EJABM European Journal of Applied Business and Management

European Journal of Applied Business and Management, Special Issue, 2017, pp. 348-358. ISSN 2183-5594

Research paper

Budget hotels in Madeira: prospects and market trends

Submitted in 31, August 216
Accepted in 25, October 2016
Evaluated by a double blind review system

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Structured Abstract

Purpose: The term low-cost has come into common use by the tourism industry in the 90s. The concept is highly attractive to destinations recording growth rates below expectations. This study aims at providing a detailed analysis of the principal factors affecting the budget hotel's development prospects in a mature destination.

Methodology: This study is based on survey carried out amongst 3-star hotel guest to identify the critical factors of success of this brand-new market niche.

Findings: Based on the results of a survey, we suggest that most visitors display a high level of disinterest in the low budget concept. The current pricing trends based on 4 and 5 stars hotels offering discounted rates prevents any attempt of developing innovative concepts based on price moves. The average visitors only accept a decrease in their level of comfort (eg. attributes and services) in exchange for huge discounts.

Practical implications: This study suggests that respondents appear to refuse lower levels of comfort in exchange for marginal discounts appear to be unfeasible. Therefore, the is no easy room for ready-to-use measures and concepts and further research is needed to re-understand customers and to study new concepts adapted to this highly uncomfortable position.

Originality/Value: This study shed some light on the prospects of developing accommodation services based on basic hotel facilities in mature destinations marked by development strategies focused on top quality accommodation and well-off tourists. Our results highlight the responsibility of governments and industry operators in developing coherent long term strategic thinking.

Keywords: low-cost, Madeira Island, Madeira hotel´s, tourism, hotels.

1. Introduction

The travelling experience has been enhanced in recent years by societal and technological advances such as the emergence of the low cost airline phenomena and by the rising disposable income levels recorded in most Western European countries. Another contributing factor relates to the changing patterns of consumption; travellers are choosing to travel more frequently, however opting for shorter stays in the surrounding countries. Other significant developments and market innovations have been taking place in the field of tourism, notably in terms of the main motivations to travel and search for accommodation services, with far reaching consequences. For example, budget accommodation such as budget hotels, hostels and guesthouses are no

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longer perceived as “inexpensive” accommodation well suitable for backpackers and students unable to pay for traditional full-service hotels. The budget accommodation product has earned a reputation and high levels of credibility and recognition, in the market as a “challenger” to “traditional/well-established hotel brands”, through their value for money, “convenience”, flexibility and perhaps most importantly, “opportunities for social interaction and a more authentic local experience” (BDO Singapoure, 2005).

The budget hotel sector has been gaining momentum in the tourism industry, with increasing market shares in a number of countries. The sector “has expanded” in an effectively manner the number of choices and options available for travellers and visitors, leading to higher levels of competition and increased pressure for well-established companies to innovate. This market segment has been extensively studied in a number of countries. However, the extant research has been mainly centred on well-established destinations, with budget hotels operating for decades. Little research has been undertaken on destinations pursuing a high quality accommodation approach, which appears to be at odds with any attempt to develop the ´low´ budget hotel segment. Therefore, it matters to test out various alternatives and conduct market research in order to identify whether the segment will be competitive or not in the market. Given that the budget product competes with other well established products it is essential to profile the target audience in order to identify their main reason to visit as well as their preferences in terms of accommodation services. Moreover, a thorough understanding the preferences of the target audience will allow the budget accommodation brands to define their pricing strategy and target the most compatible group of consumers. In this study, we identify the most desirable services attributes, rom the consumers´ point of view and look into the potential of developing this sector. Therefore, this study, aims to fill the knowledge gap by examining the following research questions: which attributes will be the most critical and valuable for potential customers in a region pursuing a top quality accommodation strategy; who are the visitors most interested in the development of this market segment; is there a large enough number of customers willing to pay?

This paper will continue with a review of the literature centred on the concept of “budget hotel” before addressing the methodology selected in this study, followed by the analysis of data results and the main conclusions. The last section offers a few recommendations.

