

Checking in on hotels' competitive behavior

Is maximizing profits the only thing that matters? IESE's Govert Vroom studies the competitive behavior of hotels and finds other concerns at play.

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Privately held companies account for roughly 50 percent of U.S. GDP and are increasingly popular investment choices. One study estimates that individuals' investments in private businesses come to about \$5.7 trillion, approaching the \$7.3 trillion invested in public companies.

But what drives the decisions of private, closely held businesses? Are their competitive strategies the same as their more widely held or public counterparts'?

While theories of strategic management tend to assume that all for-profit businesses aim to maximize profits for shareholders, this is not the whole story.

A [study](#) by Brian McCann of Vanderbilt University and [Govert Vroom](#) of IESE finds that closely held businesses appear less focused on profits than those that aren't. The evidence is seen in three key competitive behaviors that affect profitability: entering a market, exiting, and pricing according to market conditions. Using data from nearly 4,000 hotels in Texas over 8.5 years, the co-authors look at how the hotels' ownership structure affects these strategic decisions. (The hotel industry was chosen for its wide range of firms, from owner-managed inns to units of large public corporations competing locally.)

In the end, the co-authors show that closely held hotels are less responsive to market conditions in their competitive strategies than their non-closely held peers. This is likely because their owners/managers have concerns beyond financial payoffs; they may also enjoy some non-financial benefits of running a business.

A close look at the study

Closely held companies are often small or family-run businesses. The study defines its closely held hotels as those that have a limited number of shareholders, no public market for their shares, and also have owners who are actively involved in daily management. The hotel industry was chosen for this empirical study because it contains a mix of large and small establishments, both closely held and not.

To pinpoint which Texan hotels were actively managed by their owners, the study considers whether the owner and the hotel are located in the same postal code. About 55 percent of the sample was then labeled as "closely held," with the about 45 percent as "non-closely held."

With just two groups to compare, the co-authors then looked at three types of competitive behavior:

1. Entering a particular market when conditions are favorable,
2. Exiting a market when recent performance is poor, and
3. Increasing room prices as market conditions become more favorable (and vice versa).

Hotels motivated by profit would presumably be more likely to enter a booming market with high occupancy rates, more likely to close their business in a poorly performing market with low occupancy rates and more likely to adjust prices to reflect demand.

Both closely held and non-closely held businesses behaved as predicted -- but closely held businesses were significantly slower to respond to changes in the market conditions.

Counting the cost

What does a slower response to market conditions mean to hotels? Crunching the numbers, the co-authors show that when the occupancy rate rises by 11.41 percentage points, non-closely held firms in the study raised prices by an average of 2.89 percent, while closely held firms only raised them by 2.07 percent.

The difference of 0.82 percentage points may seem small, but for the average hotel in the study (with 91 bedrooms and 55 percent occupancy) this would translate into increased annual revenue of nearly \$10,000.

So why might hotel owners resist raising prices in a booming market? Perhaps they enjoy the reputation boost when their rooms are nearly fully booked. And on the flip side, when the local economic conditions are tough, hotel owners active in their business management might be especially hesitant to lower prices if it means taking a reputation hit.

Researchers have pointed to the pursuit of "socioemotional" wealth -- including family concerns, reputation and friendships, apart from financial gain -- as particularly significant in family-run and other closely held businesses. McCann and Vroom's investigation is consistent with this body of literature.

Non-financial motivators add complexity to decisions and can take managers' attention away from financial goals. What's more, when non-financial and financial objectives are in conflict, pursuing the former may mean sacrificing the latter. Indeed, when the co-authors compare the income statements of their two groups, they also find that revenues were, on average, lower in closely held firms.

In strategic management theory, the pursuit of profits as the only and final goal of companies seems to be a given. But reality is more complicated, as this study shows.

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