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PESTANA GROUP

Exploring the Spanish market

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ABSTRACT

Title: Pestana Group: Exploring the Spanish market

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Pestana, the largest Portuguese hotel chain, celebrated in 2012 its fortieth anniversary. Its portfolio included forty-seven hotels under Pestana Hotels & Resorts brand in thirteen countries across Europe, Africa and America, besides the units it managed under Pousadas de Portugal. The company's future plans for expansion focused especially on emerging destinations of South America and the traditional European markets. Pestana was present in several cities in South American countries and it had already few ongoing projects in Uruguay, Argentina, Brazil and Chile. The main question regarded Europe. Pestana was particularly interested in the Spanish market.

The case study provides therefore an overview of the company as well as the tourism and hotel industry, with especial focus in Spain. The aim of this master dissertation is to conduct a strategic analysis of the Spanish market, identifying its trends, opportunities and threats, among others. Spain is one of the top destinations in the world but the financial downturn, the difficulties in obtaining credit and the fierce competition in the hotel industry, especially from the largest international chains, were some of the setbacks for entering into such country. On the other hand, some opportunities arose as the price some hotel establishments decreased, becoming potential acquisition targets for larger companies. In addition, other entry modes, like management contracts or franchising agreements that required lower capital investments, were gaining popularity in the Spanish hotel industry.

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CASE STUDY

1. Introduction

Over the years, the family owned Pestana Group proved itself as a strong player in the hotel and resort business. Celebrating in 2012 its fortieth anniversary, the Portuguese Group still had several plans to strengthen its position not only in the domestic market but also internationally, following some of the many opportunities in the tourism industry.

José Roquette, manager at Pestana, explained the Group's focus to a Portuguese magazine:

*“Today, we have two big lines of development – South American and European capitals – a strategy that the Group has started following already. In Europe, we have the case of London and Berlin, and we have others such as Madrid, Barcelona, Brussels and Amsterdam in the pipeline. The penetration in Europe will be slower than Latin America, given the current economic crisis.”*¹

The presence of Pestana hotels in the South American market was visible, having in 2012 twelve hotels located in Argentina, Colombia, Venezuela and Brazil, planning also to enter other countries such as Chile².

In the case of Europe, the Group was present in three countries with twenty-three hotels across Portugal, one hotel in the United Kingdom and another in Germany. Plus, it was studying prospective countries, even though the European market was considered by the company more challenging than other markets such as the South American, due to the financial crisis and fierce competition from the largest international hotel chains. Among few countries, the company had publically showed its interest of entering the Spanish market, stating that “the entry in Spain will happen”³. However, Pestana's top management had to assess and consider multiple aspects of

¹ Pinto, M^a João Vieira, July 2012, «*Queremos estar entre os 25 europeus*», Marketeer, pp. 20-25.

² Coelho, Helena Cristina, August 16th 2012, *O império dos hotéis de luxo de Pestana*, Diário Económico [Online]. Available at:

http://economico.sapo.pt/noticias/o-imperio-dos-hoteis-de-luxo-de-pestana_150284.html

[Accessed October 19th, 2012]

³ Pinto, M^a João Vieira, July 2012, «*Queremos estar entre os 25 europeus*», Marketeer, pp. 20-25.

such market and decide upon the entry mode, about which the company was open-minded.

2. Company Overview

With more than €404 million of revenues in 2011, Pestana was considered the Portuguese largest group in the tourism and hotel industry. Its portfolio included almost 90 four and five-star hotels across Europe, Africa, North and South America under two brands – Pestana Hotels & Resorts and Pousadas de Portugal – and operating in the leisure, business and MICE (Meetings, Incentives, Conferences, and Exhibitions) segments.

Besides the hotel business, its core activity, the company also operated in other sectors of the tourism industry, mainly in the Portuguese market. The company claimed that this strategy not only reduced the level of dependence on other touristic agents, but also increased the attractiveness of its core business. These sectors were gaming, golf, leisure real estate and air transportation through charter flights.

2.1 The Origin

The origin of the company dates back to the middle of the 1960's when two brothers, Manuel⁴ and José Domingos Pestana, bought the Atlantic Hotel in Funchal, in Madeira Islands. This small hotel was later demolished in order to build what would soon be the Madeira Sheraton, owned by the two brothers and managed by the Sheraton hotel chain.

Madeira Sheraton officially opened in 1972, founding M & J Pestana – Sociedade de Turismo da Madeira and setting the beginning of Pestana Group's activities. Soon, José Pestana would sell his shares to his brother.

The first years were particularly challenging for Manuel Pestana. After the 1974 revolution⁵, Portugal entered in a period of a socioeconomic crisis, characterized by

⁴ Native from Madeira and at the age of 20, Manuel Pestana went in 1946 to Johannesburg and then to Mozambique, returning in the 1966.

⁵ In 1974, Portugal went from an authoritarian dictatorship into a democracy.

rising inflation and interest rates, strikes and social instability, besides the drop in demand in the hotel business.

Like other hotels in Madeira Island, the family owned business was almost bankrupt, facing several organizational problems and financing difficulties. However, Manuel was not willing to lose his hotel so, in 1976, he trusted his son, Dionísio Pestana, to save the business. Dionísio accepted the challenge, arriving to Madeira and encountering a complex situation: the workers had expelled the hotel's director and wanted the Sheraton hotel chain out of the Island.

Recently majored in Business Economics, Dionísio was a young man who did not speak Portuguese, once he was born and raised in Johannesburg. This did not prevent him from taking action right away and face the Portuguese reality and the company's situation. He met with the Sheraton chain, aiming to revise the contract between both companies. Additionally, he was able to improve the financial condition of the company after meeting with Portuguese Overseas National Bank, which forgave Pestana half of its debt. Four years after his arrival, Madeira Sheraton was finally in good health⁶.

2.2 Pestana's Evolution in Portugal

Still in Madeira, Pestana expanded its business through the construction of Madeira Beach Club in 1983, entering into the holiday ownership (or timesharing) activity. In addition, during the period of the oil crisis in 1986, Pestana acquired ITI-Investimentos Turísticos da Ilha da Madeira, holder of Casino Madeira complex and the five-star Casino Park Hotel, below its market value.

The Group expanded to mainland Portugal only after consolidating its position in Madeira. In 1992, Pestana acquired five units in Algarve jointly with another company, Salvor, followed in 1994 by the opening of Pestana Atlantic Gardens Ocean & Conference Aparthotel in Cascais and more investments in the holiday ownership business.

⁶Only in 1990, the Sheraton Chain passed the management of the Madeira Sheraton to the Pestana Group. The hotel was renamed Madeira Carlton Hotel and later, Pestana Carlton Madeira because Pestana trademark was only created afterwards.

In 1996, it also diversified to other business, acquiring golf courses in Algarve and Sintra. Besides this, Pestana also expanded to the airline business with euroAtlantic airways which was specialized in aircraft leasing and aircraft charter solutions.

In 2001, Pestana Palace, a late nineteenth century former palace, was opened in Lisbon. In 2003, alongside with Caixa Geral de Depósitos, Fundação Oriente and other two companies, Pestana won the international bid for the management of Pousadas de Portugal for twenty years – a state-owned hotel chain composed of luxury, historic and rustic units in Portugal. These hotels represented a small part in Pestana’s business, approximately of 5 percent⁷.

The company continued to invest in Portugal and in 2012 had twenty-three units, apart from the Pousadas. In total, the Portuguese market represented approximately 65 percent of its revenues.

2.3 Internationalization

Pestana’s expansion outside Portugal started in 1998 in Mozambique, the year in which the company initiated the management of three four-star hotels: Pestana Rovuma Hotel & Conference Centre in Maputo, a building once owned by Manuel and later nationalized; the Pestana Inhaca Lodge in Inhaca Island; and the Pestana Bazaruto Lodge in Bazaruto Archipelago.

Brazil was the next choice, having been acquired in 1999 the Rio Atlântica Hotel in Copacabana, Rio de Janeiro, and a year later two hotels in Angra dos Reis and Salvador. Over the years, the Group continued investing in this country where in 2012 it had nine Pestana hotels, besides the luxury hotel under Pousadas de Portugal brand, the only one outside Portugal so far.

In 2002, Pestana Group celebrated “Thirty years, thirty hotels”⁸. It was also the year when Dionísio invested in his home country by purchasing Pestana Kruger Lodge Safari Resort. The following year, it expanded to Cape Verde through the acquisition of four-star Trópico Hotel. In the same year, it also entered São Tomé and Príncipe after signing a management contract regarding Pestana Equador.

⁷ Pinto, M^a João Vieira, July 2012, «*Queremos estar entre os 25 europeus*», *Marketeer*, pp. 20-25.

⁸ Pestana Group’s website.

Available at: <http://www.pestana.com/es/institucional/pages/grupo.aspx> [Accessed Nov. 6th 2012]

Until this date, Pestana Group had only internationalized mainly to Portuguese-speaking countries, apart from South Africa. But in 2006, it acquired hotels in Buenos Aires and in 2008 in Caracas.

The first expansion to a European country, besides Portugal, happened in March 2010 when Pestana opened the Pestana Chelsea Bridge in London. In May of the following year it opened the Pestana Berlin Tiergarten.

In 2012, it inaugurated Pestana Bogotá 100 in Colombia, Pestana South Beach Art Deco Hotel in Miami and Pestana Casablanca in Morocco. For the latter, the company signed a management contract with the Spanish Inveravante Group.

Besides its complementary businesses, Pestana Group operated at this point in time forty-seven hotels under Pestana brand located in Portugal, Brazil, England, Germany, Argentina, Venezuela, Mozambique, South Africa, Cape Verde, São Tomé and Príncipe, Colombia, the United States and Morocco, and thirty-eight hotels under Pousadas de Portugal brand.