2. Literature Review

In this section we will provide an overview of the concept of budget hotel, prior to the analysis of the critical factors of success in this market. Firstly, we address a number of methodological problems pertaining to the very definition of budget hotel. The terms “budget hotel”, limited service” and “economy hotel” have been used interchangeably in the literature (Rahimi & Kozak, 2016, p. 4; Chan & Ni, 2011; Brotherton, 2004; Fiorentino, 1995). In fact, a unanimous definition of budget hotel is still lacking (Brotherton, 2004; Chan & Ni, 2011; Subramanian, Gunasekaran, & Gao, 2016). However, Ren et al (2015, p. 14) based on Brotherton (2004) and Senior and Morphew (1999) consider that five similarities are shared by most hotels pertaining to this segment: “a low tariff structure, minimum range of facilities, limited range of services, strategic location plus modern and modular construction” (See also Luo & Yang, 2016). Brotherton (2004) adds aspects such as “a strong brand, extensive geographic coverage of the hotel network, good accessibility, a centralized reservation system, standardized layout and offerings, lower room rates, relatively limited services and good value for-

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money offers”. Peng, Zhao & Mattila (2015, p. 141) provide a relatively similar definition, because the authors refer that key features of the industry are “limited service, simple rooms, standardized accommodation, low cost, low construction and operation costs, and fewer than 150 rooms” (See also Fiorentino, 1995; Zhang, Ren, Shen & Xiao (2013). Payne (2005) considers that the budget hotel segment tries to adhere to a strict “stick to the basics” philosophy. By basics Payne (2005) considers issues such as “cleanliness, safety, convenience, comfort and low price” (See also Moshin & Lengler, 2015). In the same vein, Moshin and Lengler (2015, p. 25) consider that budget hotel product focus primarily on bed and breakfast service “without any other additional services”. In general, factors such as good standard accommodation at low tariff, high value for money, convenient location, relatively limited service, reservation system and easy access to the main roads are reported in the literature. The main target of this segment lies in the low-middle class in general, young student, travels with low budget and tourists, which would suggest that such customers are not too demanding. However, issues such as “cleanliness safety, and product and service quality” are, nonetheless, critical in this sector. As in other segments of the industry, guests expect acceptable to high levels of “utility, service, amenities, and security”, in order to be satisfied. In the end, the budget hotel product aims at providing “simple and comfortable accommodation at a modest price.” The budget hotel segment has been preferred for shorter stays and factors such convenience in terms of location (close to the city centre or main access roads) have been decisive in the urban context. Although price considerations are still much too dominant in this segment, issues of convenience and the overall management of the travel budget must be highlighted.

As observed by Blanco, Oehmichen & Frood (2011, p. 373), the budget hotel segment has been “positioned at the lowest extreme of the value-for money equation”, by being concerned in offering basic accommodation at “affordable prices”, the key distinguishing feature of this segment. However, the sector has witnessed in recent years increased visitor’s expectations and the emergence of upscale budget and even design budget hotels. Expectations among potential visitors have been growing. Owing the changing demand patterns and “shifting preferences” and to the increasing number of reasons to visit a destination, budget brands have been forced to overcome its negative and stereotyped image of a cheaper alternative to traditional accommodation in the vicinity of the city centres, in order to establish themselves as a gateway to “interactive and immersive experiences” (BDO Singapoure, 2005, p. 12). In this vein, budget brands are being forced to offer, besides basic accommodation services, “customised value-adds” (BDO Singapoure, 2005, p. 12) to retain and attract customers. In fact, travellers are expecting to enjoy “consistent and high-quality accommodation”, besides affordable prices (Yan et al, 2016, p. 513). In general, visitors are increasingly price sensitive, less brand loyal and more sophisticate. As reported by Rahimi and Kozak (2016), even within the context of the budget hotel sector, customers are increasingly expecting value for money; value for money is more important “in gaining satisfaction” than loyalty, recognition or customized services. Peng et al (2015, p. 145) show that guests opting for this product “do not simply want a bed or to sleep but have a mix of consumption needs”.

Budget hotels are urged nowadays to “differentiate their product according to the demands of customers” (Subramanian et al, 2016, p. 201; Gu et al., 2012); of course, the ultimate goal of providing comfortable accommodation at modest price continues to be a game changer. It is important to bear in mind that budget hotels have been subject to heavy pressure to control costs, (Yan et al, 2016, p. 512) either because budget hotels charge lower prices leading to narrower operational margins or because investors expect

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a "swift return of the investment". Daily operations have been strongly pressed to keep costs to a minimum, which poses practical problems in terms of the development of innovations and high quality service.

