionisio faced once he arrived in Madeira.

After spending most of his life in Johannesburg, where he was born and raised, he faced harsh economic conditions. However, under his leadership, they succeeded and, in a few years, precisely four years, were able to turn the hotel into a profitable business (and even today is one of the most profitable hotels in the Group).

2.3. Portuguese market

The expansion strategy of the PHG started in 1985, with the construction and opening of Madeira Beach Club, the first Resort in the Pestana Vacation Club. This exclusive club offers its members preferred access over the 100 hotels as well as unique holidays experiences in the thirteen Pestana resorts.

¹ Only in 1990 the Sheraton chain end its management partnership with Pestana. The hotel was renamed Madeira Carlton Hotel and, later Pestana Carlton Madeira after the creation of the new Pestana Group trademark.

One year later, in 1986, the Group acquired the five-star hotel Pestana Casino Park, an iconic building in Madeira, designed by Oscar Niemeyer (Pritzker Prize winner), below its market value. Pestana identified a business opportunity during the oil crisis when ITI-Investmentos Turisticos da Ilha da Madeira, the previous owner of Casino Madeira, was facing financial downturns. This acquisition strategy proved to be a success and would be extended to future acquisitions.

The expansion to Portugal's mainland was only possible after consolidating its position in Madeira region. This expansion started only in 1992, twenty years after the first hotel in Madeira. It would continue until the end of the decade, setting the beginning of its leadership in the tourism sector in Portugal. In 1992, Pestana acquired five units in Algarve and one in Cascais, Pestana Atlantic Gardens Ocean & Conference Aparthotel. During the 90s, it also diversified to other businesses after acquiring an aircraft leasing and charters company and golf courses in Algarve.

In 2001, the Group opened Pestana Palace Lisboa – Hotel & National Monument, the first hotel of the Pestana Collection hotel brand, a late nineteenth-century former palace. In 2003, the Portuguese Government conceded the management, for twenty years, of the Pousadas de Portugal historic hotels to PHG, after winning an international bid, allowing the Group to double its portfolio.

2.4. Internationalization

The internationalization process started in 1998, in Mozambique, with the management of three four-star hotels: Pestana Inhaca Lodge, Pestana Bazaruto Lodge, and Pestana Rovuma Hotel & Conference Centre in Maputo, a building once owned by Dionisio's father, Manuel and later nationalized.

After the African Continent, the Group started its expansion in South America, with the first investment in Brazil, after acquiring Pestana Rio Atlântica, in 1999. Over the years, the company continued to invest in the country, with a Portfolio of over four hotels.

The year 2002 was a special year for the Group, with the celebration of the moto "Thirty years, thirty hotels". In that same year, Dionisio decided to invest in his home country by acquiring Pestana Kruger Lodge Safari Resort, in South Africa. Over the following years it continued its expansion in the African Continent, currently managing hotels in 5 countries, Cape Verde, São Tomé, South Africa, Mozambique and more recently Morocco.

For a long time, the Group wanted to expand within the European Continent. However, due to the fierce competition and regulatory adversities, it had to put aside that ambition until all the conditions were gathered. Finally, in 2010, the company opened its first hotel in a European Capital Outside of Portugal, the Pestana Chelsea Bridge hotel, in London. After that the PHG did not stop and one year later opened hotels in Berlin, the Pestana Berlin Tiergarten, followed by Barcelona, Amsterdam, and Madrid.

The debut in the North American market started in 2012, with the Pestana Hotel in South Beach Miami. It was also the first Portuguese hotel company to enter in the North American Market.

Only eight years later, the Group would expand its presence in this market with the opening of the New York City hotels.

Currently, the international market represents more than 10% of the Group's revenue, and the goal is to continue to expand Pestana's brand over borders.

2.5. Partnerships

The first partnership of the Group was back in 2003 with the integration and management of Pestana Pousadas de Portugal after winning the concession from the Portuguese Government. This partnership with the Portuguese Government recognized of the Group's expertise in developing the Portuguese identity within the tourism sector.

The most recent partnership was in 2016, beginning of the joint venture between Pestana and Cristiano Ronaldo and the fourth brand: Pestana CR7 Lifestyle Hotels. That same year, the PHG opened two hotels under the CR7 brand umbrella, in Funchal and Lisbon. A few years later the company would open Pestana CR7 Madrid, New York, and Marrakesh.

This partnership was essential to target a new segment, millennials, and at the same time, allowed to use CR7 brand and reputation to unlock strategic locations such as in Madrid, New York, and Paris.

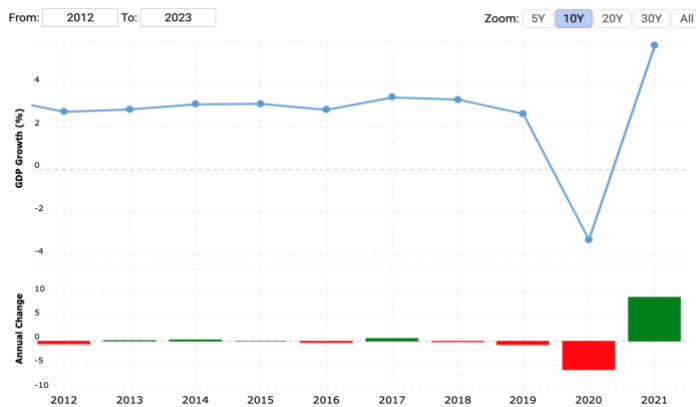
3. The Hospitality Industry

The year 2021 was marked by a slow recovery from the Covid-19 pandemic. After years of moderate growth, the world economy ended up being severely affected by the world pandemic. Restrictions on population mobility were imposed by local Governments, to prevent the spread of the infection and reduce the constraints on the overloading health

system. Shortages in supply and reductions in available income due to lay-offs, deeply affected the global economy's GDP, leading to a deep recession (exhibit 3).

The development of vaccines and the global vaccination policy contributed to reducing the severity of Covid-19 cases, reducing the number of infections, hospital admissions, and mortality numbers. Conditions improved compared to the previous year but were still far from those in 2019. The global vaccination process was long and carried out at different rates, varying from country and region. The most developed countries were able to accelerate this process while emerging countries struggled to keep the pace due to weaker social and health structures.

Exhibit 3: World GDP growth rate over the last 10 years - 2012 – 2022.



Source: macrotrends.com & IMF.org

The hospitality industry was severely affected by mobility measures adopted in local policies. Border controls were maintained throughout the year, with specific requirements to conduct pre-and post-arrival testing. In some countries, quarantine periods were mandatory upon arrival, discouraging tourists from traveling to those destinations.

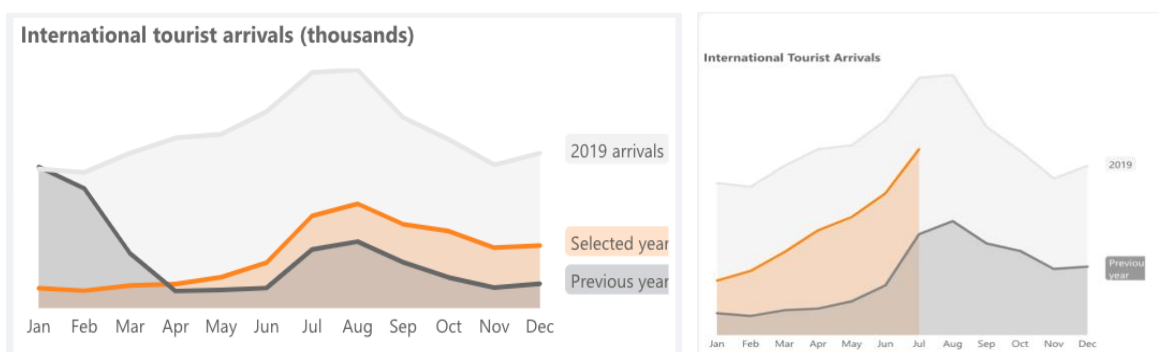
As the vaccination process continued to accelerate, local restrictions started to be lifted off. Domestic travel overlapped long-haul destinations in 2021. After more than a year of restrictions, most families decided to take short trip holidays to hotel resorts, preferably on beach and rural environments, to enjoy time together and put behind the dark days of lockdown. The peak season, from June to August, was higher than in 2020 but still lower than in 2019 (exhibit 4). Families were eager to go on holidays as soon as the market opened, confirming the importance of tourism as an essential service for the health and well-being of the population.