2.4 Future Strategic Plans

Pestana still wanted to consolidate itself internationally, being among the Europe's top 25 hotel chain. Along this line of thought, the company believed that there were still things to do as José Roquette explained:

*“There is a lack of greater exposure in European capitals and in South America, iconic cities that can provide greater visibility to the Pestana Group”*⁹

Dionísio intended to continue its investments in South America with the aim of being present in all capital cities of that continent¹⁰ and consolidate Pestana's brand. For that, the company had three projects under development: the Pestana Montevideo in Uruguay, the Pestana Buenos Aires Golf Hotel & Residences in Argentina and other

⁹ Pinto, M^a João Vieira, July 2012, «*Queremos estar entre os 25 europeus*», Marketeer, pp. 20-25.

¹⁰ Monteiro, Carina, July 28th 2011, *Grupo Pestana tem novos administradores para América do Sul*, Publituris [Online]. Available at: <http://www.publituris.pt/2011/07/28/grupo-pestana-tem-novos-administradores-para-america-do-sul/> [Accessed November 6th 2012]

project in Brazil. Likewise, it was negotiating the acquisition of another unit in Brazil and the construction of a new hotel in Santiago, in Chile¹¹.

The main question regarded the European continent, but the company was already studying several opportunities in some of these markets, appraising their dimension, political and economic stability, legal clarity, good access routes, security, and presence in other markets that emit tourists to the market in question, being these the main criteria for choosing a market.

Spain was under its eye, publicly announcing such interest, being Madrid one of the main objectives. In fact, Pestana had been analyzing the Spanish market for many years, considering several options for entering the entrance into such market and persistently studying ownership and management proposals in order to approach this market, but still with no final decision or conclusion.

First, it was important for the company to understand the country's situation and make an assessment of the industry, and then decide what strategy to follow. The strategic options regarding the Spanish market were several, but the economic condition of this country, and Portugal as well, the lack of credit and the competition were some of the setbacks, being these the biggest challenges faced by the company regarding its expansion and internationalization.

Despite this, Dionísio confirmed Pestana's active position in the search of the best opportunity and entry strategy:

*“We are looking for the opportunities in Madrid; prices have fallen and it may be close to happen. We have spoken to the bank, because they are the ones with the hotels under difficult situations, but there are still adjustments to be made regarding the price.”*¹²

Furthermore, Dionísio described the Group's path as prudent and careful, without taking unnecessary risks and setting a limit for its debt of 30 percent of the

¹¹ Baptista, Ana, July 28th 2011, *Grupo Pestana reforça na América do Sul*, Dinheiro Vivo [Online]. Available at: <http://www.dinheirovivo.pt/Empresas/Artigo/CIECO008819.html> [Accessed Nov. 6th 2012]

¹² Pereira, Ana Torres, June 1st 2012, *Grupo Pestana está a negociar entrar em Espanha*, Jornal de Negócios [Online]. Available at: <http://www.portugalglobal.pt/PT/PortugalNews/Paginas/NewDetail.aspx?newId=%7B199B6035-B5A4-43E9-A0DC-02E8067F7D04%7D> [Accessed November 7th 2012]

assets¹³, and intended to keep the same strategy for the future. In addition, the company was considering widening its hotel offer by betting on three-star hotels, besides four and five-star, in order to cover a higher range of projects and destinations.

3. The Competitive Environment

Despite the economic and financial challenges in many countries, the industry presented overall positive results. In 2011, the growth rate of international tourist spending was of 3.8 percent comparing to the previous year, reaching €740 billion (See **Exhibit 1**). The number of international tourist arrivals surpassed 982 million¹⁴, representing increase of 4.6 percent during the same period of time. 2012 started showing even greater results, and the forecast was for this number to reach one billion by the end of that year. In a long-term perspective, it was expected to grow about 3.3 percent annually until 2020¹⁵ (See **Exhibit 2**).

At this point in time, tourism market was very concentrated, given that 45 percent of the international arrivals in 2010 were for the top ten countries, although the trend was for this level of concentration to decrease.

Several destinations had been emerging over the years, especially in the Asia Pacific region, challenging the traditional European and North American ones. The long-term forecast was for emerging countries to have more tourist arrivals than the developed ones, although its growth rate between 2010 and 2011 was lower in the first case due to the setbacks in the Middle East and North Africa. But for the first time in history international arrivals were estimated to be higher in emerging economies in 2012.

On the other hand, Europe saw strong growth in arrivals from emerging economies in 2011, particularly Russia, China and Brazil. It was expected for this trend to continue throughout 2012, but it was unlikely to compensate for the decline in intra-regional visitors.

¹³ Coelho, Helena Cristina, August 16th 2012, *O império dos hotéis de luxo de Pestana*, Diário Económico [Online]. Available at: http://economico.sapo.pt/noticias/o-imperio-dos-hoteis-de-luxo-de-pestana_150284.html [Accessed October 19th, 2012]

¹⁴ United Nations World Tourism Organization (UNWTO) Annual Report 2011

¹⁵ UNWTO Tourism towards 2030

Furthermore, the 2008/2009 financial crisis had affected the tourism and global hotel industry, especially the European economies which in 2012 were still struggling in innumerable ways. Although the uncertainty about the European economy and the governments' austerity did not cause major falls in tourism demand, the trend was of slowing growth¹⁶. Still, there were differences in performance within the European market. In particular, it was the case of Southern Europe nations that relied on massive deficits. And Spain was no exception, neither was Portugal.

José Theotónio, Pestana's CFO, stated:

*"[The crisis] it has particularly affected our hotels in Portugal since the relevant markets for these units are decreasing consumption: national and Spanish markets."*¹⁷

In these countries, credit constraints were the main problem for a great number of companies not only in the hotel industry but in other industries as well, and it was expected to continue as so¹⁸. In fact, access to financing was the most problematic factor for doing business in Spain (and in Portugal).

3.1 The Spanish Market

Spain ranked as the thirtieth most competitive country in the world in 2012¹⁹, classifying it as an innovation-driven economy in terms of stage of development, instead of a factor or efficiency-driven economy.

The Spanish reality was characterized not only by the credit constraints, as referred, but also by the alarming unemployment rates and raising taxes. For the first time in history, unemployment rates reached the 25 percent in 2012, and the 54 percent for the youth unemployment²⁰.

¹⁶ European Tourism 2012 - Trends & Prospects, 2nd Quarter 2012, European Travel Commission

¹⁷ Jones, Benjamin, May 8th 2012, *Euro crisis impacts hotels in different ways*, HotelNewsNow.com. Available at:

<http://www.hotelnewsnow.com/mobile/articles.aspx?articleid=8142> [Accessed October 20th 2012]

¹⁸ Ernst & Young, *Indicadores Económicos de la Industria Hotelera Española 2011*

¹⁹ The competitive analysis was based on 12 pillars: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication and innovation. Schwab, Klaus; Sala i Martín, Xavier, *The Global Competitiveness Report 2012–2013*, World Economic Forum.

²⁰ Eurostat, Unemployment statistics (Data up to September 2012)

Furthermore, in September 2012, the VAT increased three percentage points to 21 percent for the general category and two percentage points to 10 percent in the case of the reduced category, maintaining unchanged the 4 percent of the super-reduced one.

3.1.1 Tourism in Spain

In 2011, Spain ranked as eighth most competitive country in travel and tourism, falling two positions since 2009²¹, analysis that was based on several factors such as regulations, environmental sustainability, security, health and hygiene, transport infrastructure, tourism infrastructure, price competitiveness, among others. Its attractiveness relied also on diverse aspects of the country like its location, climate, coasts and islands, culture and environmental variety. In addition, it was the third most popular congress and convention destination in the world in 2011, after the United States and Germany²², the second country in the world in 2012 with more monuments classified as World Heritage Site²³, after Italy, and the top golfing destination for European golfers²⁴.

Representing more than 10 percent of the GDP²⁵, tourism in Spain was noticeably a large market, ranked between the world's top ten countries in terms of international tourist spending and international tourist arrivals (See **Exhibit 3** and **4**). Moreover, the growth of international tourist arrivals in Southern and Mediterranean Europe was mostly driven by the most common destinations, and Spain was one of them with almost 8 percent growth between 2010 and 2011. This growth was in part due to the wave of protests and conflicts known as the Arab Spring which started at the end of 2010 in the Middle East and North of Africa, especially in Egypt, Libya and Tunisia, which were causing the migration of tourist flows to other destinations. As for the international tourist spending, it accounted for approximately €38 billion, representing a significant increase comparing to the previous year.

²¹ Blanke, Jennifer; Chiesa, Thea, *The Travel & Tourism Competitiveness Report 2011 – Beyond the downturn*, World Economic Forum

²² International Congress and Convention Association (ICCA). Available at: <http://www.iccaworld.com/> [Accessed November 6th 2012]

²³ UNESCO World Heritage List Statistics. Available at: <http://whc.unesco.org/en/list/stat> [Accessed November 6th 2012]

²⁴ Esteves, Tiago da Cunha, *Golfistas alemães e escandinavos são os que mais viajam para o estrangeiro*, Publituris [Online]. Available at: <http://www.publituris.pt/2012/10/30/golfistas-alemaes-e-escandinavos-sao-os-que-mais-viajam-para-o-estrangeiro/> [Accessed November 6th 2012]

²⁵ Figuerola, Manuel, January 2nd 2012, *El peso del turismo en el PIB*, Hosteltur [Online]. Available at: http://www.hosteltur.com/155480_peso-turismo-pib.html [Accessed December 4th 2012]

The international tourists had as country of origin predominantly other European countries, such as the United Kingdom, Germany and France (See **Exhibit 5**). Regarding the Autonomous Regions of destination, Catalonia, the Canary Islands, the Balearic Islands and Andalusia were among the most popular ones, receiving a great part of the international tourists (See **Exhibit 6**). Regarding the Spanish residents, the total number of trips accounted for 160.8 millions in 2011 (rising approximately 1.7 percent comparing to the previous year), out of which 147.4 corresponded to domestic tourism (See **Exhibit 7**). It was also known that a big percentage of this number stayed at owned, family or friends' dwelling.

Moreover, the national Government approved a plan for the period 2012-2016 with the aim of increasing the competitiveness and profitability of the tourism industry, establishing a budget between the €1,600 and €1,800 million for the period. The actions would include the international promotion and better positioning of Spanish destinations, the development of a loyalty program for tourists in order to create incentives for return²⁶, a more efficient process for obtaining visas and the review and possible amendment of certain laws.

