

# Conceptual Study on Socio-Economic Impact of the Decline in Firm Performances of Hotels in Sri Lanka

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### **Abstract**

The study aims to determine the socio-economic impact of the decline in firm performances of hotels in Sri Lanka. Evidence from previous research found that 91% of the hotels listed in the Colombo Stock Exchange (CSE) were in the distress zone and this study aims to fill the prevailing knowledge gap by determining the socio-economic impact of this decline. The study will be conducted using a sample of 33 hotels listed under the consumer services sector of the CSE, by considering the firm performance as the independent variable while the dependent variable is the socio-economic impact. The firm size was considered as the moderating variable. Indicators such as Return on Equity (ROE), Return on Assets (ROA) and occupancy rate derived from annual reports and other publications was used to measure firm performance while several indicators derived from statistical reports published by the Sri Lanka Tourism Development Authority (SLTDA) and Central Bank will be used to measure socio-economic impact. The research will be conducted during a period of 10 years from 2009 to 2019. Findings from the research will contribute to the existing literature on the assessment of socio-economic impacts and are beneficial to a variety of stakeholders such as hotel managers, government, tourist development authorities and upcoming researchers.

**Keywords:** socio-economic impact, firm performance, hotels, tourism

## 1. Introduction

### *1.1 Background of the Study*

Tourism is one of the fastest growing sectors in the world. It is believed that world tourism can help reduce the financial gap between developing and developed countries by creating a new economic order and by ensuring economic and social development in developing countries (Rahman, 2010).

According to the United Nations World Tourism Organization (UNWTO), “Tourism comprises the activities of persons traveling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes” (Camilleri, 2018). Tourism is a foremost industry in the services sector and is also considered to be one of the major foreign exchange earning industries in Sri Lanka. According to the statistical report produced by the Sri Lanka Tourism Development Authority (SLTDA), tourism has contributed 15.9% of the total foreign exchange earnings of Sri Lanka in 2018. Tourism also acts as a mode of providing employment with a total of 388, 487 people were employed in the tourism sector directly and indirectly in 2018 (SLTDA, 2018).

Tourism is a booming industry in Sri Lanka. According to the statistics of SLTDA, 2,333,796 tourists arrived in Sri Lanka through the period from 1st January 2018 to 31st December 2018 (SLTDA, 2018). However, recent events like the Easter Sunday Attacks in April 2019 which recorded 42 foreign fatalities, have led to a decline in tourism of Sri Lanka. In May 2019, tourist arrivals to Sri Lanka was 70.8% less when compared to the same period of 2018. It was also noted that the hotel occupancy had plummeted to 20% even amidst strategies adapted by the hoteliers to lure more customers (Mariathan, 2019).

The most recent event of the COVID-19 pandemic also has evidently created an adverse effect on tourism as it discourages travelling. According to the UNWTO, the pandemic will lead to a 20–30% drop in international tourist arrivals in 2020 which would result in a loss of USD 300–450 billion international tourist receipts (UNWTO, 2020). Countries that have high dependence on the tourism sector will have the highest economic shocks due to the COVID-19 pandemic, and will also affect the tourism labor (Maniga, 2020). In Sri Lanka, tourist arrivals had fallen by 70.8% in March 2020 after the pandemic. Hotels, restaurants, airlines, travel agencies, tourist shops and similar establishments are also facing operational difficulties (Samarathunga, 2020).

Hotels play a main role in attracting tourists to a destination and are the primary form of accommodation for tourists. The hotel industry is a cyclical industry and is highly sensitive to the changes in the economy as well as tourist arrivals. Economic conditions and tourism sectorial growth or decline can have a strong impact on the performance of hotels. The effects of these events have been studied separately. However, there is hardly any research done on the socio-economic impacts of these events. This research aims to determine the socio-economic impact of the decline in firm performances of hotels in Sri Lanka and determine whether the hotel size moderates the impact created.