For the hospitality industry, it was also a period of mutation and adaptation. The sector had to adapt to different and more demanding standards imposed by customers and local governments to ensure safety and public health.

There was also a significant shift in terms of destinations. The big cities' destinations suffered the most during the pandemic and took longer to recover their activity. Depending greatly on cultural and professional events, the main capitals and metropolis struggled to attract tourists. The pandemic created new opportunities for companies and employees, enabling people to work

from home remotely, hence reducing severely on-site meetings and conferences hostage. Additionally, city centers took a long time to re-open their restaurants, shops, cafés, and museums. According to UNWTO, only at the end of the summer did business and cultural centers start to receive more tourists.

Exhibit 4: Monthly evolution per international tourist arrival 2019 – 2022.



Source: UNWTO – Tourism dashboard – tourism results.

The last two years drastically shaped the hospitality industry. The severe reduction in demand and the labor market transformation greatly impacted on tourism organizations. During this period, many workers left the industry to work in less affected sectors. So once the flow of tourism started to return gradually, organizations needed to recruit and recover the working force that migrated to other sectors. A sector that in 2019 employed one out of ten jobs², is now struggling to find workers that are key to support the operational activity of the sector³. Additionally, customers are becoming even more demanding of the service's quality and flexibility.

² United Nations World Tourism Organizations (UNWTO, Policy Brief 2022)

³ International Labor Organization (ILO), 2022, The future of work in the tourism sector: Sustainable and safe recovery and decent work in the context of the COVID-19 pandemic.

For hospitality, new concepts gain more importance, such as CRM, Revenue Management Analytics, and Loyalty Ratios. Hence, it escalated the complexity of hotel management. Additionally, customer retention, cost efficiency, and revenue optimization became critical sectors to ensure business success.

Despite all the previously mentioned challenges, tourism and the hospitality industry once again proved its resilience and capability to adapt to different and more demanding standards imposed by the market.

3.1. US Market

Over the last decades, the U.S. economy has been considered one of the top global economies in the world. For many economists, the country is considered an engine of the world economy since there is a strong correlation between the world output and the movements of economic growth in U.S.⁴.

For a long time, the country has maintained its powerhouse status that relies on its abundant natural resources, well-educated and productive workforce, and sophisticated physical and digital infrastructure.

The country is ranked as the tenth most competitive country in the world in 2022, maintaining its position since 2020⁵. For several years the country has been ranked in the top three economies in the world and, even today continues to sustain competitive conditions for enterprises conduct business in the market. The most attractive indicators perceived by investors are the business environment and dynamism of the economy, as well as the easy access for companies to get financing. Additionally, the unemployment rate in the country continues to be low (around 5%) with a very talented and skilled workforce.

The lowest indicators are related to tax regime, immigration laws, and political instability. Nevertheless, the United States was the top FDI⁶ destination worldwide in 2021, replacing China and so reaffirming the country's attractiveness from an investor's perspective⁷.

⁴ International Monetary Fund (IMF) paper 2001 - The Impact of U.S. Economic Growth on the Rest of the World: How Much Does It Matter?

⁵ IMD World Competitive report 2021

⁶ FDI – Foreign Direct Investment, can be defined as the purchase of a particular organization's interest by another foreign organization.

⁷ Organisation for Economic Co-Operation and Development (OECD) report 2022

3.1.1. Tourism in US – Market Overview

Tourism and hospitality are strongly correlated since both rely heavily on international and domestic travelers.

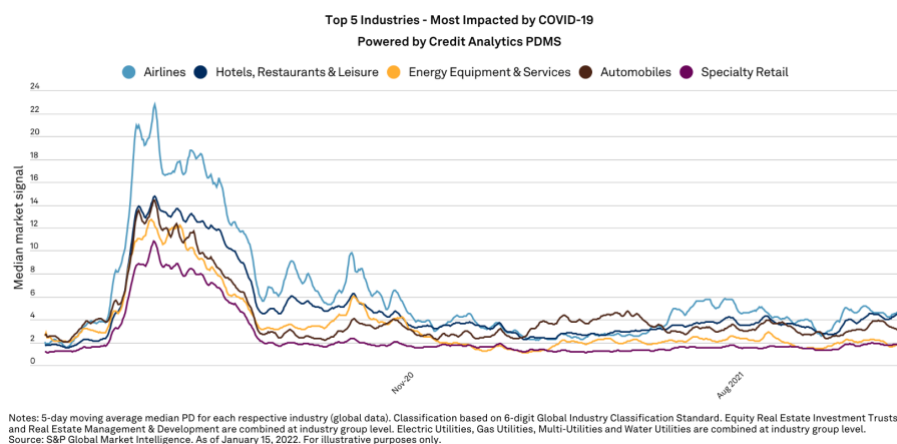
For U.S., these sectors continue to be a critical driver of economic growth and employment, supporting over 9,5 million American jobs and contributing around \$1,9 trillion.

The country continues to be one of the top destinations for global travel and tourism⁸. Just in 2019, the country received 79,4 million international visitors that contributed \$239,4 billion to the U.S. economy⁹, making the U.S. the global leader in revenue from international travel and tourism.

The tourism and hospitality sector thrived for a long time, benefiting from sustainable growth, until March 2020, when the Covid-19 pandemic broke out.

The pandemic had severe effects on the global economy and impacted all sectors. However, when we analyze the most impacted industries by the global crisis, Tourism and Hospitality rank number one and two (exhibit 5).

Exhibit 5: Top five industries impacted by Covid-19



Source: S&P Global Market Intelligence

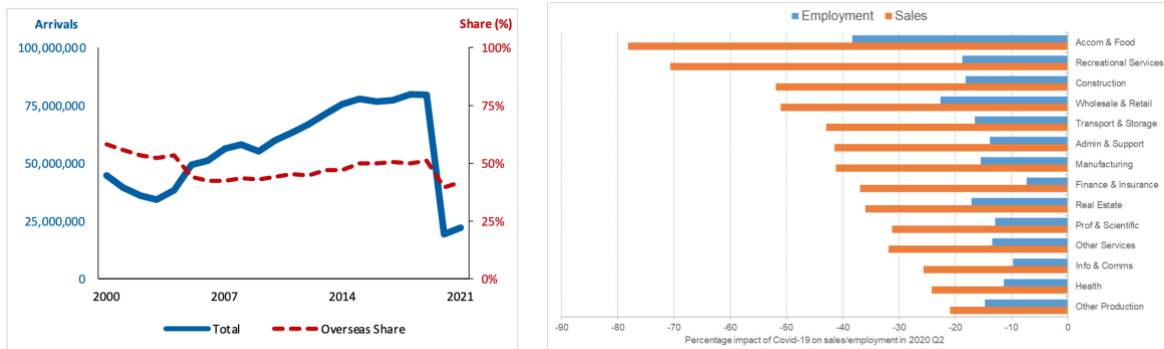
Once a global pandemic was decreed, the U.S. government, as well as other countries, adopted mobility measures to slow the spread of the virus. The impact was immediately felt on airlines and subsequently on the food and accommodation sector (exhibit 6).

⁸ United Nations World Tourism Organizations (UNWTO, Tourism dashboard

⁹ U.S. Chamber of commerce – National travel tourism strategy, report 2022

In December 2020, international travel arrivals were -84% more than the previous year. While in 2021, the U.S. inbound arrivals represented an increase of +15% when compared to 2020 (22,1M) however, it remained 50% below 2019 levels.