3.1.2 Hotel Industry in Spain

In 2011, the total spending in the hotel industry increased 8.4 percent to €11,600 million, registering a higher growth in holiday units (10.1 percent) than urban units (5.3 percent)²⁷. The total number of travelers accommodated in hotels accounted for 85.4 million, representing an increase of 4 percent comparing to 2010²⁸, and were mostly accommodated in four-star hotels. Furthermore, 54 percent out of the total number of travelers were Spanish residents and 46 percent non-residents, mostly from other European countries (See **Exhibit 8** and **9**). However, 61 percent out of the 286.8 million of the total hotel overnights corresponded to non-residents. Besides this, between 2010 and 2011, the growth in hotel overnights was of 12.55 percent for non-residents and -

²⁶ The plan was to create loyalty cards associated to Spanish companies based on an accumulation of points system.

²⁷ DBK, April 2012, *Establecimientos Hoteleros 2011*

²⁸ Instituto Nacional de Estadística, *Encuesta de Ocupación Hotelera (EOH) 2011*.

1.83 percent for residents, tendency that was expected to continue for the near future²⁹, given the financial crisis and unemployment lived in Spain.

The regions that accommodated a higher percentage of these travelers were Catalonia, Andalusia, Community of Madrid, Balearic Islands and Canary Islands (See **Exhibit 10**).

In the year 2011, there were on average fifteen thousand hotel establishments operating nationwide and 1,427,700 rooms, and it was estimated that 30 percent of these establishments were managed by a hotel chain. On average, the occupation rate in terms of available beds grew by 5 percent in 2011 (See **Exhibit 11**). The average daily rate (ADR) accounted for €70, 1.4 percent higher than 2009. Disaggregating it in categories, the ADR was of €148 for five-star hotels, of €78 for four-star hotels and €58 for three-star hotels. As for the revenue per available room (RevPAR), it grew 6.4 percent, reaching the €40 – per categories, €86, €52 and €37, respectively³⁰.

On the other hand, investments in the hotel industry were direct and negatively affected by the credit limitations, but some were more affected than others. Independent hotels would be more vulnerable to volatile market conditions than the largest hotel chains, as credit became harder to obtain, becoming potential acquisition targets. Also hotel chains were affected in terms of bank loans.

However, it was somehow different for international hotel chains. The presence of large and foreign hotel chains in Spain were becoming more powerful and were expected to gain more market share in the future since credit was being cut to Spanish hotel firms. In fact, the foreign hotel supply more than doubled during 2011, and the objective for many of them was to expand even more in Spain³¹. At this point in time, the main foreign hotel chains in the Spanish market were Marriott International (AC by Marriot and Ritz-Carlton, among others), Accor (Novotel, Sofitel, Mercure, Ibis), Wyndham Hotel Group, InterContinental Hotels Group, Starwood Hotels & Resorts and Hilton Worldwide, which were all among the top ten hotel chains in the world. Still, some Spanish hotel chains presented good results in their home country. It was the case

²⁹ Instituto de Estudios Turísticos (IET), *Balance del Turismo 2011 – Resultados de la actividad turística en España*, Abril de 2012

³⁰ IET, *Balance del Turismo 2011 – Resultados de la actividad turística en España*, Abril de 2012

³¹ Alcocer, Álvaro, February 6th 2012, *Las cadenas hoteleras extranjeras, al asalto del mercado español*, Preferente [Online]. Available at: <http://www.preferente.com/noticias-de-hoteles/las-hoteleras-extranjeras-al-asalto-del-mercado-espanol-190093.html> [Accessed November 7th 2012]

of NH Hoteles, Meliá, Riu, Barceló and Iberostar, the Spanish top five hotel chains in revenues, and among the 35 top hotel chains in the world, yet moving further way from the ten largest global chains³².

Furthermore, the top ten hotel chains in terms of number of rooms concentrated in 2011 18 percent of the capacity of the hotels in Spain: Meliá with 3.8 percent, NH Hoteles with 3 percent, Barceló with 1.9, Riu with 1.7, Marriott with 1.4, Iberostar with 1.4, Accor with 1.3, H10 Hoteles with 1.2, Husa Hoteles with 1.2 and Best Hoteles with 1.2 percent³³.

In general, the growth of the Spanish hotel capacity remained low throughout 2011 and it was seen mostly in urban areas and in the four and three-star category. Overall, a lower percentage of growth was expected for the following year³⁴, though it was projected that urban areas like Madrid and Barcelona would have higher values.

Some of the Spanish largest hotel chains were even reducing its real estate assets in order to increase liquidity and invest in other markets (Asia, South America, Middle East and Africa), and it was expected to continue as so for the near future³⁵, although keeping its management in most cases. In addition, many hotel owners and investors were selling its assets as well. Given the financial crisis, the price of hotel establishments was falling. It was the case of the acquisition of seven hotel establishments including the InterContinental Madrid by the Lebanese investor Toufic Aboukhater for €450 million to Morgan Stanley's real estate fund, which had acquired the assets for €634 million back in 2006.

The difficulty in obtaining credit was increasingly making hotel companies to seek for expansion strategies that would require low capital outflow, like management contracts and franchising, which were gaining acceptance in Spain. The percentage of

³² Blanco, Y., November 25th 2010, *Las cadenas hoteleras españolas se alejan del 'top ten' de la industria*, Expansion.com [Online]. Available at:

<http://www.expansion.com/2010/11/24/empresas/transporte/1290635432.html> [Accessed Oct. 28th 2012]

³³ Nexohotel.com, July 6th 2012, *Las diez principales cadenas hoteleras españolas concentran sólo el 18% de la capacidad alojativa de nuestro país*, [Online]. Available at:

<http://www.nexotur.com/nexohotel/diez/principales/cadenas/hoteleras/espanolas/concentran/solo/18/capacidad/alojativa/nuestro/pais/50233/> [Accessed November 7th 2012]

³⁴ CBRE Market View, *Hoteles España 2011*

³⁵ Yuste, Ivar, January 30th 2012, *Perspectivas del mercado de inversión hotelera en España para 2012*, 02B [Online]. Available at:

<http://www.02b.com/es/notices/2012/01/perspectivas-del-mercado-de-inversion-hotelera-en-espana-para-2012-1630.php> [Accessed October 30th 2012]

hotel property in the case of Spanish hotels was higher comparing to the largest international hotel chains, which had been focused essentially on signing management and franchising contracts for expanding in Spain. However, Spanish hotel chains were embracing more and more these types of strategies.

In fact, it was expected for these types of strategies to continue in the short/medium term in the case of both Spanish and international hotel chains³⁶, gaining more popularity in detriment of other strategies like owner-run and leasing. And although the latter was the most popular format for the types of new contracts signed in 2011 in Spain, around 70 percent established part or even 100 percent of variable return to the landlords.

There were also some important business combinations between hotel companies. For instance, it was the case of the acquisition of half of the Spanish leading business-urban hotel chain AC Hotels (85 hotels) by Marriott in 2011, which would be operated under *AC Hotels by Marriot* and *Autograph by Marriot* brands. Another example in the industry was the Spanish hotel chain Meliá International Hotels, which signed a sales and operations contract with the Chinese Jin Jiang International Hotel Company, with the aim of cooperating in the expansion of the Spanish Group throughout China and the expansion of Jin Jiang International in the European market.

Actually, Pestana had already adopted a similar strategy in Portugal, signing in 2009 commercial and distribution agreement for a minimum period of three years with the German group Rewe Touristik Hotels, which included tour operators, travel agencies and hotel brands such as LTI hotels, Club Calimera, and PrimaSol, for the Pestana Grand Hotel in Madeira. In 2011, signed the same agreement for the Pestana Viking in Algarve. Pestana would keep the management of these hotels, respecting the standards determined by Rewe and changing the unit names to LTI Pestana Grand Hotel and LTI Pestana Viking Hotel, the only two hotels with LTI brand in Portugal. Rewe would commercialize these hotels in Germany, Switzerland, Austria and Benelux, which were relevant markets for the Portuguese inbound tourism.

But access to credit was not the only issue. As unemployment rates rose, consumers started to cut unnecessary costs – which include leisure, entertainment and tourism spending. Not only in Spain but in other countries as well, travelers were

³⁶ Ernst & Young, *Indicadores Económicos de la Industria Hotelera Española 2011*

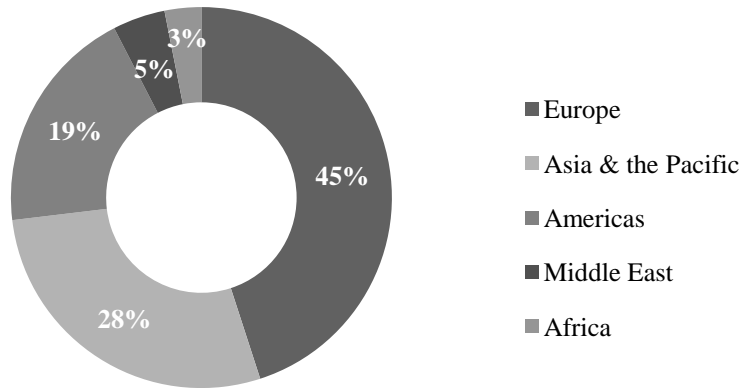
becoming more price-sensitive and cost-conscious, looking more and more for discounts and special offers. At this point, there was already a clear reduction of the MICE segment and a higher price sensitivity on the corporate segment.

4. Outlook

It was indeed a difficult time for Spain and, overall, the expectations were not the greatest. Even though Pestana had decided already to enter the Spanish market, it was important for the company to reach a conclusion about the opportunities in the tourism and hotel industry, considering the relevant factors and events. Was Spain a good option? It was then imperative to define what would be the possible entry strategies and which the one most suitable for the company was.