### *1.2 Statement of Problem*

The research aims to determine the socio-economic impacts of decline in firm performances of hotels in Sri Lanka. It was noted by Nagendrakumar et al. (2020) that 91% of the listed firms under the tourism sector which is now reclassified as consumer services by the Colombo Stock Exchange (CSE), have collapsed. The research further proved that all the hotels except three are currently in the distress zone with a higher propensity for bankruptcy. The SLTDA reports also show a decline of 18% in the tourism arrivals in Sri Lanka in 2019 compared to 2018, which is mainly due to the aftermath of the Easter Sunday attacks of 2019. This has also affected the financial performance of the hotel sector severely and it was found that this event had adverse effects on firm financial performances in terms of solvency (Sathiamoorthi et al., 2020).

Whilst the listed firms are collapsing in terms of going concern (Nagendrakumar et al. 2020), it was also found that despite many researches being conducted on the current situation of the tourism sector, there are hardly any researches being done to determine the socio-economic impact of the decline in firm performances of listed hotels in Sri Lankan context. Hence, this research attempts to bridge the prevailing knowledge gap by providing insights on the socio-economic impact of the decline of firm performances of listed hotels in Sri Lanka.

### *1.3 Research Questions*

With reference to the above research problem, and due to the lack of research done to determine the socio-economic impact of decline in firm performances of hotels in Sri Lanka, several research questions are developed. The research will focus on the three following research questions:

- What are the economic impacts of the decline in firm performances of hotels in Sri Lanka?
- What are the social impacts of the decline in firm performances of hotels in Sri Lanka?
- Does hotel size moderate the socio-economic impacts of the decline in firm performances of hotels in Sri Lanka

### *1.4 Research Objectives*

With reference to the above-mentioned research questions, the overall objective of this research is to determine the socio-economic impact of decline in firm performances of hotels in Sri Lanka. Several sub-objectives have been formed to aid with the achievement of the main objective.

Main objective:

- To determine the socio-economic impact of the decline in firm performance of hotels in Sri Lanka.

Sub objectives:

- To determine the economic impact of the decline in firm performance of hotels in Sri

Lanka.

- To determine the social impact of the decline in firm performance of hotels in Sri Lanka.
- To determine if hotel size moderates the socio-economic impact of the decline in firm performance of hotels in Sri Lanka.

## 2. Literature Review

According to the World Travel and Tourism Council (WTTC), tourism is one of the largest economic sectors in the world as of 2018; tourism contributed to 10.4% of the global Gross Domestic Product (GDP) and has grown by 3.9% compared to 2017. Worldwide, 319 million jobs are created through travel and tourism which contributes approximately 10% of the global employment (WTTC, 2019). Tourism can have several impacts on the host country as well as the locals in the country. Any change in tourism or tourism development will thereby affect the residents of the country as well. The following will examine the socio-economic impacts of tourism in terms of positive and negative impacts.

### 2.1 Economic Impacts of Tourism

Research over the years have found that tourism has several socio-economic impacts which can be both positive and negative. When reviewing the positive impacts of tourism, it mainly contributes to the GDP of a country by increasing domestic income. Tourism acts as an instrument that aids in transferal of money from 'income generating' economies to 'income receiving economies'. The income created by an initial spending by tourists is multiplied and created income several times. This is known as the 'multiplier effect' and international tourism aids in generating income to the economy and multiplying it (Zaei & Zaei, 2013).

Another major positive economic impact of tourism is the employment opportunities it creates as tourism mainly a labor-intensive industry. Tourism creates direct employment opportunities in industries such as hospitality, tours and transport, guiding, management, restaurants etc. It also creates indirect employment opportunities such as entrepreneurship environmental management and other opportunities in supportive industries (Lalrinchchani, 2020; Potdar, 2013; Kidane & Berhe, 2017). Tourism also has a positive impact on the balance of payments of payment as it aids in earning foreign currency. The balance of payments has three main effects from tourism which are primary effects, secondary effects, and tertiary effects (Ardahaey, 2011).

Economies or regions that thrive to attract tourists will increase investment and it will lead to development in the regional areas. For tourism to improve and provide positive impacts to an economy, the public sector must boost tourist rates on loans for businesses or construction and operation of facilities for tourists by the government. Thereby, tourism will also result in increased investments in an economy along with regional development (Toboro, 2014). Tourism can also lead to infrastructure development and development of rural areas. Infrastructure, that consists of motorways, water, electricity, health, defense, communications, and public transport, are important factors to increase tourism in an economy. Therefore,

governments will be keen to develop infrastructure to improve existing tourist facilities or to establish new attractions. As rural and less developed areas are found to attract most tourists, it will lead to development in such areas (Edet, Mbu, Etim, & Titus, 2014).