Exhibit 6: U.S. International arrivals from 2000-2021 | Impact on sales and employment in 2020

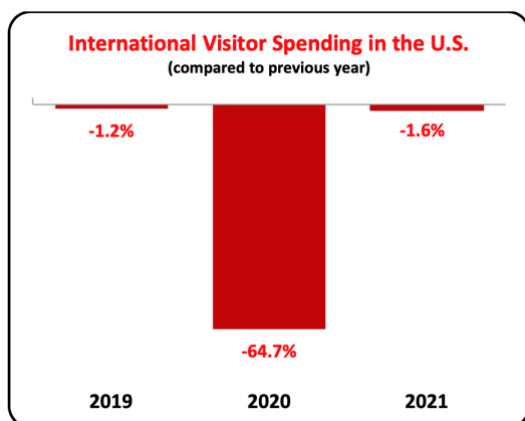


Source: International Trade and Administration – *Factsheet International Visitation, 2022*

Source: Economic Observatory, 2020– *Which firms and industries have been most affected by Covid-19?*

Although there was an increase in international arrivals in 2021, the spending level was below 2020 (-1,6%). The reduction of available income and changes in the market mix from international inbounds negatively impacted the average spending of international visitors (exhibit 7).

Exhibit 7: International visitor spending in U.S. 2019-2021



Source: U.S. Department of Commerce, International Trade Administration, Industry & Analysis, National Travel and Tourism Office; Bureau of Economic Analysis; Statistics Canada; Instituto Nacional de Estadística y Geografía (INEGI); U.N. World Tourism Organization.

Top 10 arrivals to the United States:

Given its proximity to U.S., Mexico supplanted Canada in 2020 as the top source market for international travel to United States. This status continued in 2021, as Mexican arrivals rose (+52,7%) while Canadian arrivals fell (-47,4%) from 2020 due to differences in Covid-19 travel restrictions between countries (exhibition 8).

Six of the top 10 arrival markets in 2021 were not in the top 10 in 2019, most from South and Central America.

The market mix of international arrivals directly impacts the average spending of international visitors. According to IMF data, South American and Central American countries have lower GDP per capita than Asian and European countries. Hence, international inbound is gradually recovering from the pandemic but mainly through visitors with lower available income, resulting in a lower expenditure per visit to the U.S. economy.

Exhibition 8: Top 10 U.S. Arrivals in 2021

	Country	Arrivals	Share	Change from 2020	Change from 2019	Change in 2021 Rank
	Total	22,100,453	100.0%	15.0%	-72.2%	From 2019
1	Mexico	10,396,724	47.0%	52.7%	-43.3%	↑ +1
2	Canada	2,529,022	11.4%	-47.4%	-87.8%	↓ -1
3	Colombia	1,063,659	4.8%	293.8%	12.7%	↑ +10
4	United Kingdom	460,749	2.1%	-36.9%	-90.4%	↓ -1
5	India	433,305	2.0%	29.0%	-70.6%	↑ +5
6	Ecuador	407,417	1.8%	140.6%	-10.8%	↑ +15
7	Dominican Republic	405,869	1.8%	127.1%	-16.9%	↑ +12
8	Peru	404,937	1.8%	340.5%	22.0%	↑ +20
9	Argentina	301,794	1.4%	52.6%	-64.7%	↑ +6
10	Guatemala	279,896	1.3%	249.5%	-0.8%	↑ +24

Source: U.S. Department of Commerce/ ITA/ I&A / National Travel and Tourism Office (NTTO) / ADIS / I-94 Program

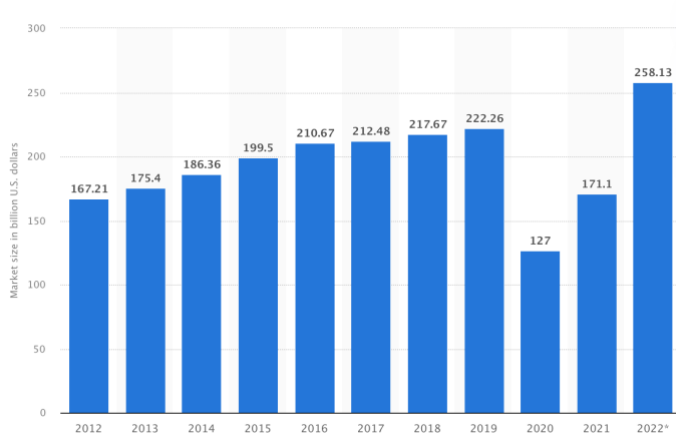
3.1.2. Hospitality in US – Market Overview

The hotel and motel sector market size within United States has grown substantially over the years. Its peak was reached in 2019, with a market valuation over \$222 billion before the downsize of 2020 and 2021, due to the pandemic crisis. For 2022, the market size in the sector was forecast to reach 258.13 billion, the highest valuation over the last 10 years (exhibit 9). However, as was previously mentioned, the average spending per visit has decreased over the last few years, so this forecast should be interpreted with caution.

In addition, this sector contributes significantly to the employment rates in the job market. In 2021, the number of hotel jobs in the United States amounted to 1.82 million, representing

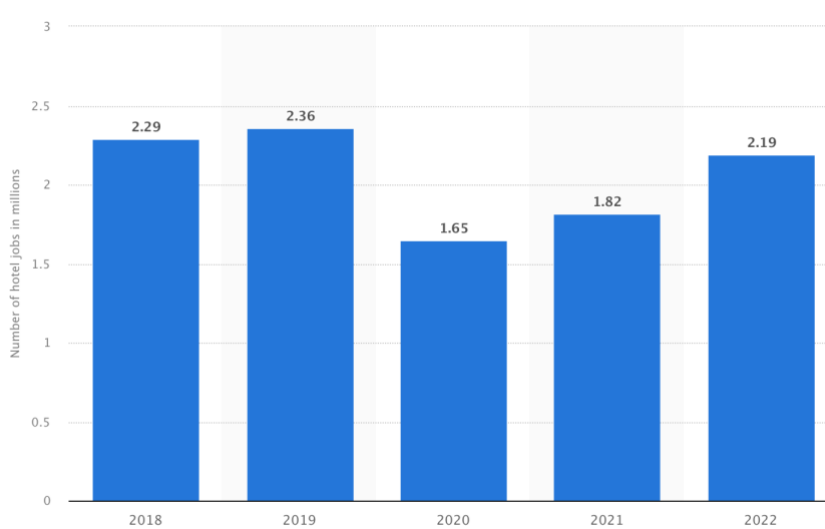
an increase over 2020 (1,65 million jobs) but still lower than the levels of 2019 when this sector alone employed 2,36 million workers (exhibit 10).

Exhibit 9: Market size of the hotel and motel sector in the United States from 2012 to 2021, with a forecast for 2022(in billion U.S. dollars)



Source: IBISWorld - United States; 2012 to 2021

Exhibit 10: Number of hotel jobs in the United States from 2018 to 2021, with a forecast for 2022 (in millions)



Source: United States; Oxford Economics; 2018 to 2021

Additionally, this industry highly relies on immigrant workers, representing over 30% of the hospitality workforce, to ensure hotel operations keep running. Its weight varies depending on the State and city. For instance, in Florida, the hospitality industry employs over 33% of immigrant workers, meaning 1 out of 3 are immigrants. This situation is very relevant when we analyze U.S. labor market policy concerning working visas. The country is very strict with working permits and has become even more strict after President Trump election in

2016. More recently, with Biden's Administration some of the labor market laws changed and eased to ensure that companies and strategic sectors would not face workforce shortages. However, the U.S. market is still considered one of the most challenging labor markets to enter for foreigners.

Top Destinations in U.S.

The country has a lot to offer, from its vibrant cities, remarkable landmarks, National parks, and unique art and culture experiences. United States tops the third destination in the world, along with France and Spain, according to United Nations World Tourism Organization.

The remarkable landmarks, business hubs, and unique pop culture have attracted generations of tourists over the last decades. The country continues to mutate and influence new generations through its social media content, technology advancements, and entertainment platforms, so its popularity is expected to continue over the next years.