As mentioned above, the budget hotel sector is facing increased competition from other segments of the industry, which has highlighted the need to increase guest satisfaction, retention and loyalty. Moreover, the sector is required to "meet and exceed customers' expectation in an effective manner (Moshin & Lengler, 2015, p. 24). Accordingly, the budget sector is forced to guarantee "efficient service management" in any circumstance (Peng et al, 2015, p. 139). However, for the time being, the sector is very much linked to price discounts and basic services, which continues to attract to attract a huge number of customers. Because the region under analysis aims at attracting high spending tourists by offering top quality accommodation and excellence in services, with ultimate goal of being a quality tourism destination, to carry out any initiative in this market segment may be counterproductive. Tis study attempts to deal with the case in question.

3. Methodology

The questionnaires were administered in Madeira from September to July of 2014. Visitors hosted in a 3-star hotel were approached to participate in this study. The objective of this study were clearly stated on the page header of the questionnaire. The first draft of the questionnaire was tested by the means of a pilot test "prior to administering" to analyse the ""clarity" of the language" and to ensure the validity and interpretability of the answers. The suggestions deemed appropriate were incorporated in the final draft of the questionnaire. In total, complete data were obtained from 385 respondents.

The survey questionnaire was designed to collect quantitative data from a sample of guests likely to be interested in the budget hotel concept. The questionnaire was prepared in Portuguese and English and included 20 questions and was segmented in 5 sections. Respondents were first asked about their socio-demographic background. Then, respondents were invited to identify their preferences in terms of room service and accommodation services in general. Visitor´s willingness to opt for the budget hotel concept was thoroughly examined in the following section. Travel motives and the main reasons to visit the region were analysed in the last section.

As with prior studies on budget hotels centred on the analysis of the most relevant attributes, we adopt in this research an attribute focus. The extant literature offers valuable insights on the key attributes deemed worth of further analysis. Peng et al (2015, p. 141) examined "hotel room, amenities, room facilities, shower, housekeeping services, internet, breakfast, and transportation convenience". Nash, Thyne & Davies (2006) studied the impact of location, price, quality, simple design and membership. Justus (1991) analysed factors such as location, good price and value for money and quality assurance. In the same vein, Fiorentino (1995) highlighted attributes value for money and consistency. Additionally, factors such as "staff professionalism, accuracy of reservation, tangibles, cleanliness and comfort, noise level, parking, security, accuracy of billing, location, and pleasant stay" were found to affect visitors´ satisfaction (Zhang, Cai & Kavanaugh, 2008). Ren, Qiuc, Wang & Lin (2015) based on the analysis of online comments of Chinese customers identified the following critical factors: cleanliness of the room, room size, shower room, facility, quietness, location and staff service. Based on the Uk, Brotherton (2004) investigated the success factors for budget hotels and identified seven dimensions; customer service, core product, strategic control, hygiene and quality, consistency, pricing, and location. Others

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(Knutson, Beck, Kim & Cha, 2009) have adopted an experimental view, to "underline" the customer experiences. Clemes, Gan & Ren (2011) identified three dimensions affecting the customer experience in the motel sector; interaction, physical environment, and outcome quality. Moreover, the authors identified the value/price construct as the moderating factor between service connecting quality with customer satisfaction.

Data were analysed in three stages. First, descriptive statistics analysis was performed to explore the overall sample profile. Then, principal component analysis (PCA) with varimax rotation was used to identify the underlying motives to travel to the region. During the third stage, the factors previously identified were included in a binary logistic regression with the aim of identifying the traits and characteristics leading to high levels of interest in the budget concept.

4. Results

The following paragraphs present vital statistics on the socio-demographic profile of the respondents. As shown in Table 1, around 83,3% visitors come from Madeira´ traditional markets and around 67% of the respondents hold an undergraduate studies diploma. About 35% of the visitors are from Portugal. This fact is consistent with the fact that Portuguese nationals play an important role in the 3-star business segment, partly due to economic factors. In 2015, Portuguese nationals rank fourth in terms of nights spent in hotel establishments, but first in terms of the business segment.