Tourism also creates economic empowerment as the benefits of tourism are long lasting that is, the financial gains created by tourism will benefit the economy and the residents in the long-term as well. Tourism can improve local infrastructure and educational opportunities for residents which will have long-lasting effects (Ramukumba et al., 2012). In addition to these, tourism also has several other positive impacts. Tourism mainly contributes to national income and GDP of a country. It also helps generate foreign exchange through inbound tourism and also aids economies by improving the demand for goods and services in the country which will increase business for local businesses catering for tourists and lead to higher domestic income (Rout et al., 2016). Furthermore, tourism results in tax revenue earned from tourism which helps in reducing budget deficits and can also benefit the locals of a country (Gnanapala & Sandaruwani, 2016).

However, tourism can also have negative economic impacts on an economy. Economies can also get overly dependent on tourism as tourism often depends on external demand (Gnanapala & Sandaruwani, 2016). If economies are overly dependent on tourism, they will be susceptible to changes in demand for tourism. In cases of economic instabilities, the tourist demand might fall, and economies can collapse if the industry is not diversified (Ardahaey, 2011). Another negative impact is the seasonality of tourism and the tourist arrivals change due to climate, vacation periods, seasons, economic situation etc. Employment created by tourism can also therefore be seasonal and the economy may face overcrowding of public services and higher prices during tourist arrival seasons (Stylidis & Terzidis, 2007). Tourism can create leakages in the economy that are produced when the revenue earned goes out of the economy in terms of profits for international corporations or purchase of external products and services. Leakages are created mostly due to the development of international businesses and can cause no improvement or economic growth as revenue leaves the economy. Leakages can also be caused if the jobs generated through tourism are filled by foreign employees and not residents of the country (Letoluo & Wangombe, 2018).

Furthermore, Tourism tends to increase economic costs by driving the prices. A major consequence of tourism is high prices in restaurants where the locals may find the food to be overpriced. Tourism increases the demand for goods and services and higher demand for limited resources such as water, food, transport, electricity etc. can drive the prices high causing inflation (Phoummasak et al., 2014). Another major negative impact of tourism is the competition it creates for resources and infrastructure. It is argued that tourism takes away resources such as land, labor, and capital away from other sectors that need these resources for instance fishing and agriculture (Stylidis & Terzidis, 2007).

## *2.2 Social Impacts of Tourism*

When considering social impacts, the impacts can again be positive and negative. A main positive impact is the increased quality of life of residents. According to the WHOQOL Group (1996), quality of life reflects an individual's perception of how their life is placed in

context of culture, value systems, goals, objectives, standards, and concerns. Tourism will also provide opportunities for upgrading as well as developing recreation and entertainment facilities (Jaafar et al., 2015). Another positive impact is conservation of culture. Tourists are attracted to destinations due to numerous features such as culture, landscapes, crafts, and architecture. Therefore, local communities will be encouraged to conserve cultural heritage and natural resources that attract tourists, improve and conserve local arts, crafts, cultural events and architecture, and conserve local culture (Ratz, 2000). Tourists and locals have three main ways of contact which are when tourists buy goods and services from locals; when tourists and locals share facilities; and when locals and tourists meet at cultural activities. These contacts can help locals and tourists understand the differences in behavior and culture and thereby improve understanding among residents and tourists (Gnanapala & Sandaruwani, 2016).