The most visited cities in U.S. are New York, followed by Miami and Los Angeles. Each is very different from the other. New York is known for its iconic landmarks, from the Statue of Liberty to the Empire State Building to Central Park and Broadway Street, has long been associated for its power and prestige.

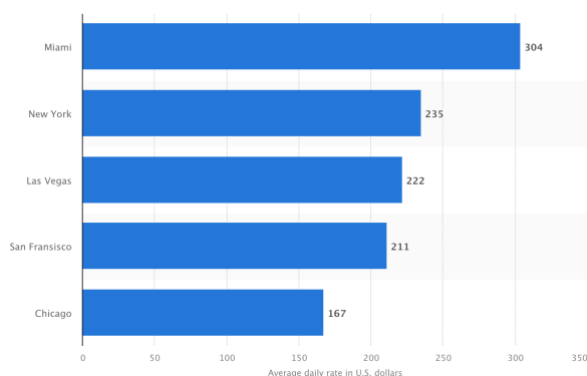
Miami is known for its famous beach, warm weather, Hispanic culture, unique street art, and gastronomy. Lastly, LA, the city of Angels, in California. The city is often associated with America cinema and the music industry.

Though New York ranks the most visited city in U.S. when analyzing the average price per rate, Miami outranks., with an average of 304 U.S. dollars (exhibit 11).

The city has become more expensive over the last years due to the influx of high-profile financiers lured by Florida's income tax benefits.

For Pestana U.S. those indicators are very positive since it reinforces the investment made by the Group in those two cities.

Exhibit 11: Selected cities with the most expensive hotel rates in the United States as of June 2022(in U.S. dollars)



Source: United States; Trivago; as of January 2022

3.2. Pestana US Operations

In every internationalization strategy a company should address the following questions: why, where, what, and how. For Pestana, the answers to those questions were very clear.

Why United States: the market is very attractive, given the volume of international inbounds and domestic travelers. Additionally, the Group’s strategy is to diversify its portfolio to mitigate the risk of being exposed to the economic crisis of a specific country. Finally, according to the Group’s founder, Dionísio Pestana, the U.S. market represents the “*Champions League*” of Tourism and Hospitality. All the key players operate there and its where the industry’s main transformations occur before being implemented in other markets.

Where in United States: for a long time, the Group wanted to enter in New York City due to its unique features and what it represents to the Tourism industry. However, Pestana was aware of the difficulties in terms of entry costs and cultural and legal differences. Hence, when presented with a unique investment opportunity in Miami, it decided to postpone the NY ambition and expand the operations to Miami, Florida. The climate and culture of Miami were very similar to South America countries where the Group successfully implemented a solid business model (Brazil, Argentina, and Uruguay). Thus, after developing market research, it decided to move forward with the investment since all the data indicated that it was a calculated risk. Only in 2015 all the conditions were gathered to move forward in NYC in two different locations.

The What: this question is related to what PHG can offer to the host market that differentiates from its competitors. After, over 40 years of expertise, the domestic and international markets, the Group was aware of its competitive advantage. Its success was accomplished

through its unique assets' locations, and cost-controlled strategy, and highly qualified professionals trained to customize and frequently interact with the end customer, providing the ultimate Portuguese hospitality experience.

Finally, the How: refers to the entry mode strategy. For this topic, the Group followed different approaches that will be extensively address in chapter: 3.2.1. Entry Mode.

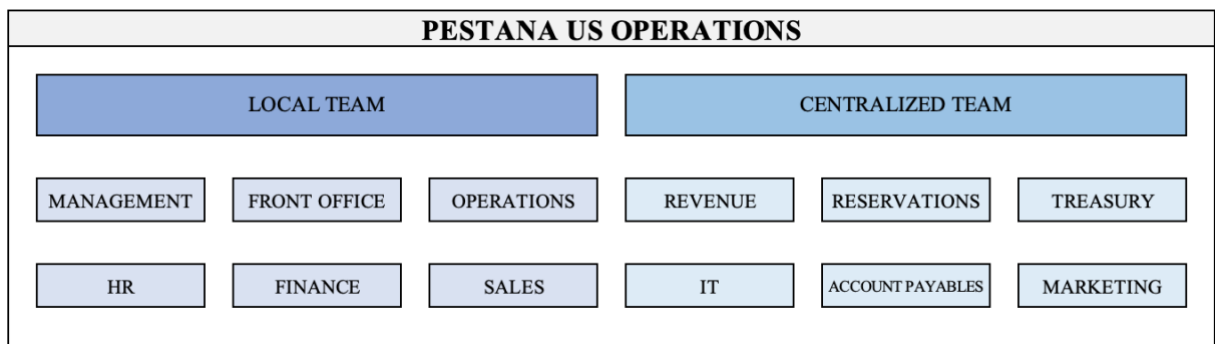
Currently, the Group operates in U.S. with three units, in two cities, as previously mentioned (exhibit 12).

Exhibit 12: Summary of Pestana U.S. units.

Name	Pestana South Beach	Pestana Park Avenue	Pestana CR7 Times Square
Location	Miami	New York City	New York City
Rooms	98	95	176
Staff	35	20	23

The operations team is split between local and centralized teams that support U.S. operations from Portugal (exhibit 13).

Exhibit 13: Pestana U.S. operations



This unique structure aligns with the Group's strategy, since it allows to balance local and Portuguese costs, which are significantly lower. However, it also originates some challenges that will be address in more detail on chapter 3.2.3. Challenges.

3.2.1. Entry Mode

There is a clear preference to follow an asset-heavy strategy in its expansion strategy. This strategy relies on acquiring, renovating, rebranding, and managing its business units.

However, more recently, the Group started to develop additional entry mode strategies that result in a collaborative relationship with a third-party entity, such as lease agreements and joint ventures, to accelerate its expansion.

For Pestana, there are several benefits to following a high-control strategy. It allows more control in terms of daily operations, promotes a more coherent group-wide communication and culture, yields advantages in terms of its intangible assets, like brand awareness and reputation and can also benefit from asset valuation.

In recent years, the company celebrated a partnership with the CR7 brand, a 50-50 joint venture with Cristiano Ronaldo. Nonetheless, even in this model, the Group maintains complete control over the management and invests a substantial stake in the development of the assets.

A few examples of business units where the Group relies on lease agreements, such as management fees. In those situations, the property already exists but it's being explored by Pestana, through a monthly fee, paid to the third party, owner of the property.

The Group recently adopted a riskier entry strategy that relies on ground lease agreements. These contracts consist in paying a fixed fee to the landowner, while the development, management, maintenance, and legal costs are supported by the developer, in this situation, Pestana. Additionally at the end of the contract, the asset belongs to the landowner, not the developer. Meanwhile, these contracts usually are long-term agreements (over 70 years), so the developer can benefit from building assets in prime locations that otherwise would represent a high acquisition cost and recover its investment for an extended period time while paying a pre-defined monthly fee to the landowner.

In U.S. the company followed two entry strategies. In Miami, the approach was full ownership through the acquisition of an existing asset, followed by renovation. In New York City, the entry mode relied on ground lease agreements, with a duration of 100 years, a prevalent entry mode in that location, and through a joint venture with CR Unipessal (Cristiano Ronaldo Unipessoal). According to Tomás Gonçalves, on average, the land represents 30% of the cost of the asset. In NYC it represents 50%. So, for the company was essential to find a feasible entry option to justify the investment. After several years of analyzing macroeconomic and industry indicators provided by internal and external partners, the Group signed the agreement with both business units.

Although the approach of NYC business units was incoherent, at a certain level, to the asset-heavy strategy, it enabled the Group to sustain its expansion strategy while creating the synergies, economies of scale, and customer experience that so far were key for the

company's success. Additionally, it allows the Group to recover its investment in the short term and even negotiate the agreement conditions in the long term.

3.2.2. Challenges

The focus of this chapter is to address the main challenges the Group faced during its expansion to New York City and was split into three different phases: development (phase I); covid pandemic (phase II); daily operations (phase III).