Around half of the respondents are female, which appears to correspond to what would be normally expected owing to the huger number of couples and families travel to the island. A sizeable proportion (26,8%) of respondents are adults aged between 25 and 32 years, with 28,8% aged between 50 and 59 years old. The average age is 47,8 years old. Around 46,5% of the respondents are married. The most frequent class of monthly net household income is 1000-2000€ (35,6%), followed by the 2000-3000€ category (30,6%). On average, respondents earn 1855,2 euros per month.

Table 1: Key Socio-demographic characteristics

Nationality	
Portuguese	35,80%
French	16,10%
British	16,60%
German	14,80%
Other	16,60%
Age	
18-29	15,60%
30-59	62,30%
60 and more	22,10%
Gender	
Male	49,10%
Female	50,90%
Marital Status	
Single	36,40%
Married	46,50%
Other	17,10%
Income	
Less than 500 euros	2,30%
500-1000 euros	12,20%
1000-2000 euros	35,60%
2000-3000 euros	30,60%
3000-4000 euros	8,60%
4000-5000 euros	3,40%
5000 and more	7,30%

The key issues considered in this study are analysed now. When asked about the key factors driving/decisive factors when it comes to make a choice, respondents indicated convenient location, good value for money and en-suite facilities. Overall, the results suggest that the respondents surveyed in this study appear to be part of the ideal target segment. As found out by Zhang et al (2013) and Brotherton (2004), a convenient location is single out by respondents as a determinant factor for choosing an hotel. Further details on the ideal segment are provided hereafter. It is worth to mention that around 40% of the respondents would accept a reduction in the number service available in exchange for a 10% price discount. Interestingly, visitors from the UK and Portugal were the most willing to accept a lower level of service for a slight price discounts. However, the data clearly indicates that it is reasonable to assume that only a fraction of the respondents will be genuinely interested in the budget hotel concept. Around 39% of the respondents would accept to surrender their ´privileges´ in terms of quality of service for a 25% or more price discount, which is to be considered impracticable against a background of several years of failing prices in the tourism sector. These results are fundamentally in line with those of Ren et al (2015) and Yan et al (2016), because travellers are expecting higher levels of consistent and high-quality accommodation, besides affordable prices (Yan et al, 2016, p. 513).

A sizeable number of the respondents are not interested in trading their current levels of comfort for price discounts. However, the question remains as to which segments are more interested in the concept. In this study we employ the Logit Binomial model, with the key variable of interest is defined as a dichotomous one. In terms of independent variables, we employ a wide range of variables concerning individual behaviours and socio-demographic data, in line with Fiorentino (1995) and Mohsin and Lengler (2005). As observed by Perales (2012, p. 1105), the logit binomial model is commonly employed in the field of tourism “to deal with categorical data”, obtained through a survey. The Logit Binomial model, in order to classify tourists requires the discreet endogenous variable to take value 1, when respondents accept a slight price decrease in exchange (being therefore the most interested in opting for the budget hotel concept) and 0 otherwise. The variable considered in the questionnaire that more approximately reflected their interest in the product, results from the question being asked to respondents to state their preferences on the concept based on the degree of price discounted in exchange for a reduction in the level of service provided.

In general terms, the probability of accepting a slight price decrease is given by the equation $Yi = (Xi\beta) + ui$, where “stands for the logistic distribution function” and ui stands for the non-observable characteristics. Yi stands for the dependent variable taking value 1 when and 0 otherwise and Xi stands for independent variables employed in this study. The independent variables considered in this study were the following ones. The variables relating to main reason to visit the island were designed as f1 (motive1), f2 (motive2), f3 (motive3), f4 (motive4) and f5 (motive5). These variables were defined based on the findings of the factor analysis applied as a data technique reduction to the set 20 motives to visit the island. Five categories of ages are employed in this study, being represented by following dummy variables: Age1 for “tourists aged 25-29”, Age2 for tourists aged 30–39”, Age3 for tourists aged 40-49, Age4 for tourists aged 50-59 and Age5 for tourists aged 60 or more. Age1 will adopt value 1 when the respondent is aged 25-29 and 0 when not. Similarly, two dummy variables were integrated in the final model, corresponding to three levels of income: income1 for “low income”, income2 for “medium income” and income3 for “high income”. Finally, the variable gender takes value 1 if the respondent selected the option “male” and 0 when the option female has selected. The remaining variables are readily interpretable.