Social impacts, however, can be negative since tourism can lead to changes in behavior of local community due to the demonstration effect. This is when the behavior of tourists influences the local community leading to a change in social values. This becomes a negative influence as international tourists might behave in atypical ways when away from home, due to lack of constraints and therefore, the local communities might misinterpret tourist behavior (Castela, 2018). Another major negative impact of tourism is that it leads to the commercialization of culture, values, and social interactions for the purpose of earning a monetary reward. Tourism leads to the commercialization of the social lives of local communities thereby making local culture and traditions a commodity. Tourism also results in a decline of social relationships as social and human interactions will be transformed into a resource for earning a living (Sandeep & Vinod, 2014). Tourism can also lead to overcrowding of local facilities and amenities which would inconvenience the local community. Tourism can lead to traffic congestion, noise pollution, competition for resources, conflicts and crowding leading to exceeding to community tolerance limits (Bello et al., 2017). Additionally, tourism can also lead to tension and conflicts between residents and tourists as well as tourism supporters and non-supporters. Tourist cultural values and ideologies may also clash with the local culture creating conflicts. The seasonality of tourism can mean that the local employees may have to overwork during tourist arrival seasons due to which they may overlook social, family, and cultural responsibilities. Overall, tourism can lead to negative attitude in residents due to conflicts and hectic lifestyle (Kreag, 2001).

### *2.3 Empirical Research Findings*

There have been several studies conducted in Sri Lanka related to tourism and its socio-economic impacts. Weerasinghe et al. (2019), conducted a research on Corporate Social Responsibility (CRP) and financial performance in tourism industry. A major finding of this research when analyzing the Return on Equity (ROE) of firms in the tourism industry was that, even though the number of tourists that arrive in Sri Lanka were increasing over the years, the ROE of the firms listed in the CSE have dropped significantly over the years. Following this, Nagendrakumar et al. (2020) conducted research to determine the sustainability of firms operating in the tourism sector using Altman's original Z score model (1968). The research concluded that 91% of the listed hotels in Sri Lanka were in the distress



zone while the remaining 9% were in the safe zone and that no hotels were in the gray zone. The study revealed that the hotels in Sri Lanka show higher propensity of bankruptcy.

When considering research conducted on socio-economic impacts of tourism in Sri Lanka, Gnanapala and Sandaruwani (2016) states that tourism provides more positive socio-economic impacts than negative impacts. The study was conducted in three under developed villages in Sigiriya and the study also concluded that though there are many positive impacts and opportunities provided, the locals cannot get the maximum benefits from these as the tourism development activities does not include the local community participation and due to constraints such as lack of education, finance and entrepreneurship and other skills. The study suggested using Community Based Organizations (CBO) to increase local community participation and help the locals benefit more from tourism. Research conducted by Nayomi and Gnanapala (2015), also concludes that tourism has both positive and negative impacts. The study was conducted in Dambulla, Sri Lanka and was mainly related to the hotel, Heritage Kandalama. The research states that the negative impacts, however, are low in comparison to the positive impacts of tourism and that the local community bears positive attitude towards tourism development and believes tourism to be an income generation tool to active and passive participants. This study also recommends the use of awareness and education programs to get the maximum benefits from tourism.

A study conducted by Rauf et al. (2019) also revealed consistent results stating that though there were several positive impacts of tourism, the local community was not getting the expected benefits. This research was conducted in the Eastern Province of Sri Lanka and found that the respondents perceive the economic impacts from tourism to be positive however, the perception of socio-cultural impacts were negative, and the perception of environmental impacts were not significant. According to the study, people engaged in tourism such as business owners perceived tourism to be 99% beneficial and 1% harmful while the local community perceives 70% of the implications of tourism to be positive and 30% negative. This concludes that people engaged in tourism has a more positive attitude towards tourism. This conclusion was also made by Sawant (2017) in the research conducted on socio-economic impacts of tourism development in Aurangabad, India. The study states that the impacts of tourism can be both positive and negative however, it concludes that the people who display involvement in tourism and tourism related businesses face more negative impacts from tourism than people who do not display involvement in tourism but the attitude regarding tourism of the involved residents is positive. The locals however, recognized that they are not involved in planning and development process of tourism.

The study by Kozhokulov et al. (2019), also stated that there is a positive impact on the economic and social growth of the Issyk-Kul region, Kyrgyzstan due to tourism. The study found that the socio-economic impacts have grown marginally every year except for the years of political instability. The study concluded that tourism has a positive impact on employment, tourism has increased in importance after the economic downturn which led to a decrease in export opportunities and that tourism can aid in preserving natural resources rather than harm the environment if rational development is established. Research conducted by Aliyeva et al. (2019), on the socio-economic impacts of tourism in East Kazakhstan Region and concluded



that tourism positively impacts the economic and social magnitudes of regional development. The research also found that the socio-economic impacts have increased over the years from 2003 to 2018 however, the effects of economic conditions such as the 2008–2009 recession and Kazakh currency default in 2014–2015 seemed to be reflected in the indicators. Both studies showed increasing positive socio-economic impacts over the years except for years with instabilities in the host countries while using different indicators to measure economic and social impacts of tourism. This suggests that different indicators can be adopted to measure the impacts of tourism.