Phase I: The contracts for the two NYC units were signed in 2015. However, due to several bureaucracies (construction permits and local law certificates), the units were only completed between 2020 and 2021. In United States, the legal obligations may vary depending on the local obligations of each State. Additionally, there is a strong lobby industry in critical sectors of the economy (Labor and Tourism). To overcome those obstacles, the Group had to hire local consultants and law firms to assist in those two topics. Phase II: after a few months of opening Pestana Park Avenue, the world faced a global pandemic that led to a complete shutdown of the tourism and hospitality sector. For Pestana U.S. it was a very challenging period. After a significant investment in development supporting monthly rents, and building a team, the company was forced to close its hotels and layoff a significant part of its employees. Additionally, during this period, the Pestana CR7 Times Square was still in construction and was forced to postpone its development, due to healthcare measures imposed by the local Government.

Once the covid restrictions started to lift off, the Group could finish Pestana CR7 and reopen the remaining units. However, a new challenge arose after the lockdown, related to a talent shortage. The labor market started to mutate during this period of economic turmoil, as a significant part of the workforce in the sector migrated to other industries.

Phase III: several challenges result from the daily operation, mainly when its structure is split into different geographies. As previously mentioned, Pestana U.S. is organized into a local team and centralized teams, with the last being in Portugal. This organizational structure's main challenges are related to language and time zone differences, which may contribute to miscommunications between internal stakeholders. To mitigate those situations, the Group implemented a team on the Reservations and IT department in Portugal that aligns its schedules with U.S. (EAST) time zone. Through this strategy, the Group could guarantee the support of local team in key business areas.

According to the Director of U.S. Operations, the main challenge during the expansion period was the adaptation to the local culture, which was very different from the operations in Miami. The mentality, work process, and social norms were a significant shock during the assembly process of NYC team. However, Pestana knows that “the host market always wins, so it is up to Pestana to adapt to the market and share and instruct the local team of Pestana values and principles”. To sustain this approach, the Group usually starts with a team of foreigners and gradually integrates Portuguese employees in the host market after a certain period. Additionally, the company promotes workshops with headquarters by sending local teams to Portugal for a short time to learn and embrace Pestana culture. Finally, to overcome the talent shortages influenced by the pandemic, the U.S. operations accelerated its mobility program (Pestana Mobility) which consists of bringing Portuguese talent for 3 months to the U.S. consistently. Through this strategy, the market benefits from a highly specialized workforce which can share Pestana’s values and principles with the local team.

3.2.3. Competitors

The hospitality industry is characterized as being highly fragmented. According to Forbes magazine (2020), the top three chains represent less than 10 percent of the industry’s total revenues. Hence, contributes to an increased power for buyers and accelerating rivalry. For Pestana, this represents both an opportunity and a threat.

The Group compares its business model to other international chains, such as Marriot, Accor, Intercontinental Hotel Group, and Iberian counterparts. However, when developing a new business unit, a benchmark list is defined that compares the new business unit with its closest competitors (Comp Set). From that point forward, the new hotel will compare to the Comp Set in terms of the crucial industry indicators: pricing by analyzing the average daily rate (ADR), occupancy (OOC), Revenue generated per available room (RevPar) and in terms of guest satisfaction (GRI – Global Review Index), through platforms such as Review Pro that aggregates data collected from over 175 websites such as Booking.com, Google and TripAdvisor.

In United States, a competitive set (Comp Set) list was defined for each hotel according to the size of the business unit (rooms), geography (localization), and expected RevPar. The year 2022 has been very positive, with Miami achieving its best result since its opening and Park Avenue (NYC) overachieving in all crucial performance indicators – occupancy, ADR,

and GRI (reputation). According to the Director of Operations, Pestana CR7 Times Square (NYC), still has space for improvement in all the key indicators. To accelerate its performance the Group will make a significant investment in 2023 to improve the rooms and common areas.

The Group tends to align its pricing and service to the market. However, its differentiation strategy relies on its capacity to develop economies of scale, and through its service that relies on a strong selling story that aims to deliver to its guests a “Portuguese experience”.

3.2.4. Future Strategic Plans

In United States, the ambition is split into two stages: recover the initial investment and later focus on expansion plans.

The focus, in the short-term, is to improve the performance indicators of all business units and hence, achieve financial break-even for its New York units.

From all business units, only Pestana CR7 Times Square is below its fair share (RGI). However, the Group already defined a strategy to improve its performance indicators.

Once the current business units deliver all the key indicators, it can start stage two which relies on its expansion plans in the market. Currently, there is a project to enter Newark, New Jersey, through a management contract with a strategic partner. The following plans are to develop new business units in other cities throughout the East Coast – Boston, Washington, and Chicago.

For the Chairman and founder, Dionisio Pestana, ambition should be addressed as the ability and intention to *“fly with weight on your shoes”*. A rational approach that balances the emotional expectation to push the business to new levels but always relies on financial indicators to support that ambition. So far, this approach has been the success of the Group over its fifty years of existence.

4. Outlook

The last years were indeed very challenging for Pestana U.S. operations. Once all conditions were gathered to open its business units, the Group was forced to close its hotels due to Covid restrictions. The pandemic shapes the sector at different levels forcing the company to adapt to the new reality. Currently the most significant challenges are related to the labor market and the competitive environment in Miami and New York City.

The Group's ambition for its U.S. Operations is very clear, however, the company should evaluate what has changed since it entered the market and evaluate if its decisions in terms of entry strategies, location, and business model were the most suitable. After that assessment is concluded, it can adjust its strategy to future opportunities.

II. Research Note

This section focuses on introducing pertinent academic principles suited to the teaching note chapter that follows. This chapter covers relevant frameworks that will allow students to apply those concepts and principles, together with the data gathered from the case study, to answer the questions laid-out on the teaching note section. The main frameworks addressed in this section are Entry Modes, Porter's Five Forces, CAGE distance framework and competitive advantage.

1. Entry Mode

In international trade, entry modes are an arrangement that enables a company to expand its products, services, technologies, and human resources into a non-domestic market (Root, 1994). There are two major market entry modes, direct investment, also called "asset heavy" (Low, 2015) and non-equity, or "asset light" (export and contractual agreements), that represent lower commitment from its investor.

Once the management team decides on the strategy, it needs to evaluate the specific entry mode that it will adopt (Pan & Tse, 2000). Each strategy will differ in three crucial aspects: the level of risk, the degree of control/resources allocated, and the estimated ROI.

For many multinational companies in the lodging industry, globalization is a mandatory strategy to ensure the future survival and sustainable growth (Zhao & Olsen, 1997), in part influenced by the saturation of domestic markets. Thus, companies need to exploit business opportunities in existing and new markets to foster future growth.

In general, the entry mode decision of a firm depends on various variables that can be partially summarized in environmental factors (political, social-cultural, economic, ecological, and technological), task environment dimensions (property location, competitors, customers, partner selection) (Zhao & Olsen, 1997) and through an overall analysis of country risk (Hill, 1990 and Kim & Hwang, 1992). These variables may influence the entry mode strategy followed by the companies (Zhao & Olsen, 1997) which can vary from franchising, joint ventures, strategic alliances, management contracts, and

acquisitions (Tse & Olsen, 1990). Moreover, each of these possible modes of entry implies different degrees of ownership and control (Contractor & Kundu, 1998; Darder, F.L., Garcia Villar, C. & Pla-Barber, 2010). According to Agarwal & Ramaswami (1992), control is defined “as the ability of the firm to influence the various management systems of the organization to improve its competitive position and maximize returns on firm-specific assets”. In the hospitality sector, this control can be summarized in four degrees: (a) daily management operation of the hotel, (b) control over physical assets, (c) organizational routines, and (d) control over codified assets (brand and reserves software) (Contractor & Kundu, 1998). Hence, a framework can be conceptualized to compare the level of control and entry mode strategy (Table 1).

Table 1. Entry modes and control.

Entry modes				
Extent of control	FDI (fully owned hotel)	FDI (shared ownership)	Management contracts	Franchise contracts
Strong control	a, b, c, d	d	d	d
Weak control		a, b, c	a, c	c
No control			b	a, b

Source: Contractor and Kundu (1998a).