Exhibits

EXHIBIT 1 – International market spending (2011)



Source: UNWTO Annual Report 2011

EXHIBIT 2 – UNWTO Tourism Towards 2030: International tourism by region of destination

	International Tourist Arrivals received (million)					Average annual growth (%)					Share (%)	
	Actual data			Projections		Actual data			Projections		2010	2030
	1980	1995	2010	2020	2030	1980-'95	95-2010	2010-'20	2020-'30	2010-'30		
World	277	528	940	1,360	1,809	4.4	3.9	3.3	3.8	2.9	100	100
to Advanced economies ¹	194	334	498	643	772	3.7	2.7	2.2	2.6	1.8	53	43
to Emerging economies ¹	83	193	442	717	1,037	5.8	5.7	4.4	4.9	3.8	47	57
Europe	177.3	304.1	475.3	620	744	3.7	3.0	2.3	2.7	1.8	50.6	41.1
Northern Europe	20.4	35.8	57.5	72	82	3.8	3.2	1.8	2.2	1.4	6.1	4.5
Western Europe	68.3	112.2	153.7	192	222	3.4	2.1	1.8	2.3	1.4	16.3	12.3
Central/Easter Europe	26.6	58.1	95.0	137	176	5.3	3.3	3.1	3.7	2.5	10.1	9.7
Southern/Mediter. Europe	61.9	98.0	168.9	219	264	3.1	3.7	2.3	2.6	2.5	18.0	14.6
Americas	62.3	109.0	149.7	199	242	3.8	2.1	2.6	2.9	2.2	15.9	13.7
Asia Pacific	22.8	82.0	204.0	355	535	8.9	6.3	4.9	5.7	4.2	21.7	29.6
Africa	7.2	18.9	50.3	85	134	6.7	6.7	5.0	5.4	4.6	5.3	7.4
Middle East	7.1	13.7	60.9	101	149	4.5	10.5	4.6	5.2	4.0	6.5	8.2

Source: World Tourism Organization (UNWTO)

¹ Classification based on the International Monetary Fund (IMF)

EXHIBIT 3 – International tourist arrivals

Rank	Countries	Series	Million		Change %	
			2010	2011*	10/09	11*/10
1	France	TF	77.1	79.5	0.5	3.0
2	United States	TF	59.8	62.3	8.8	4.2
3	China	TF	55.7	57.6	9.4	3.4
4	Spain	TF	52.7	56.7	1.0	7.6
5	Italy	TF	43.6	46.1	0.9	5.7
6	Turkey	TF	27.0	29.3	5.9	8.7
7	United Kingdom	TF	28.3	29.2	0.4	3.2
8	Germany	TCE	26.9	28.4	10.9	5.5
9	Malaysia	TF	24.6	24.7	3.9	0.6
10	Mexico	TF	23.3	23.4	4.2	0.5

Source: United Nations World Tourism Organization (UNWTO)

* provisional figure or data;

TF: International tourist arrivals at frontiers (excluding same-day visitors);

TCE: International tourist arrivals at collective tourism establishments.

EXHIBIT 4 – International tourist spending

Rank	Countries	US\$				Local Currency	
		Billion		Change %		Change %	
		2010	2011*	10/09	11*/10	10/09	11*/10
1	United States	103.5	116.3	9.9	12.3	9.9	12.3
2	Spain	52.5	59.9	-1.2	14.0	3.9	8.6
3	France	46.6	53.8	-6.0	15.6	-1.1	10.1
4	China	45.8	48.5	15.5	5.8	15.5	5.8 (\$)
5	Italy	38.8	43.0	-3.6	10.9	1.4	5.6
6	Germany	34.7	38.8	0.1	12.0	5.3	6.7
7	United Kingdom	32.4	35.9	7.5	10.9	8.4	6.9
8	Australia	29.8	31.4	17.4	5.5	-0.2	-6.2
9	Macao (China)	27.8	..	53.2	..	53.5	..
10	Hong Kong (China)	22.2	27.7	35.3	24.7	35.6	25.0

Source: United Nations World Tourism Organization (UNWTO)

* provisional figure or data;

.. figure or data not available;

EXHIBIT 5 – International tourist entries broken down by country of residence (2011)

	Total	% Change
Total	56,694,298	7.6
Germany	9,030,697	2.5
Austria	586,539	4.5
Belgium	1,779,073	9.6
Denmark	921,048	-1.8
Finland	564,834	11.4
France	8,498,430	4.6
Ireland	1,280,465	8.8
Italy	3,766,597	7.9
Norway	1,117,375	9.9
Netherlands	2,776,058	21.9
Portugal	1,787,705	-5.7
United Kingdom	13,611,003	9.4
Russia	858,545	41.8
Sweden	1,282,911	15.3
Switzerland	1,373,643	18.7
Rest Of Europe	2,666,952	4.6
United States Of America	1,148,186	1.2
Argentina	299,396	8.3
Brazil	360,006	49.2
Canada	228,285	20.5
Chile	37,396	111.2
Mexico	233,293	25.6
Venezuela	105,853	106.6
Others America	459,887	-11.9
Japan	334,314	0.4
Rest Of The World	1,585,809	10.4

Source: IET - www.iet.tourspain.es

EXHIBIT 6 – Tourist entries broken down by main destination (Autonomous Regions) in 2011

	Total	% Change
Total	56,694,298	7.6
Andalusia	7,884,875	6.0
Aragon	311,833	-5.9
Asturias (Pr. de)	199,135	10.5
Balearic Islands	10,099,465	9.8
Canary Islands	10,187,690	18.3
Cantabria	305,163	9.7
Castile - La Mancha	153,088	0.6
Castile and León	1,081,162	9.5
Catalonia	13,767,684	4.7
Valencia (C.)	5,383,340	7.2
Extremadura	180,585	-3.8
Galicia	685,022	-0.5
Madrid (C.)	4,606,471	-0.6
Murcia (R.)	645,439	-4.6
Navarre (C. Foral)	187,257	6.8
Basque Country	970,181	7.4
La Rioja	45,907	-13.4

Source: IET - www.iet.tourspain.es

EXHIBIT 7 – Number of travels by domestic and outbound destinations

	2008	2009	2010	2011
Total	168,843,820	167,012,614	157,856,547	160,754,374
Domestic (Spain) Tourism	157,614,545	154,995,306	145,477,420	147,407,636
Andalusia	28,456,420	28,679,657	25,776,964	26,819,589
Aragon	8,274,067	7,016,188	5,881,664	5,952,034
Asturias (Pr. de)	4,165,626	4,400,475	4,452,204	5,129,824
Balearic Islands	2,970,993	2,724,367	2,750,968	2,940,028
Canary Islands	4,308,093	5,106,519	5,019,101	4,512,818
Cantabria	3,067,865	3,231,128	3,755,147	3,263,706
Castile - La Mancha	13,312,812	11,886,639	11,355,997	11,585,423
Castile and León	16,374,469	16,389,055	17,205,004	15,756,591
Catalonia	22,843,296	22,366,755	20,531,052	22,251,838
Valencia (C.)	17,323,886	17,762,051	15,548,853	15,569,698
Extremadura	4,989,959	4,951,486	4,678,074	4,386,584
Galicia	8,652,457	8,474,302	8,018,305	7,553,873
Madrid (C.)	11,075,067	10,437,356	9,547,929	10,108,078
Murcia (R.)	3,677,497	3,577,084	3,585,900	3,594,376
Navarre (C. Foral)	2,903,251	2,897,481	2,322,903	2,403,252
Basque Country	3,512,200	3,449,127	3,332,977	3,782,019
La Rioja	1,500,273	1,475,414	1,530,899	1,665,709
Ceuta And Melilla	206,314	170,221	183,479	NA
Outbound Tourism	11,229,275	12,017,308	12,379,127	13,346,738
Germany	552,568	611,440	621,366	765,592
France	2,393,511	2,375,012	2,270,325	2,423,234
Portugal	1,396,541	1,371,442	1,492,909	1,633,719
United Kingdom	720,471	857,651	898,547	1,145,977
European Union	7,246,309	7,616,341	8,014,910	8,951,730
Rest Of Europe	1,390,354	1,423,169	1,350,209	1,506,991
Europe	8,636,663	9,039,510	9,365,120	10,458,721
North America	343,929	377,346	357,270	399,856
South America	987,077	1,118,206	975,317	1,061,810
America	1,331,006	1,495,552	1,332,587	1,461,666
Africa	897,995	1,156,736	1,252,484	1,010,910
Asia	353,934	321	414,659	406,962

Source: IET - www.iet.tourspain.es

EXHIBIT 8 – Number of travelers and overnight stays by categories of establishment

Category	Number of travelers			Number of overnight stays		
	Total	Residents in Spain	Residents abroad	Total	Residents in Spain	Residents abroad
TOTAL (2011)	85,366,976	45,824,882	39,542,094	286,761,260	111,524,330	175,236,930
HOTELS: Golden stars						
Five	4,870,061	1,976,914	2,893,147	15,671,047	4,506,588	11,164,459
Four	37,392,836	19,341,041	18,051,795	129,583,303	46,483,742	83,099,561
Three	25,977,159	13,384,500	12,592,659	98,100,499	35,563,721	62,536,778
Two	6,706,895	4,284,862	2,422,033	17,933,742	9,872,446	8,061,296
One	2,481,733	1,604,681	877,052	6,094,809	3,351,550	2,743,259
INNS: Silver stars						
Two and three	4,361,568	2,950,932	1,410,636	10,434,203	6,192,903	4,241,300
One	3,576,728	2,281,953	1,294,775	8,943,661	5,553,382	3,390,279
Annual rate	4.25%	-1.17%	10.19%	6.45%	-1.83%	12.55%

Source: Instituto Nacional de Estadística (INE)

Year	Total number of people accommodated in hotels
1999	58,588,944
2000	59,282,522
2001	59,904,302
2002	59,868,812
2003	62,531,379
2004	66,831,268
2005	70,629,025
2006	81,855,902
2007	84,423,433
2008	82,998,878
2009	77,140,317
2010	81,888,872
2011	85,366,976

Source: Instituto Nacional de Estadística (INE)

EXHIBIT 9 – Number of travelers and overnight stays by country of residence (2011)