Turker and Ozturk (2013) concluded that the impacts of tourism can be both positive and negative. The research stated that the residents have a positive attitude regarding tourism mainly because of the economic impact and perceived the social and environmental benefits as advantages but to a low degree. The research also stated that the perception of the socio-economic impacts of tourism differed due to location. According to a study conducted by (Liu & Li, 2018), residents agree that tourism results in positive economic and social impacts. The respondents have environmental concerns associated with tourism although they wish to develop tourism in the region by appealing to more tourists. The study also found that residents who perceive that tourism in Puri and Varanasi, India is developed, agree more with the positive socio-economic impacts of tourism while respondents who perceive tourism in the regions to be at the initial stage of development are more concerned about the negative environmental impacts.

Yang and Chen (2008) conducted research on the impacts of Nature Based Tourism (NBT) in Taiwan and concluded that NBT has a moderate impact on businesses. The study also found that business manager perceived socio-cultural benefits of tourism higher than economic and environmental costs as well as economic, environmental, and socio-cultural costs. Furthermore, the research identified that the respondents' perception of the government has a higher importance in identifying the respondents' perception of benefits from NBT than the level of dealings with the government. The respondents also believed that the government plans NBT and its development in an upright manner. Another study, conducted by Liu et al. (2012), which was conducted on the impacts of NBT participation in Wolong Nature Reserve, China, concluded that NBT has a positive socio-economic impact on the households. Another major finding of the study was that households that were engaged in jobs or businesses related to tourism held a negative perception of the environmental impacts of tourism and believe NBT has more non-financial benefits in comparison to the households that are not engaged in tourism.

The research by Rout et al. (2016) concluded that the impact of tourism on the economy is significant and positive in terms of macro-economic growth and concludes that developing a strategic plan for promoting tourism in the long-term will result in an increased macro-economic growth in India and that development of tourism is a significant factor in defining the economic growth of a country. This was consistent with the research by Puah et al. (2018), which concluded that tourism has a significant positive impact on the economic growth of Malaysia due to the capital investments and the tourist receipts. As both variables used, that is tourist receipts and capital investments had a significant positive impact on GDP,

it was concluded that tourism-led growth subsists in Malaysia. A study conducted by Havi and Enu (2013), conducted in Ghana, also concluded that tourism has a positive economic impact since an increase in international tourism will lead to an increase in nominal GDP per capita. The study also found that increase in domestic tourism can lead to an improvement in international tourism due to the existence of unilateral causality between the two variables. This was consistent with the findings of Gautam (2008), that there is a significant relationship between GDP of Nepal and tourism financing of the country. Tourism financing in terms of tourism promotion, aviation investments, and loans provided, have contributed to economic growth of the country significantly. In addition to this, a study conducted in Jammu and Kashmir by Nengroo et al. (2016), states that tourism has a positive impact on economy as well as on employment. The study revealed that revenue from tourism has shown a growing trend continuously except for the time period with high political instabilities in the states and that positive inflows from tourism has led to increased employment. The studies show evidence that tourism can impact the economic growth of a country positively.

### 3. Conceptualization Framework

Figure 1 represents the conceptualization framework that was developed for this research. This conceptualization framework was used to determine the socio-economic impact of decline in firm performance of hotels in Sri Lanka.