Note: a, Daily management and quality control; b, control over physical assets; c, control over organisational routines and tacit elements of the firm; d, control over codified strategic assets.

Literature suggests that given the dynamic and complex environment organizations operate in. Entry mode decisions cannot be reduced to a set of variables (Altinay, 2000). However, there is an overall understanding that a hotel organization must analyze external and internal environments before moving forward with an international expansion strategy (Zhao & Olsen, 1997; Altinay, 2000) given the “*environmental diversity, complexity and uncertainty in host-country hotel markets*”. Hence, companies need to recognize the different variables that can impact the success of international expansion.

2. CAGE

Ghemawat (2001), created the CAGE distance framework to support companies in their international expansion decision by measuring the impact of distance and differences between countries. The model evaluates four dimensions (Cultural, Administrative, Geographic, and Economic) and compares the key attributes that arise from a distance and how those affect different industries or products (Table 2).

Table 2: The CAGE distance framework (Ghemawat, 2001)

	Cultural Distance	Administrative Distance	Geographic Distance	Economic Distance
attributes creating distance	different languages	absence of colonial ties	physical remoteness	differences in consumer incomes
	different ethnicities; lack of connective ethnic or social networks	absence of shared monetary or political association	lack of a common border	differences in costs and quality of: <ul style="list-style-type: none"> • natural resources • financial resources • human resources • infrastructure • intermediate inputs • information or knowledge
	different religions	political hostility	lack of sea or river access	
	different social norms	government policies	size of country	
	institutional weakness	weak transportation or communication links	differences in climates	
industries or products affected by distance	products have high linguistic content (TV)	government involvement is high in industries that are: <ul style="list-style-type: none"> • producers of staple goods (electricity) • producers of other "entitlements" (drugs) • large employers (farming) • large suppliers to government (mass transportation) • national champions (aerospace) • vital to national security (telecommunications) • exploiters of natural resources (oil, mining) • subject to high sunk costs (infrastructure) 	products have a low value-to-weight or bulk ratio (cement)	nature of demand varies with income level (cars)
	products affect cultural or national identity of consumers (foods)		products are fragile or perishable (glass, fruit)	economies of standardization or scale are important (mobile phones)
	product features vary in terms of: <ul style="list-style-type: none"> • size (cars) • standards (electrical appliances) • packaging 		communications and connectivity are important (financial services)	labor and other factor cost differences are salient (garments)
	products carry country-specific quality associations (wines)		local supervision and operational requirements are high (many services)	distribution or business systems are different (insurance)
			companies need to be responsive and agile (home appliances)	

Source: Ghemawat, "Distance Still Matters," *Harvard Business Review*, September 2001 (79, no. 8.)

3. Porter's Five Forces

The model was developed by Michael E. Porter, in 1979, which identifies and evaluates five competitive forces that helps companies to structure and determine competitive environment. The model can be applied to any industry to measure the attractiveness, competition intensity, and profitability of an industry or market.

According to Porter, an industry can be defined by the following considerations: the threat of new entrants; the threat of substitute products or services; bargaining power of customers; bargaining power of suppliers; and competitive rivalry (Table 3). "The collective strength of these forces determines the ultimate profit potential in the industry, where profit potential is measured in terms of long run return on invested capital" (Porter, 1979).

In the center of the framework is analyzed an overview of the competitive landscape of a given industry (competitive rivalry), which refers to the number of competitors that operate in the market and industry and other factors such as industry growth rate, service/product differentiation, and cost structure.

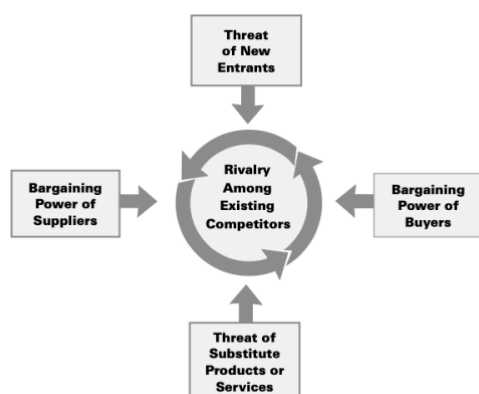
The potential of new entrants can also affect a company’s power. According to Porter (1979), new firms usually “bring new capacity, the desire to gain market share, and often substantial resources”. Hence, the market and especially the customers would benefit from the entry of new players in the market. However, the capability to enter in the market also depends on its barriers. There are six main factors that can influence the barriers to entry that, if high, can deter a new player from entering the market: product differentiation, government policy, capital requirements, economies of scale, cost structure disadvantages, and access to distribution channels.

The power of suppliers evaluates how easily suppliers can change the industry’s cost structure. The fewer suppliers within an industry, the more a company would depend on a supplier. Similarly, the power of customers evaluates the ability of customers to influence the price structure of an industry. This force is affected by a company’s current client base structure and the capability to expand their client base structure.

Finally, the threat of substitutes can also affect an industry P/L since it can strangle a company’s earnings and growth. If a product or service is easily substituted a price ceiling can be created, and hence a company’s power is weakened. To reduce this threat, an industry can upgrade its products or services through innovation, patents, marketing, and differentiation.

Porter (1979) concludes that the collective force of these five dimensions shapes the competitive landscape, position, and profitability of an industry.

Table 3: Porter’s five forces model (1979).



Source: Porter, “How competitive forces shape strategy,” *Harvard Business Review*, May 1979 (Vol. 57, No. 2), pp. 137–145.

4. Competitive Advantage

There are several relevant theories about this topic, and each of them adds additional conditions to ensure a sustainable competitive advantage for firms.

To Michael E. Porter (1985), competitive advantage can be obtained through cost efficiency or product/service differentiation (Table 4). Though, some companies try to position themselves in the middle, meaning that they are not able to be recognized as outstanding in any of these strategies, in the long term can lead to a below-average performance, since it competes in disadvantage to companies that pursue clear strategies of cost leadership or differentiators. Hence, an enterprise should sacrifice the pursuit of one strategy on behalf of the other and define a clear and consistent strategy to achieve sustainable advantage.

Though companies pursue both strategies to achieve a competitive advantage, due to specific industry conditions, in the long term, it tends to face pressures from competition to adapt their position in one generic strategy on behalf of the other.

Generic strategies can help companies achieve a competitive advantage. However, it “does not lead to above-average performance unless it is sustainable vis-à-vis competitors”. To do so is essential for a firm to understand the environmental landscape of the industry and allocate its resources to the proper channels.

Additionally, the literature also suggests that companies that define a strategy based on market leadership goals can be dangerous. While market share is a very relevant indicator of competitive position, “*industry leadership is not a cause but an effect of competitive advantage*”. A firm that is focused on nurturing and developing a successful competitive advantage strategy is closer to achieving market leadership than an enterprise that is just pursuing leadership.

For companies is also critical to define and select competitors and industry structure that which they will compete. By doing so, it can enhance its competitive advantage through the definition of the right competitors and the potential market share it should hold since, as previously mentioned, a substantial share is rarely optimal.

Table 4: Porter's generic strategies (1985).

		COMPETITIVE ADVANTAGE	
		Lower Cost	Differentiation
COMPETITIVE SCOPE	Broad Target	1. Cost Leadership	2. Differentiation
	Narrow Target	3A. Cost Focus	3B. Differentiation Focus

Source: Porter "Competitive Advantage: Creating and sustaining superior performance" *Free press*, 1985.

Nevertheless, additional research suggests that for a company to benefit from a sustainable competitive advantage, its unique strategy must be difficult to be replicated by its competitors (Barney, 1991).

III. Teaching Note

1. Introduction

This section is dedicated to serving as a guide plan for the instructor on how to approach this case study. The aim is to be a walkthrough and, in addition, share some suggestions and recommendations for the class discussion.

2. Synopsis

Pestana Hotel Group, the largest hotel chain of Portuguese origin, started its internationalization expansion process in 1998, and from that point forward never stopped. Its internationalization strategy initially focused on two business approaches: emerging and traditional European markets. This case study focuses on analyzing the most recent expansion in the U.S. market.