As depicted above, the main objective of the econometric approach lies in the identification of the socio-demographic traits and characteristics that more effectively characterize the respondents exhibiting the highest levels of interested in the budget hotel product. In order to estimate the parameters, we employed the statistical program STATA 13. The variables Age2, High income, and Motive2, do not appear on the final model as such variables were defined as reference, to minimize multicollinearity problems. The key findings of from the results depicted in Table 2 are the following ones: executives, repeat visits, longer stays, low income individuals, respondents travelling for business or cultural related purposes, respondents aged 40-49 years old and those ones high higher scores on the factor 2 (traditional factors of attraction) and on factor 5 (escape) are those ones more interested in the concept; on the contrary, employees in the service sector, respondents scoring above average on the item image, respondents traveling for sport and recreation purposes, British nationals, married respondents and individuals aged 25-29 are the least interest in the budget hotel offer. The validity of the model can be assessed based on the percentage of correct predictions ("predicted value coinciding with the observed value"). The model under analysis "holds "a forecasting capacity of 79%. Such visitors do not seem willing to lose the opportunity to enjoy a high level of service provided by traditional hotels. In fact, it is increasingly easy to take advantage of above standard service owing to declining rates per night. Our results are in line with past studies to a certain extent.

The analysis of the recent evolution of the tourism industry in Madeira offers some means of reflection to deepen our analysis. Room rates in Madeira fell through the 00s (See Graph 1). More precisely, the average room rate fell 32,5% in the period 2000-2010. The average room rate in 2014 (36,80 euros at constant prices) was still below the 2000 average (43,66 euros at constant 2014 prices). This fall can be attributed to a strong competition from other exotic and cheaper destinations. In the meanwhile, the labor costs increased by 4,5% between 2000 and 2010. Although a slight reduction in the labor costs was noted 2000-2014 as a whole (-7%), this cannot be considered sufficient to match the losses incurred by the operators in terms of revpar. It must be conceded the industry have been experiencing substantial financial losses and relatively low levels of profitability. It may therefore be concluded that any attempt to develop from scratch the model in Madeira will be forced to overcome obstacles otherwise considered unsurmountable.

Table 2: Binary

Dep. Variable: Interest in staying at a Budget Hotel	Coef.	Std. Err.	P>z
Socio-demographic data			
Age2	-0,663	2,304	0,004
Age3	-0,276	1,027	0,788
Age4	1,514	0,839	0,071
Age5	0,129	0,660	0,845
Age6	-0,865	0,668	0,195
Married	-1,298	0,435	0,003
Gender	0,384	0,416	0,356
Income: low	3,107	0,763	0,000
Income: high	0,761	0,867	0,380
Profession:executive	5,757	1,598	0,000
Profession:selfemployed	-0,749	0,802	0,350
Profession:student	0,749	0,774	0,333
Profession:publicservant	0,095	0,676	0,888
Profession:services	-4,168	1,566	0,008
Profession:industry	-0,407	0,580	0,483
British National	-1,263	0,697	0,070

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Other Nationality	0,999	0,617	0,106
German National	-5,493	4,710	0,244
French National	-0,454	0,849	0,593
Travel arrangements and motives			
Number of previous visits	1,603	0,513	0,002
Length of Stay	0,295	0,119	0,013
Travelling with children	0,494	1,023	0,629
Motive1:	0,543	0,541	0,316
Motive3:	3,276	0,915	0,000
Motive5:	2,933	0,907	0,001
Motive6:	-4,738	2,296	0,039
Image	-0,635	0,344	0,065
Motivations and Satisfaction			
levelpricesnexttrip	0,812	0,440	0,065
Satisfaction	-0,148	0,428	0,729
f1:Traditional advantages	-0,241	0,258	0,351
f2:Cost advantages	0,541	0,230	0,019
f3:Cultural attractions	-0,156	0,260	0,550
f4:Sport activities	-0,113	0,289	0,695
f5:Escape and rest	0,547	0,217	0,012
_cons	6,135	14,356	0,669

Most destinations have been trying to apply a "developmental" agenda based on the encouragement of top quality accommodation, such as luxury hotels, which is completely at odds with the concept and philosophy budget hotel concept. Moreover, the marketing policy has been re-focused on the attraction of high-spending, and quality tourists, to increase the value "rather the scale" of tourism, based on a "tourism destination of excellence" policy. In a few instances, the ultimate goal is to reduce islands´ dependence upon "mass, summer-sun market" by attracting the well-off and by developing from scratch "attract niche markets" and special interest tourism, to address the problem of seasonality. With regards to Madeira, the PENT states that the accommodation needs to be up-graded, owing to an excess of boarding houses (pensões). This market segment amounts to the second most expressive type of accommodation in some instances, which leads such regions to experience setbacks in terms of RevPAR. For Madeira, the main goals are to growth in value and to enjoy increased attractiveness through the year based on new qualifying products. This has been generally interpreted as meaning top quality accommodation.