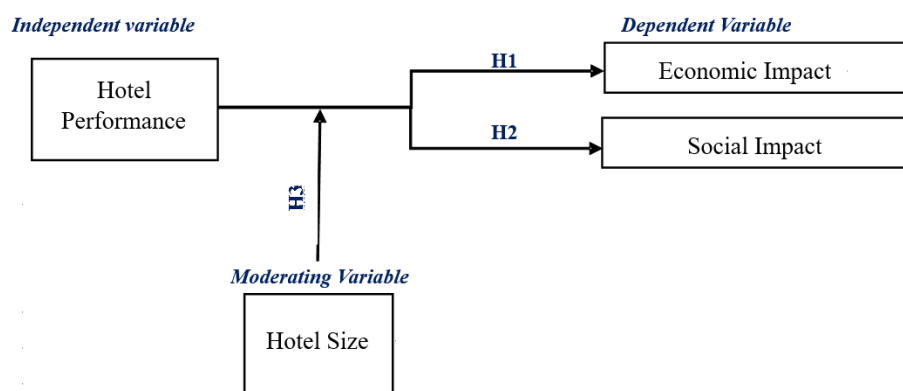


Figure 1. Conceptualization framework

### 4. Hypotheses of the Study

The research aims to determine the socio-economic impact of the decline of firm performance in hotels in Sri Lanka. To achieve this objective, the above conceptualization framework according to which the hypotheses of the study were built as follows.

H1: There is a significant economic impact from the decline of firm performance in hotels in Sri Lanka.

H2: There is a significant social impact from the decline of firm performance in hotels in Sri Lanka.

H3: Firm size moderates the socio-economic impact of the decline of firm performance in hotels in Sri Lanka

## **5. Implications of the Study**

According to Nagendrakumar et al. (2020), 91% of the hotels listed in the CSE in Sri Lanka have currently collapsed and there are hardly any researches addressing the socio-economic impact of this decline and this research aims to fill the existing research gap. Determining the socio-economic impacts of the decline in firm performance can be useful for a wide range of stakeholders. The study will have both theoretical and managerial implications.

Existing literature have used several theories and models including the input-output model, Keynesian-type multipliers, cost-benefit analysis, computable general equilibrium (CGE) frameworks and tourism satellite accounts to assess the socio-economic impact of tourism (Chou & Huang, 2016). This study will contribute to the existing literature and theories by determining the socio-economic impact of decline in firm performances of a developing nation. This research also contributes to the current literature on impacts of tourism in Sri Lanka and helps in increasing the understanding and management of these impacts and thereby support the development of the tourism industry.

The hotel owners and management can use the findings of this research in decision making to identify the priority problems and what needs to be done to improve the performances of the hotels. The management can also use the information to formulate new strategies to further improve and maintain the corporate performance of the hotels. The research is also of significance to the government as the findings of the research can be used to identify the problems and areas of development that exist in the tourism sector in Sri Lanka. The government can then plan and develop a national policy framework for tourism to make necessary reforms and uplift the tourism sector (Velasco, 2016). The research findings can aid the government in making sure that the management of tourism in Sri Lanka is more efficient, effective, and all-inclusive.

## **6. Directions for Future Research**

This research lays the foundation for many future researches since this study is limited to listed hotels in Sri Lanka, future researchers can conduct research on the entire tourism industry that consists of hospitality, transportation, travel facilitation, entertainment and non-listed establishments. The researchers can also conduct studies to find out the impact of current events such as the COVID-19 pandemic on the different sectors of the tourism industry. Furthermore, future studies can be conducted to determine tourist behavior and identify why arrivals to listed hotels in Sri Lanka have declined.

## **7. Conclusion**

In conclusion, this concept paper shows the outline of the study on socio-economic impact of the decline in firm performances of listed hotels in Sri Lanka. Previous research had found that 92% of the hotels in Sri Lanka show higher propensity for bankruptcy and recent events such as the Easter Sunday attacks have an extremely negative effect on the tourism industry.

Even though there are many studies being conducted on the current situation of the tourism sector, there are hardly any studies done to determine the socio-economic impact of the decline in firm performances of hotels in the Sri Lankan context. The paper further gives a theoretical background for the topic by discussing various studies conducted to related topics. The research will be conducted on a quantitative approach and will use financial performance measured by ROA, ROE, and occupancy rates as the independent variables while economic and social impacts measured through indicators, are considered as the dependent variables while the moderating effect to the impacts, is determined by the hotel size. The research will help in determining the socio-economic impacts of the decline in firm performances that can be beneficial to a variety of stakeholders such as the government, tourist development authorities, industry stakeholders and upcoming researchers.

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