The case study and research note aims to provide relevant information to evaluate the expansion strategies followed by Group in the two regions where they are currently operating – Miami and New York City. The case study also reflects the main challenges and opportunities that hotel chains can face when entering the U.S. market.

3. Teaching Objectives

This case study aims to share with students a real-life example of an internationalization strategy followed by a Portuguese company in the hospitality sector. The research questions were prepared for students to address relevant frameworks such as entry strategy modes, competitive advantage, and internationalization strategies.

This case can be integrated into both undergraduate and master programs that focus on Strategy courses, business internationalization, and adaptive strategies.

4. Suggested Assignment Questions

The following suggested questions aim to help students understand and analyze the case study and its elements.

The instructor can decide how to approach the preparation of the case study. It can be assigned as an in-class assignment, take home, or read the case before class. The assignment can be answered individually or in small groups.

1. Analyze the attractiveness of the industry Pestana operates.
2. What was the entry mode strategy adopted by Pestana Hotel Group in U.S. market, and how do they differ between Miami and New York City operations? What are the advantages and disadvantages of those strategies?
3. Imagine working for the Business and Development Department of Pestana Hotel Group. Would you continue to invest on U.S. market and expand its operations? Please apply CAGE framework concepts.

5. Analysis and Discussion

1. Analyze the attractiveness of the industry Pestana operates.

This question can be approached through several frameworks. However, Porter's Five Forces continues to be one of the most relevant frameworks to address the attractiveness of the competitive environment of a particular industry.

Porter's Five Forces:

- *Threat of new entrants*

According with UNWTO, the Tourism and Hospitality continue to be a relevant sector for the global economy and is the 6th largest sector in the U.S. economy. Though the industry faced a significant decrease during Covid pandemic, all the indicators point for a slow recovery of the sector. The potential barriers to entry in the U.S. market are the capital requirements, which can differ according to the entry mode strategy adopted by the company (asset light vs. asset heavy), licenses and legal requirements, and economies of scale.

Over the last years, the hospitality sector became more flexible in terms of financial requirements due to the development of new business formats that rely on management contracts. Those new business models facilitated the entry of new players and as the expansion of large hotel chains to new markets.

Entry can also be very challenging due to legal restrictions and government permits. In the United States those legal requirements are even more complex due to local policies that may vary in each State. This represents more complexity and additional costs to potential investors. Overall, there is a moderate threat of new entrants in the U.S. market.

- *Threat of substitute products or services*

The sector has a few substitutes that can affect the number of customers; however, those alternative services represent a small share of overall accommodation indexes. Examples of alternative accommodations are Airbnb, family, or friends' accommodations. Overall, the risk of substitute services is relatively low.

- *Bargaining power of buyers*

The hotel customers can be segmented according to the trip's motivation, which can be classified as leisure, business, and MICE (meetings, incentives, conferences & exhibitions) or in terms of origin (international or domestic). Though the number of customers is larger than the number of rooms, hotels evaluate a customer as an individual, which alone does not have the power to drive the price down. Hence, the bargaining power of buyers is low.

Additionally, it is crucial to consider that most customers are price sensitive, which can easily switch between suppliers or even freeze travel spending. It is important for hotel companies to adjust pricing to macroeconomic indicators, such as inflation and unemployment rates since it affects the available income of families and corporations, increasing the bargaining power of those buyers during those periods of economic and financial instability.

- *Bargaining power of suppliers*

The hotel sector relies on several suppliers to conduct its operations. Some suppliers may vary, depending on the service provided by the business units, such as food and beverages (F&B) or unique amenities equipment (gym, pool). Others are essential and easily relatable in every lodging chain, such as labor, legal and financial services. Though the sector is facing a labor shortage due to the migration of skilled workers after the covid pandemic, overall, the bargaining power of suppliers seems to be low. Thus, the industry can be perceived as several suppliers that can be easily substituted at a lower cost.

- *Rivalry among existing competitors/Intensity of competitive rivalry*

The hospitality industry is highly competitive, especially in New York City and Miami, due to the several players that operate in those cities. The degree of competition in this sector is mainly determined by price, location, and size.

The price is determined through rates per night comparison between a particular business unit and its direct competitors, other hotels with similar sizes and locations. That benchmark is easier to achieve on more transparent channels, such as OTAs. Additionally, the management can be more aggressive with pricing through discounts that are not visible to the other players (special rates for groups).

In terms of location and size, the direct competitors will be the ones that are closer to the business unit. For cities that are more mature in tourism, the expectation is that the competition degree is higher. Additionally, after the Covid pandemic, city destinations are facing the slowest recovery, with a reduction in demand for corporate and leisure travel, resulting in a reduction of occupation rates.

- *Conclusion about industry attractiveness*

Overall, the industry attractiveness is highly dependent on the degree of rivalry of competitors and more recently there is a shift in terms of bargaining power of labor market that is creating more pressure to the units. Hence, the sector attractiveness is medium.

Finally, the instructor may request students to identify the main opportunities and threats lodging companies may face when entering in the U.S. market.

Opportunities and Threats:

- *Opportunities*

The country continues to be a driving force of the global economy. For Pestana Hotel Group, several indicators reinforce the investment made in U.S. Is in the top three destinations of the world and the top cities that receive more inbound tourist are NYC and Miami, two locations where the Group operates.

- *Threats*

The industry was severely affected by the Covid pandemic, the demand plunged, and unemployment skyrocketed. It showed how vulnerable the tourism and hospitality sectors are to similar crises. A new pandemic can have, once again, devastating effects on the industry. Hence, is one of the biggest threats to the sector. Additionally, as previously mentioned, the market is highly competitive. A reduction in demand can urge players to reduce prices, thus creating additional pressure on companies' profit margins.

2.What was the entry mode strategy adopted by Pestana Group in U.S. market, and how do they differ between Miami and New York City operations? What are the advantages and disadvantages of those strategies?

Pestana, started its expansion strategy in U.S. market in 2012 after opening hotel Pestana Miami South Beach. The entry mode strategy adopted by the Group in Miami was full ownership through the acquisition and renovation of an existing asset. After the renovation, the company rebranded the business unit under Pestana Hotel and Resorts umbrella. This entry mode is the predominant format followed by PHG in its expansion strategy. It allows more control over

crucial operation processes from development to management and promotes a more coherent communication of the company's culture and brand. In addition, the Group can benefit from future asset valuation.

However, over the last few years, this format has been losing popularity since it requires a high commitment of resources and capital. Moreover, those factors represent a higher risk than other business models such as management contracts or franchising agreements that end up requiring lower capital outflow.

The business model followed by PHG was ground lease agreements and a joint venture for the NYC business units.

Pestana Park Avenue was developed under a ground lease agreement, on which Pestana owns the role of developer, manager, and brand. Each month, the company is bound to pay a fee to the landowner for 100 years. After the termination of the contract, the building is transferred to the landowner.

These contracts allow hotel chains to enter complex markets at prime locations and a lower cost since the land cost of an asset can represent over 50% of the total value. Additionally, it allows the developer to recover its investment in the long run at a pre-determined cost. Meanwhile this business model does not reduce the risk exposure for the developer since it requires a significant amount of money to build the hotel, while knowing that the asset will be transferred to the landowner at the end of the contract.

The Pestana CR7 Hotel is both a ground lease agreement and a joint venture. The landowner is a third party that receives a monthly fee from Pestana CR7 brand for 100 years. However, the contract is celebrated with an additional third-party entity, CR Unipessoal. In terms of management control, though it's a 50-50 partnership, Pestana has full ownership, only paying royalties to CR Unipessoal. For Pestana Hotel Group, the advantages and disadvantages are identical to the ones previously mentioned for Pestana Park Avenue. However, the risk is lower than the other business unit in NYC since the development cost is split between PHG and CR Unipessoal.

3. Imagine working for the Business and Development Department of Pestana Group. Would you continue to invest on U.S. market and expand its operations? Please apply CAGE framework concepts.