Results by countries

Countries	Number of travelers		Overnight stays	
	Total	%	Total	%
TOTAL	85,366,976	100.00	286,761,260	100.00
Residents in Spain	45,824,882	53.68	111,524,330	38.89
Residents abroad	39,542,094	46.32	175,236,930	61.11
Total Residents abroad	39,542,094	100.00	175,236,930	100.00
Total Residents in U.E. (without Spain)	29,221,608	73.90	144,982,274	82.73
Germany	7,122,227	18.01	47,000,767	26.82
Austria	386,465	0.98	1,771,063	1.01
Belgium	1,044,485	2.64	5,439,535	3.10
Denmark	463,109	1.17	2,523,244	1.44
Finland	275,427	0.70	1,314,827	0.75
France	4,227,160	10.69	12,141,416	6.93
Greece	146,534	0.37	434,151	0.25
Ireland	546,755	1.38	2,444,829	1.40
Italy	2,833,011	7.16	9,378,102	5.35
Luxembourg	76,209	0.19	446,311	0.25
Netherlands	1,485,998	3.76	7,029,259	4.01
Poland	512,299	1.30	2,454,486	1.40
Portugal	1,214,535	3.07	3,136,338	1.79
United Kingdom	7,293,020	18.44	42,194,981	24.08
Czech Republic	197,669	0.50	1,015,422	0.58
Sweden	742,767	1.88	3,905,603	2.23
Rest of UE*	653,943	1.65	2,351,939	1.34
Norway	445,760	1.13	2,338,035	1.33
Russia	979,383	2.48	5,721,741	3.27
Switzerland	690,615	1.75	3,111,393	1.78
Rest of Europe	844,455	2.14	2,711,979	1.55
Japan	607,371	1.54	1,020,401	0.58
United States of America	1,994,258	5.04	4,384,027	2.50
Rest of America	2,350,885	5.95	5,375,830	3.07
African's countries	421,396	1.07	930,590	0.53
Rest of the world	1,986,354	5.02	4,660,653	2.66

* Rest of UE: Bulgaria, Cyprus, Slovakia, Slovenia, Estonia, Hungary, Latvia, Lithuania, Malta and Romania

Source: Instituto Nacional de Estadística (INE)

EXHIBIT 10 – Travelers and average stay by destination (Autonomous Regions)

	Number of travelers			Average stay
	Total	Residents in Spain	Residents abroad	
TOTAL	85,366,976	45,824,882	39,542,094	3.36
Andalusia	14,894,506	8,992,305	5,902,201	2.84
Aragon	2,154,307	1,784,712	369,595	1.97
Asturias (Pr. de)	1,451,994	1,267,273	184,721	2.09
Balearic Islands	8,378,477	1,404,186	6,974,291	6.42
Canary Islands	7,936,706	2,245,208	5,691,498	7.37
Cantabria	1,055,791	866,210	189,581	2.23
Castile - La Mancha	4,216,226	3,372,117	844,109	1.68
Castile and León	1,911,228	1,585,070	326,158	1.75
Catalonia	16,506,258	6,608,596	9,897,662	2.92
Valencia (C.)	6,943,498	4,665,674	2,277,824	3.52
Extremadura	1,273,517	1,076,357	197,160	1.75
Galicia	3,354,068	2,631,462	722,606	2.13
Madrid (C.)	10,371,527	5,702,059	4,669,468	1.93
Murcia (R.)	1,022,373	838,733	183,640	2.63
Navarre (C. Foral)	814,826	630,773	184,053	1.89
Basque Country	2,416,091	1,608,195	807,896	1.92
La Rioja	534,021	446,306	87,715	1.75
Ceuta	80,700	59,434	21,266	2.01
Melilla	50,856	40,205	10,651	2.66

Source: Instituto Nacional de Estadística (INE)

EXHIBIT 11 – Establishments, capacity, and occupancy by categories of establishment

Category	Number of establishments	Number of available beds	Occupancy per available beds
TOTAL (2011)	14,997	1,427,700	53.47%
HOTELS: Golden stars			
Five	251	81,375	52.00%
Four	1,929	571,746	60.34%
Three	2,515	426,629	60.66%
Two	1,890	117,721	41.00%
One	1,189	51,049	32.20%
INNS: Silver stars			
Two and three	3,083	94,550	29.91%
One	4,140	84,629	28.68%

Source: Instituto Nacional de Estadística (INE)

Year	Number of hotel establishments	Number of available beds
1999	15,042	1,011,015
2000	14,870	1,033,011
2001	14,880	1,055,864
2002	13,523	1,080,290
2003	13,680	1,122,052
2004	13,845	1,175,514
2005	13,991	1,212,598
2006	14,056	1,263,779
2007	14,228	1,297,649
2008	14,696	1,340,439
2009	14,824	1,363,934
2010	14,838	1,398,900
2011	14,997	1,427,700

Source: Instituto Nacional de Estadística (INE)

TEACHING NOTES

1. Introduction

This section aims to give instructors with a guide plan, identifying the key aspects about Pestana case study. In addition, some suggestions and recommendations for the class discussion are also provided.

2. Synopsis

Pestana, a Portuguese hotel chain, was founded in 1972. It started its internationalization process back in 1998 entering into Mozambique; in 2012, the Group was present in 13 countries. The company's strategic plan for internationalization was based in two lines: the emerging destinations of South America and the traditional European markets.

Pestana was already present in several cities in South American countries and it had few ongoing projects for future expansion in Uruguay, Argentina, Brazil and Chile. The main question regarded the European capitals, showing particular interest in Spain. But yet, no decision was made. The financial crisis and the fact that the Spanish hotel industry was highly competitive were the main constraints. Nevertheless, Pestana continued to study this market in order to seek for opportunities. Is the Spanish industry attractive enough? Is it a good option to enter the market? If so, what would be the best entry strategy?

3. Suggested assignment questions

Students should read the case and prepare the following recommended questions:

1. *How would you describe the company's evolution and strategy?*
2. *How would you describe the hotel industry in Spain? What are the opportunities and threats in such market?*
3. *In your opinion, is it a good decision for Pestana Group to enter the Spanish market?*

4. *In what ways can Pestana benefit from the entrance in the Spanish market?*
5. *What are the possible modes of entry in Spain? What are the advantages and disadvantages of those strategies?*
6. *How could Pestana benefit from a strategic alliance in the Spanish market? Should Pestana try to pursue this strategy?*
7. *If eventually Pestana enters the Spanish market, what should its strategy be? (Note: you may consider the industry key success factors to answer this question)*

4. Teaching objectives

The case study was prepared with the following teaching objectives:

- For students to analyze the external environment, both at macro and microeconomic level, making use of strategic frameworks and tools, like PEST analysis, Porter's five forces and SWOT analysis, in order to identify the key aspects.
- For students to interpret and analyze the data and figures about the environment and the company.
- For students to understand the different modes of entry in a market or foreign country, both generic and specific for the hotel industry.
- For students to understand the strategic implications involved when entering into a foreign country, challenging them to identify and evaluate the possible strategies.

5. Use of the case

This case study was prepared in order to illustrate a real and particular internationalization situation, and dilemma, about a Portuguese company. It was developed as a class discussion case and might be used in strategy courses (Strategy, Strategic Management), as well as in courses of industry analysis (International Industry Analysis), both in undergraduate and master programs.

6. Relevant theory

6.1 Strategic frameworks and tools

The nature and level of competition in an industry depends on five forces – and the weaker these forces are, higher the expected profitability of the industry (Porter, 1979). In other words, the structure of an industry will drive the competition and profitability (Porter, 2008). The forces are threat of new entry, bargaining power of customers, bargaining power of suppliers, threat of substitute products or services and rivalry among existing competitors.

Furthermore, Grundy (2006) has stated that Porter's model could be further developed analyzing growth drivers and PEST factors (Political, legal and regulatory environment; Economic environment; Social and cultural environment; and Technologic environment), among other elements. Other popular tool is SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. It may be also important to determine the stage in the life cycle, a concept that was studied by Vernon (1966), among others. The generic stages are the introduction, growth, maturity and decline.

Students may find these frameworks and tools in several strategy manuals, for example:

- Lynch, Richard, 2009, *Strategic Management*, fifth edition, Prentice Hall;
- Johnson, Gerry, Kevan Scholes and Richard Whittington, 2008, *Exploring Corporate Strategy*, eighth edition, Prentice Hall.

6.2 The hotel industry

Competitors in the hotel industry are determined mainly by price and segment and especially by proximity in terms of location (Mathews, 2000).

Furthermore, Tarí, Claver-Cortés, Pereira-Moliner and Azorín (2009) identified the key success factors in the Spanish hotel industry. They are, by order, quality management commitment (leadership, quality planning, people management, customer focus, process management, supplier management, continuous improvement and product design), training, facilities (hotel category, size, number of rooms, room

equipment and number of services) and chain affiliation, information and communication technologies and information systems and environmental management.

6.3 Internationalization

International modes of entry can be classified into two generic groups: non-equity modes, including exports and contractual agreements, and equity modes (or foreign direct investment), either through joint ventures or wholly owned subsidiaries (Pan and Tse, 2000). Given the characteristics of the hotel business, exports can be excluded as an option for mode of entry. As so, the possible modes of entry in the hotel industry are again divided into two categories: equity or investment-based (joint ventures or wholly owned subsidiaries) and non-equity or contract-based, including management contracts and franchising agreements (Quer, Claver and Andreu, 2007). Students can find the generic entry modes in several strategy manuals, but do not necessarily have to search for the ones that are specific to the hotel industry once there are clues in the case study.

Furthermore, there are many theories related to internationalization process. One of them is the Uppsala School model. It states that a company enters foreign markets gradually as it increases its experiential market knowledge from current business activities which can be acquired through personal experience: first, it enters into similar markets with psychic or mental proximity (language, culture, political systems, among others) and then to markets with greater distance (Johanson and Vahlne, 1990); at the same time, companies gradually develop different entry modes (Machková, Král and Lhotáková, 2010).