5. Conclusions

Based on the responses from 385 respondents staying at a 3-star hotel in Madeira, we analyzed the market prospects of developing the budget hotel segment in Madeira. We identified several sociodemographic characteristics, and travel related variables as determinant factors in the development of this market segment. In general, the respondents express a preference for a convenient location, good value-for-money and quality service as found out by Lou and Yang (2016), Ren et al (2015) and Rahimi and Kozak (2016). Although a sizeable share of the respondents shows a degree of interest in the concept, the "average" respondent would be reluctant to accept the provision of "poor" quality services. Items such as tv, access to the internet and telephone in the room are taken to granted, being not available to be traded for price discounts. Furthermore, guests in the region under analysis have been able to experience sustained gains in terms of welfare owing to declining room rates. This is a sufficient reason for the limited interest of the respondents' in embracing the concept of budget hotel. As shown in the previous section, more than 60% of the respondents would demand at least

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a 10% discount to trade their current levels of service. Moreover, some specific segments of the current demand depict low levels on interest, namely British nationals and married respondents.

The trend towards opting for "value-for-money" products has become even more apparent during the recession in reaction to the progressive reduction of the business travel budgets. A few sectors such as the "luxury hotel market" (4-5 stars hotels) have been particularly affected by the financial crisis. However, segments with "clear value for money appeal" in the hospitality industry, namely all-inclusive cruises and all-inclusive resort based holidays succeed in achieving sufficient and consistent levels of resilience. Other reasons to be optimistic about the budget hotel sector prospects can be highlighted. A significant number of budget airlines passengers are affluent travelers using low cost airlines for moving between they home and luxury hotels for weekend breaks. The relatively well-off affluent segment interested in additional offers such as health, culture and rural activities are likely to be a key part of this segment.

Another key feature of the sector relates to the visitors´ idiosyncrasies and expectations of personalised services adapted to the legitimate expectations of the customer. Perhaps because of the growing levels of asymmetric competition exerted by atypical newcomers, it must be acknowledged that news products may lead to unfair competition for the traditional hotel industry. However, the increasing need for the development of multifunctional products aim at delivering superior customers experiences appears to be unstoppable, and the incumbent firms must be prepared to face stiff competition. It is evident that the tourism industry is increasingly complex in terms of the range of products and services it offers to travellers. A number of hotels can be termed as "multi-activity hotspots", because traditional hospitality functions (accommodation services, restaurants, etc) are complemented by additional services such as leisure and sport activities, gaming, retail/shopping and tours. Such hotels emerge as an amalgamation of "premium branded services" and low cost activities. While tourism planning and policy making will be greatly affected by all these developments, at the destination level, success depends upon his own performance in terms of matching visitors' expectations rather than on the protection of the existing sectors. The priority concern of any operator should lie in the "professionalization" of the sector based of sustained levels of quality. At macro-level, the key strategy issue relates to consolidation of the sector and the "beautification/commoditization" of the island through the improvement of the transport, cultural and sport facilities to offer a fair chance (of being completely satisfied) to all potential visitors.

To date a considerable body of research has sought to understand the critical factors of success with regards to the budget hotel industry. While this body of research provides several important insight and findings, a dearth of research focused on destinations "eager to develop"/" pursuing a luxury/well-off agenda is well evident in the literature. Research focused on "basic accommodation" and low cost facilities is notably lacking in such regions, despite the very fact that such areas rely mainly on iron tourists (who are price sensitive or travelling on a budget) to "fill up empty hotel rooms" (Kozak & Martin, 2012, p.190). This study offers an opportunity to understand respondents disinterest in the low budget hotel concept based on the factors of success that enable such regions to succeed in the past few years, namely top quality accommodation.

European Journal of Applied Business and Management, Special Issue, 2017, pp. 348-358. ISSN 2183-5594

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