To answer this question, it is essential to analyze the macroeconomic indicators of the industry in the U.S. as to understand the results the Group achieved in the market over the last few years.

As mentioned in the case study, the U.S. market remains very attractive to the tourism and lodging sector. The country remains in the top three destinations in the world, with NYC and Miami leading the top cities in terms of domestic and international travelers and spending. The market size and economic indicators are also very positive, with U.S. still being the number one economy and one of the largest markets in the world.

For the Group, the year 2022 was a very positive in the U.S. market. Miami achieved its best results since its opening in 2012, and both business units in NYC were able to deliver solid KPIs reinforcing the confidence and investment in the operations.

Though Pestana is already in the U.S. market, it is vital to evaluate and analyze its decision to continue to invest in the country. To do so, we suggest analyzing the CAGE distances between Portugal and United States. Regarding cultural distances, both countries have different languages, which sometimes can induce communication issues between headquarter (shared services) and local units (U.S. hotels). However, according to Mr. José Carlos Fernandes, the cultural distance was the most challenging aspect while managing the operations. For the U.S. Director of Operations, the American market has very different social norms compared with Portugal. Additionally, those social norms vary between Miami and NYC due to the different cultures within each city, making the cultural distance even more complex to deal with. To reduce the cultural distance, the Group decided to create a mobility program that relies on sending Portuguese employees to the U.S. market, to support local operations. Additionally, the Group sends, from time to time, its American management team to Portugal to learn Pestana's culture.

Regarding administrative distance, Portugal and United States benefit from a healthy trade relationship, reducing distances between both countries. Moreover, Portuguese companies avail of the presence of several Portuguese institutions (AICEP, Chamber of Commerce, Embassy, and Consulate) in U.S. soil to support administrative and political procedures.

For geographical distances, the Group faces challenges due to the centralization of some services in Portugal. The central distance gap is related to communication and time zone issues. However, to reduce this gap, the Group decided to adjust the schedule of crucial services based in Portugal, such as the Reservations and IT department, to the U.S. time zone.

Finally, for the economic distance, the U.S. operations had to adapt to the labor and salary conditions of U.S. market, which are significantly higher compared with Portugal. Additionally, it had to adjust the hotel rates to the reality of the competition, allowing it a higher ADR than other markets where Pestana operates.

The most significant distances were cultural and geographical. Overall, the U.S. continues to be a very attractive market and while there are some differences between Portugal and U.S., they seem like they could be more inviable for a hotel chain success. However, PHG has an answer to reduce those gaps over the following years. For the Group, the main objective is adjusting to the host country's reality but always follow a consistent cost-efficiency strategy that has been a key strategy to the company's success.

IV. Conclusion and Limitations

The purpose of this pedagogical dissertation was to give students a perspective of the international expansion process hospitality chains face when entering the U.S. market. For this case study, a Portuguese hotel group was chosen as a partner. After five decades, Pestana Hotel Group has achieved remarkable results due to its unique assets and cost-efficiency business model. The Group continues to expand internationally to overcome market saturation. Its strategy is to balance new openings in new geographies, diversify its risk, reinforce investment in existing locations, to promote economies of scale.

From an early stage, the management team understood the attractiveness of the industry. To differentiate from the competition and promote sustainable growth, it developed a robust business model that relied on unique service experiences, maintained the right assets portfolio, and developed a cost-saving strategy.

Both Miami and New York City offer a very promising value to the company, due to the market attractiveness, economy-level, and industry indicators (RevPar and ADR). For the group is essential to continuously monitor new potential markets, capitals, and second-tier cities, that can represent new profitable opportunities. The U.S. market expansion resulted from this continuous monitoring, where a favorable opportunity was presented to each location.

For this case study, three research questions were developed to promote class discussion using the available frameworks provided in the research note.

Porter's five forces model was used to assess industry attractiveness. Overall, all apparent threats are low, except competitive rivalry. Additionally, due to labor migration during the covid period, suppliers' bargaining power has increased, affected by the shortage in qualified labor. However, it is still early to assume that this impact has shifted the bargaining power of suppliers to a higher level than low.

An assessment in terms of entry modes was analyzed in the teaching notes section, evaluating the pros and cons of the strategies followed by Pestana during the expansion process in U.S. It

was the first time the Group developed a ground lease agreement in a foreign country. While there are some risks associated with this strategy, it seems a calculated risk.

The CAGE framework was used to evaluate the distances between Portugal and U.S. market. For the Group, the most challenging distances were cultural and geographic since they needed to build a new operations team in America while fostering Pestana principles and values. To reduce those gaps, several initiatives were promoted by the Group, that relied on mobility programs (Pestana mobility) and time zone alignment of key departments settled in Portugal to the US time zone.

Overall, it was imperative for Pestana to be in the U.S. given the market size, prestige, and important destination. So far, the Group has benefited from the slow recovery of the Covid pandemic, with all business units adding value to the company's portfolio.

Concerning the limitations, though the results were very positive in 2022, it is important to keep in mind that NYC business units still lack historic data since the hotels were closed in the majority of 2021, due to lockdown measures. Hence, it would be interesting to re-evaluate the performance of U.S. operations in full-year comparison. Additionally, while analyzing macroeconomic indicators, market research data is reporting an over-optimistic recovery of the industry for the short term, estimating values above 2019. This forecast seems very unlikely when we analyze year-to-date results for inbound travelers and spending amount.

Finally, it is recommended incorporating other relevant frameworks that can add new perspectives to the hospitality industry.

V. References

- Anderson, O. and Buvic, A. (2002), "Firm's internationalization and alternative approaches to the international customer/market selection", *International Business Review*, Vol. 11 pp 347-363.
- Andreu, R., Claver, E. and Quer, D. (2017), "Foreign market entry mode choice of hotel companies: determining factors", *International Journal of Hospitality and Manage*, Vol. 62, pp 111-119.
- Andreu, R., Claver, H., Quer, D. and Laura, R. (2018), "Family ownership in Spanish hotel chains: an analysis of their expansion through internationalization", *UCJC Business and Society Review*, Vol. 59 No. 3, pp 40-75.
- Barber, J., Garcia, C. and Darder, F. (2011), "Entry mode choice in the internationalization of the hotel industry: a holistic approach", *The Services Industries Journal*, Vol. 31 No. 1, pp 107-122.
- Barney, J. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17(1), pp 99-120.
- Erramilli, M. (1990), "Entry mode choice in service industries", *International Marketing Review*, Vol. 7 No. 5, pp 50-62.
- Ghemawat, P. (2001). Distance Still Matters. *Harvard Business Review*, 79(8), pp 137-147.
- Hill C. W. L., Hwang P. and Kim W. C. (1990) An eclectic theory of the choice of international entry mode. *Strategic Management Journal* 11(2), pp 117-128.
- Johanson, J., e Vahlne. J. (1977). The internationalization process of the firm-a model of knowledge development and increasing foreign market commitments. *Journal of International Business Studies*, 8(1), pp 23-32.
- Kim W. C. and Hwang P. (1992) Global strategy and multinationals' entry mode choice. *Journal of International Business Studies* 23(1), pp 29-53.
- Olsen, M. D., Crawford-Welch, S. and Tse, E. (1990) The global hospitality industry of the 1990s: a position statement. *International Conference of the Journal of Contemporary Hospitality Management*, England.
- Porter, M. E. (1979). How competitive forces shape strategy. *Harvard Business Review* (Vol. 57, No2), pp. 137-145.
- Porter, M.E. (1985). *Competitive Advantage: Creating and Sustaining Superior Performance*. Free Press.
- Root, F.R. (1994). *Entry strategies for international market*.
- Tse, E. and Olsen, M. D. (1990) Strategies of global hospitality firms. *Strategic Hospitality Management*, eds R. Teare and A. Boer, Chapter 12. Cassell Plc, England.

Zhao, Jin Lin and Olsen, M. D. (1997) The antecedent factors influencing entry mode choices of multinational lodging firms. *Int. J. Hospitality Management* Vol. 16, N°1, pp 79-98.