7. Analysis and discussion

1. *How would you describe the company's evolution and strategy?*

An interesting way of answering this question is to explain the evolution of Pestana's **business model**, and in particular, its profit formula and revenue model (Johnson, Christensen and Kagermann, 2008). Given this, there are three steps or phases.

Ownership, but not management: Pestana was founded in 1972, and the revenue model was based on the ownership of the Madeira Sheraton. In other words, the company owned the hotel but it was managed by the Sheraton Group. In this situation, Pestana paid a fee to Sheraton and assume all the risks and financial difficulties of the hotel. Since Pestana had no experience in hotel management, perhaps it was a good choice to hire a management company. And only in 1990, Sheraton left the management of the unit and Pestana assumed that position.

Ownership and management: The second stage was based on acquisitions and constructions of establishments, which the company would operate under its brand. It is also pertinent here the complementary businesses that Pestana acquired such as golfing, which reduced the level of dependence of third-party entities (vertical integration). In these cases, Pestana assumed all the risks of its businesses, but here, it did not have to pay any fees to a management company.

Management contracts and alliances: More recently, Pestana's business model saw a change when the company started signing management contracts and partner with other companies, which required much less investment. It happened, for example, in Morocco with Pestana Casablanca which is owned by the Spanish Inveravante Group, but managed by Pestana. As for the strategic alliances, it is important to highlight the partnership with German group Rewe Touristik and its consequent co-branding, among other conditions of the agreement.

This is a similar evolution to some Spanish hotel chains which, according to the case, still have a high percentage of property but are embracing these new strategies, or business models, in order to expand.

Another way to answer this question is to understand the strategy of the company using the **Uppsala model** which is explained above.

First, Pestana started its operations in Madeira in 1972 when Dionísio's father opened Madeira Sheraton. In 1976, he trusted his son, Dionísio, the business. It was not until 1992, after expanding and gaining experience in Madeira, that the company invested in mainland Portugal.

The internationalization process first started with countries like Mozambique, Brazil Cape Verde and São Tomé and Príncipe, which are culturally close due to the fact that are all Portuguese-speaking regions. During this period, Pestana also enter into the South African market and although it is not a Portuguese-speaking country, it is Dionísio's home country and perhaps this fact reflects the proximity.

Then, according to Uppsala theory, the company would expand to markets with greater distance, as it gained experiential market knowledge: Argentina, Venezuela, the United Kingdom, Germany, Colombia, the United States of America and Morocco. Pestana also developed different entry modes, for instance, the management contract to enter in Morocco.

2. How would you describe the hotel industry in Spain? What are the opportunities and threats in such market?

There are several frameworks that can be used to answer this question. For example, PEST analysis aims to identify the macro environment factors that have an impact on tourism and hotel industry. In addition, the Industry's Lifecycle can also be used in order to identify the stage in which the industry is in. Then, the Porter's Five Forces is used to assess the attractiveness of the competitive environment. Finally, students may identify the opportunities and threats taking into account some of the conclusions from the latter frameworks.

PEST Analysis:

- *Political, Legal and Regulatory Environment*

Within the political factors, there is the plan of the national Government for 2012-2016, which is expected to have a positive impact on the tourism industry. The measures include: the international promotion and better positioning of Spain which

may attract more tourists; the loyalty programs and cards for tourists, aiming for them to repeat the trips; a more efficient procedure for issuing visas; and the review and possible amendment of the legislation, among others.

In addition, the fact that Spain belongs to the European Union also contributes positively because EU citizens can travel freely to the member countries, not requiring any visa, which is particularly important once the major part of the international tourists come from the EU.

Spain is a politically stable country and that has a positive impact. As mentioned in the case, there was a shift in international tourist arrivals from the Middle East and the North of Africa to safer countries, like Spain.

- *Economic Factors*

The financial downturn, affecting especially the Eurozone, has a direct and negative impact due to the credit restrictions and constraints. Therefore, it can be assumed that the Government response to the crisis will somehow shape the future results and performance not only of the tourism and hotel industries but also of other industries. On the other hand, as the prices of some establishments have fallen due to the crisis, it may represent an opportunity for some companies that are looking to acquire.

Furthermore, VAT increased in September 2012, affecting both companies and individual consumers. Plus, unemployment in Spain has reached alarming levels in 2012, surpassing the 25 percent. In general, companies are cutting their budgets and therefore this has negative consequences on the hotel industry because business travelers and MICE are becoming more cost-conscious and price-sensitive. These factors also affect the disposable income of the individual consumers, which are expected to cut their spending in activities related to leisure and entertainment and become more price-sensitive.

- *Socio and Cultural Environment*

The economic environment has affected, in some extent, the social and cultural environment and consequently having a negative impact on the demand in the hotel industry. Spanish travelers are expected to become more reluctant when it comes to

traveling. These factors had an impact on the number of Spanish residents accommodated in hotels and in the overnight stays, which have decreased from 2010 to 2011 by 1.17 percent and 1.83 percent (**Exhibit 8**), respectively. The domestic tourism has actually increased during that period by 1.32 percent (calculated with data from **Exhibit 7**), but there are less Spanish domestic travelers willing to stay at hotels, meaning that they are choosing other options such as owned, family or friends' dwelling, for instance, which are less expensive; and those who do choose hotels, are reducing the overnight stays.

- *Technological Environment*

Spain ranks among the top ten most competitive countries in the world in the travel and tourism industry. As mentioned, the ranking is elaborated according to several factors, few of them corresponding to technological ones. It is the case of transportation and access routes, tourism infrastructure and environmental sustainability, contributing positively to the hotel industry.

Industry Lifecycle:

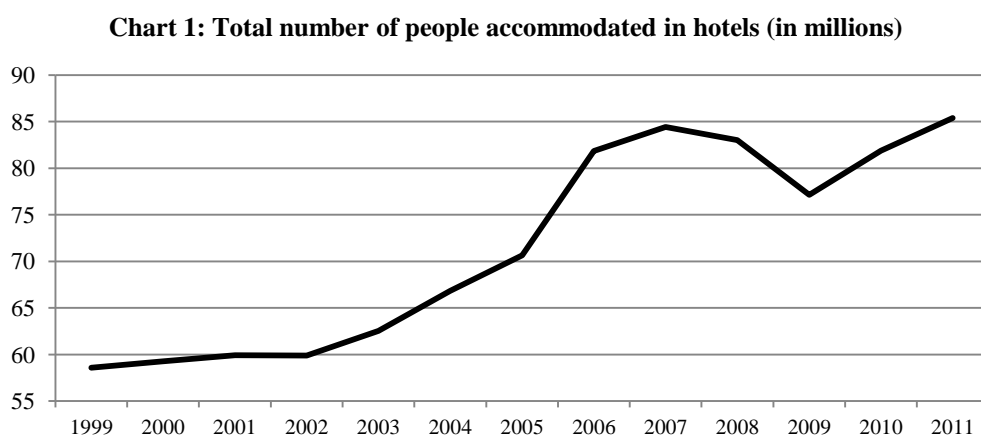
In order to determine in the stage the Spanish hotel industry – introduction, growth, maturity and decline – it is important to assess several indicators. For example, it may be important to analyze the demand, the investments, the number of competitors, the market growth, size and profitability throughout several years, among other possible elements, so as the trends and forecasts. In this particular case and with the information that is available, the parameters can be the growth in international tourist arrivals, the domestic tourism, the total number of people accommodated in hotels, the number of hotels establishments and the number of available rooms, along with other factors.

First of all, the global trend is for emerging destinations to receive more international tourists than traditional ones. The expected average annual growth of international tourist arrivals in advanced economies is 1.8 percent between 2010 and 2030, which is lower than in emerging economies (**Exhibit 2**).

Although Spain is not discriminated in the forecasts presented in **Exhibit 2**, values are presented for Southern and Mediterranean European region. The international tourist arrivals grew on average by 3.1 percent per year between 1980 and 1995 and 3.7 percent between 1995 and 2010. In a long term perspective, it was forecasted to increase

annually by 2.5 percent until 2030. It was also estimated that the share in international tourist arrivals will decrease from 18 percent in 2010 to 14 percent in 2030 for the Southern and Mediterranean Europe, considering the global tourism industry. It is also relevant to mention that despite that the international tourist arrivals grew by 8 percent and non-resident tourists accommodated in hotels by 10 percent between 2010 and 2011, this is likely to have happened in part because of the conflicts in the Middle East and North Africa region, shifting tourists to safer destinations like Spain. Furthermore, **Exhibit 7** shows that the Spanish domestic tourism has seen a decrease between 2008 and 2011, although it was probably linked to the financial crisis.

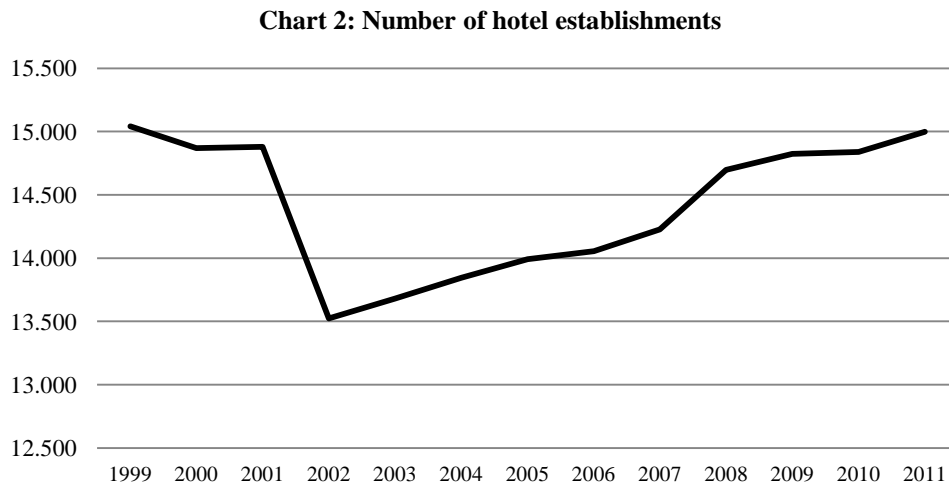
Regarding the tourists accommodated in hotel establishments, its evolution is shown in the following graph:



The evolution of the number of people accommodated in hotels during the beginning of the 2000's was positive but rather low, near 1 percent annually. Between 2002 and 2005, the growth was higher, rounding 5 percent annually. The greatest growth during this decade happened between 2005 and 2006 with approximately 16 percent. The following years were not as good – there was even a decrease between 2007 and 2009, which was possibly connected with the crisis as mentioned previously. 2010 and 2011 showed positive results, although at a slowing pace. It is relevant to mention here that the crisis was still affecting Spain and the demand of the hotel industry, given the government measures such as the VAT increases.

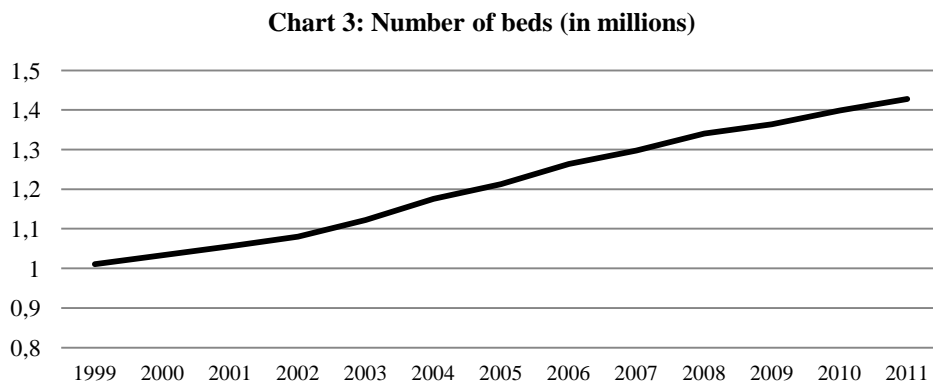
On the supply side, it is noticed that the number of hotel establishments operating in Spain is quite similar comparing the year 1999 and 2011 – around 15,000

units – although there were some changes during that period of time. **Exhibit 11** and the graph below shows precisely that:



It seems that there was some type of shock between 2001 and 2002 given its decline of 9 percent – although it is not described in the case, it is related perhaps to the September 11 attacks. After that year, the evolution of the number of hotels has been positive. However, this growth has been relatively low – an average of annual growth of 1.16 percent between 2003 and 2011. Within this period of time, 2008 was the year of highest growth (about 3.3 percent).

The same analysis can be done to the number of available beds. In this case, the evolution was positive for all years between 1999 and 2011, with an average of annual growth of approximately 3 percent. The highest increase was seen between 2003 and 2006 with a rise of about 4 percent annually. After that, the growth has slowed down.



Overall, the Spanish hotel industry is reaching the **mature stage** due to its slowing growth rates, though the performance of the industry was disrupted by the financial crisis.

Although in a mature stage, new competitors may still be attracted into to the Spanish market. In fact, foreign chains even doubled its presence during 2011. Considering this fact with the low growth rates of new supply or installed capacity, it can be assumed and concluded that the level of concentration is becoming higher. In 2011, the ten largest chains in terms of number of rooms concentrated 18 percent of the capacity of the hotels in Spain. Furthermore, it is mentioned in the case that only 30 percent of the hotel establishments were managed by a hotel chain. Here, some opportunities may arise for them, once a large number of establishments (about 70 percent) are expected to be more vulnerable to the crisis.

Porter's Five Forces:

- *Threat of new entrants*

According to the case, the overall growth in hotel capacity remained low in 2011 compared to the previous year. According to **Exhibit 11**, the number of hotels only increased 1 percent during this period and number of available beds 2 percent. This means that some hotels increased its capacity, but it was not though a significant increase, and the latter percentages were even expected to decrease in the near future. Furthermore, it is required large financial resources in order to enter into the hotel industry, especially in the case of new companies, which consequently means that the threat of new supply is low in this sense.

However, there is a difference between new supply and new companies entering in a market. In fact, there are many international hotel chains that are entering into Spain, taking over the management of existing hotel units. Here, the threat was higher. In addition, the trends in the market show that it does not necessarily require a big investment, given that there are business formats in which the investment is low. This happened mainly to management companies, the ones that take care of the operations.

Taking into account all the elements, it can be considered that the threat of new entrance was moderate.

- *Threat of substitute products or services*

According to the data from the case, there are substitutes for hotels. This is reflected for instance in the comparison of number of international tourists arrivals in Spain and the number of international tourists that were accommodated in hotels. Spain received in 2011 around 56.7 million international tourists as seen in the **Exhibit 3**, but only 39.5 were accommodated in hotels according to **Exhibit 8**, meaning that approximately 17.2 million (the difference between the two values), which represents about 30 percent of the international tourist arrivals, were accommodated in substitutes of the hotel establishments.

Furthermore, this can also be shown in the domestic tourism data, although in this case the comparison is not as accurate because it is presented the number of trips of Spanish residents as apposed as the number of people who travel within Spain. Anyway, there were approximately 147 million trips in 2011 (**Exhibit 7**) and only about 45.8 million Spanish residents stayed at hotels (**Exhibit 8**).

This means that substitutes are present in the industry, otherwise tourist arrivals would match the number of people accommodated in hotels. The substitutes can be, for example, friends or family apartments and camping facilities, which are less expensive than hotels. However, the threat is rather low or moderate due the fact that tourists may not have access to some of these substitutes, for instance, family or friends dwelling. In the case of camping facilities, the customer profile is in practice different from hotel customers either because of the lifestyle or motive for the trip.

- *Bargaining power of buyers*

There are different types of customers or segments according to the motivation for the trip – leisure, business and MICE segments. Within these segments, there are also differences between the international and domestic tourists.

Overall, the number of customers is high, though an individual customer is small in size and losing a client is not that significant for a company, therefore, in this sense, the bargaining power of buyers is not strong once a single customer cannot drive down the price. Furthermore, although there is brand loyalty, the switching costs for customers are not significant. Besides, there are substitutes and many hotel brands in different categories.

However, it is mentioned in the case that tourists were looking even more for special discounts and special offers, and here, the bargaining power of customers may be higher. The unemployment rates and the VAT increases, among other factors, affected especially the Spanish domestic tourism once the Spanish residents were reducing and cutting costs such as leisure spending. Besides that, hotels may be forced to reduce its prices due to the increasing price sensitivity of business travelers and of MICE segment.

- *Bargaining power of suppliers*

There are many types of supplies: labor, real estate, furniture and machines, food and beverages, hotel utilities, technology advertising and other marketing services, consulting and legal services, among many others.

Taken as a whole, there are many suppliers in the hotel industry although it is not explored in the case study. In addition, substitutability of the suppliers is also fairly possible and inexpensive. Therefore, the bargaining power of suppliers appears to be low.

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

The degree of competitive rivalry is high due to several factors.

First of all, competition in the industry is determined essentially by price and segment and especially by proximity in terms of location (taken from the section of Relevant Theory). Competition by price is related in part to the category of the hotel. In other words, it is expected for a three-star hotel to compete with other three-star hotels, for example. However, if a four-star hotel decides to lower its prices or offer a price discount, it becomes a direct competitor of those three-star units, competing perhaps with other segments. Concerning the location, the competitors will be those that are closer. In such traditional and mature market as Spain, it is probable and expected for the most common destinations (Madrid, Barcelona or the Islands, for example) to have a fiercer competition.

In addition, the growth of the number of hotels remained steady and low which may be another indicator, along with the fact that demand is much lower than the offer

according to the occupation rates in **Exhibit 11** that indeed is a highly competitive industry.

Then, the growing presence of international hotel chains in Spain was becoming more and more evident. In fact, these chains more than doubled its presence in 2011.

- *Conclusion about the attractiveness of the industry*

The industry seems to be driven especially by the rivalry among existing competitors. Considering all, the attractiveness appears to be medium.

Opportunities and Threats:

- *Opportunities*
 - Top ten countries in terms of international tourist spending and international tourist arrivals.
 - Third most popular congress and convention destination in the world in 2011; the second country in the world in 2012 with more monuments classified as World Heritage Site, and the top golfing destination for European golfers.
- *Threats*
 - The Spanish domestic tourism had been affected by the financial crisis and unemployment; the crisis can become an opportunity because prices of hotel establishments are expected to decrease.
 - Highly competitive market; it can also be considered an opportunity for establishing partnerships and alliances between hotel companies in order to combine resources to face other competitors.

3. In your opinion, is it a good decision for Pestana Group to enter the Spanish market?

To answer this question, it is important firstly to understand whether if the country fits the Pestana's criteria, although the company has already the objective of entering into the Spanish market. In the case (The Group's Strategic Plans for the Future), it is presented the main criteria for the company to choose a market. These are: the dimension of the market, political and economic stability, legal clarity, good access

routes, security, and presence in other markets that emit tourists to the market in question.

Regarding the dimension of the market, Spain is one of the largest of the world, ranking in the fourth and second place in terms of international tourist arrivals and international tourist spending.

As for the stability, it can be an issue for the company when it comes to the economic condition of Spain. The crisis and the difficulties of obtaining credit can become a significant problem for the company. However, prices of the hotel establishments are going down and the company has already been studying them, so it seems not to be a problem, although Dionísio actually mentioned that they are still high. Anyway, as a large hotel chain, it is apparently easier to obtain credit compared to smaller hotel chains, hotel companies in financial difficulties and independent hotels. Besides that, the company may explore other ways to enter into the Spanish market.

Spain is one of the most competitive countries in the world, especially in the travel and tourism industry, in which it ranked in 2011 in the eighth position. According to the information given in the case, this ranking is based on several criteria like regulations, security and transport infrastructure, among others. Therefore, it can be assumed that the Spanish market fits the requirements of legal clarity, good access routes and security. For the latter criterion, it can be added that the 2010/2011 growth in international tourist arrivals was due to the conflicts in the Middle East and North of Africa. Therefore, these tourists considered Spain as a safe destination.

As for the last criterion (the presence in other markets that emit tourists to the Spanish market), it can be understood from the comparison between the countries in which Pestana is present and the Spanish inbound tourism. The Group has hotels in thirteen different countries: Portugal, Brazil, England, Germany, Argentina, Venezuela, Mozambique, South Africa, Cape Verde, São Tomé and Príncipe, Colombia, the United States and Morocco.

According to **Exhibit 5**, the international tourists who arrived to Spain in 2011 accounted for 56,694,298 people, out of which more than 90 percent came from other European countries. The most important were: the United Kingdom, Germany, France, Italy, Netherlands and Belgium, which together accounted for approximately 70 percent

of the inbound tourism. Out of these countries, Pestana is present in two of them: the United Kingdom and Germany. However, in these countries, the Group has only one unit in each (London and Berlin), so its presence it is not as strong. In fact, the only European country in which Pestana has a strong presence is Portugal, having hotels across the main destinations under two brands (Pestana Hotels & Resorts and Pousadas de Portugal). Still, Portugal represented in 2011 just 3.2 percent of the Spanish inbound, and besides, the total number of Portuguese tourists arrived in Spain has decreased 5.7 percent comparing with the previous year.

Pestana should also consider the attractiveness of the industry when deciding whether should enter into the Spanish market or not. Therefore, this point will depend on what students may have answered in Question 2. As mentioned in the previous question, the hotel industry is characterized by being highly competitive, which is a big threat. But Pestana has the experience, and if a good opportunity emerges, it seems to be a good option for the company to enter in Spain.

4. In what ways can Pestana benefit from the entrance in the Spanish market?

First of all, being considered the Portuguese largest hotel chain and having a strong presence in this market, it is expected to be known by the Portuguese population. Furthermore, according to **Exhibit 9**, 1,214,535 Portuguese tourists were accommodated in hotels in Spain in 2011. Although its growth was relatively low (3.07 percent), Portugal still represented the sixth emitting country to the Spanish hotel industry in that year. For that reason, it is possible for Pestana to acquire some of these Portuguese tourists if it enters the Spanish market, given that a person is more likely to stay in a hotel if its brand is known.

Then, it would be a way to increase the brand awareness and recognition among tourists and residents. Therefore, Pestana can gain more customers (residents in Spain or from other countries) in other countries where it is present. For example, according to **Exhibit 7**, the major destinations for Spanish residents in 2011 were France (18 percent of the total Spanish outbound tourism), Portugal (12 percent), the United Kingdom (9 percent) and Germany (6 percent) – and Pestana has units in the three last countries (23 across Portugal, 1 in London and 1 in Berlin). Furthermore, South America represented 8 percent of the outbound tourism, where the company has several hotels and is planning to further invest.

5. *What are the possible modes of entry in Spain? What are the advantages and disadvantages of those strategies?*

INVESTEMENT-BASED

- **Ownership (or wholly owned subsidiaries):**

It is a common business format in Spain as mentioned in the case, especially in the case of national hotel chains, in which the unit is owned and operated by the same organization. Actually, it is also the predominant format of Pestana hotels once it owns and operates the units, with some particular exceptions like Pestana Casablanca in Morocco. However, owner-run hotels are losing popularity in Spain because it requires a high commitment of capital and resources, and credit is getting harder to obtain. In addition, due to the economic and financial context of the Spanish market, it is not easy to obtain credit from the banks. Besides, the company has to bear the risk from borrowing, if it is the case. Perhaps the largest hotel chains can obtain it but they are actually changing its business model and focus more on management contracts, franchising agreements and other strategies that require low capital outflow.

On the other hand, some opportunities arose as the price of the hotel units decreased given the financial crisis, especially in urban hotels in Madrid and Barcelona. Furthermore, Pestana has already been analyzing the prices of some hotels in difficult, although Dionísio stated that they have not fallen enough. So, perhaps, Pestana should wait if they decide for this format, because the company has internally established a limit for its debt. In contrast, if Pestana chooses another business format that requires low capital, it can contract debt in other markets like South America, in which might be easier to obtain credit, and still comply with that maximum debt limit.

The advantages and disadvantages of finance leases³⁷ are identical, once this type of lease transfers substantially all the risks and rewards of ownership to the hotel company.

³⁷ In the case, it is mentioned leasing as a business format. It is important to mention that there are two types of leases: finance and operating leases. The first transfers all the risks and rewards to the tenant, while in the second, they remain with the landlord.

- **Joint Ventures**

A joint venture is the cooperation or partnership of two or more companies in which both share rewards and risks, involving shareholding. One example is the joint venture between AC Hotels and Marriott International, establishing a co-branding strategy, after the acquisition of 50 percent of the Spanish company by Marriott.

The advantage may include the synergies between the companies through the combination of resources, expertise and distribution channels – and in the latter example, the combination of strong brand names. As for the drawbacks, some conflicts may occur due to disagreements between the parties.

CONTRACT-BASED

- **Management contracts:**

Management contracts are agreements or business formats between the establishment owner and a hotel management company, separating therefore ownership from operations. There is no official definition of management contracts but usually the owner retains the financial and legal responsibility of the property and the management company operates the hotel, pays hotel expenses and receives a settled fee, although it depends on the conditions of the contract.

It is actually a good business format for moments of crisis, once it requires low capital commitment. However, there may be less flexibility in management decisions and there may be conflicts between the owner and the management company.

The advantages and drawbacks of operating leases³⁸ are similar due to the fact that these leases do not convey the rights of ownership to the hotel company.

- **Franchise agreements:**

It is business format in which a company gives the right for using its brand to other company in exchange for a fee. There are no capital requirements and it is a way for a company to rapidly expand its brand. However, there is lack of control from the franchisor, although the franchisee has to guarantee certain requirements.

³⁸ In the case, it is mentioned leasing as a business format. It is important to mention that there are two types of leases: finance and operating leases. The first transfers all the risks and rewards to the tenant, while in the second, they remain with the landlord.

- **Strategic Alliances**

Strategic alliances are mentioned in the case and can also be considered an entry mode as well. For example, it is the case of the alliance between Pestana and Rewe Touristik. The German Group became responsible for the distribution in several countries (Germany, Switzerland, Austria and Benelux) of two of Pestana hotels, establishing also a co-branding strategy between Pestana and LTI (one of Rewe's brands): LTI Pestana Grand Hotel and LTI Pestana Viking Hotel, being both managed by Pestana. Before this alliance, Rewe Touristik did not have or manage any hotel units in Portugal and, therefore, this case of strategic alliance can be understood as another type of entry mode. From Rewe's point of view, the advantages and disadvantages of this strategy are similar to franchising agreements.

6. *How could Pestana benefit from a strategic alliance in the Spanish market? Should Pestana try to pursue this strategy?*

The benefits will vary depending on the type of strategic alliance and the type of company that Pestana would partner with. For answering this question, students may take again the example of the alliance between Pestana and Rewe Touristik presented above. If Pestana adopts a co-branding strategy in Spain with a local hotel chain, the benefits would embed a greater exposure of its brand in the market and a much lower risk comparing to a situation where Pestana enters with no alliance or co-branding strategy. Regarding whether Pestana should pursue this strategy or not, it will depend on the level of control the company wants to take on. The fact is that Pestana manages all the units that are under its brand and has never followed a franchising strategy, which may indicate that the company wants to have certain control of its units and brand. If indeed that is the case, one way of benefiting from co-branding is to establish a co-management agreement as well.

But there are other types of alliances that do not include co-branding and that would be useful for Pestana. For instance, the Spanish hotel chain Meliá International Hotels signed a sales and operations agreement with the Chinese Jin Jiang International Hotel Company, in which both parties partnered in order to cooperate in the expansion of Meliá throughout China and of Jin Jiang in Europe. Besides this, it is also common for hotel companies or chains to partner with other types of companies like restaurants, tour operators, travel agencies, among others.

7. If eventually Pestana enters the Spanish market, what should its strategy be?

Students may think about the key success factors of the Spanish hotel industry in order to formulate the strategy of the company, along with other possible factors.

One of the criteria for the company to choose a country is the presence in other markets that emit tourists to the country in question. Possibly, this criterion may refer to the awareness and recognition of the brand in different markets. Giving an example, Spain receives many tourists from the United Kingdom. Although Pestana has only one unit in London, this can create brand awareness and recognition among the English residents and the English tourists that visit Spain. Therefore, if the Group enters Spain, it should use its brand as it has done over the years and not create a new one.

Furthermore, given the condition of the Spanish market, the best options of mode of entry would be management contracts, although Pestana is also looking for acquisition and ownership opportunities. It would be an easier way of expansion, related also with one of the industry's key success factors: size and number of rooms. If an opportunity emerges, it would also be a good option to make an alliance with a Spanish hotel chain, rather small or medium because it may be more difficult with larger ones, and explore co-branding strategies.

In addition, its core business focuses on four and five-star hotels, and is also considering entering the three-star category. Therefore, other categories can be excluded. Nonetheless, the company must consider that there is a risk, if it indeed enters the three-star category, of damaging the quality perception in other markets. Besides this, it is important to consider that in 2011, more than 74 percent of the tourists accommodated in hotels stayed at three and four-star hotels, units that presented the higher occupation rates (**Exhibit 8**). In any case, Pestana should establish competitive prices due to the fact that it is a highly competitive industry, taking into account the average daily rates – the ADR that were presented in the case study were €148, €78 and €58 for five, four and three hotels.

Then, other key success factors are quality management commitment that includes, for example, leadership, quality planning, people management, customer focus, process management, supplier management, continuous improvement and product design, as referred in the Relevant theory. Pestana has already the knowledge

experience, whether in four or five-star hotels. In addition, given the geographical proximity to Portugal, it may benefit from current supplier relationships when it comes to the Spanish market.

Distribution channels and communication are also essential. As mentioned before, Pestana has an agreement for the distribution of two units in the Portuguese market with Rewe Touristik. Perhaps, it should explore also the opportunity of establishing other type of alliance or agreement with the German Group regarding the Spanish market, in order to benefit from its traveling agencies and tour operators.

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