Chapter 83
The Impact of Macroeconomic Factors on the Hotel Industry Through the Financial Leverage Trends:
The Portuguese Case

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ABSTRACT

In Portugal, news shows that the impact of COVID-19 in the hospitality sector was more noticeable compared to other sectors. This chapter aims to understand the historical trends of hotel industry financial leverage and to analyse the impact of macroeconomic factors on it. Based on the Portuguese reality, it aims to propose a model to be used by managers and shareholders to control the effect of financial leverage over their companies. Two issues are supporting this study: one is if companies evaluate the impact of the chosen financing sources on shareholders' return; another is to understand whether there is a change in the financial leverage effect, either due to macroeconomic factors or due to cyclical factors not controlled by the market, such as the current pandemic (COVID-19) which demands new challenges to companies. Results highlight that the perception of financial leverage by hotel managers is crucial in crisis situations, as the current case of the pandemic caused by COVID-19.

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INTRODUCTION

The financial mix of each company impacts its risk and performance, being a key factor to sustain its competition and to create value for society (Damodaran, 2016). Therefore, companies should monitor their financial mix.

The pecking order argues that managers prefer to use self-financing to fill financial needs (Myers, 1984; Myers & Majluf, 1984). Although not always self-financing is enough, and so managers must look for liabilities, being the most used the credit from suppliers (commercial credit) and/or bank loans. These two types of financing offer advantages and limitations. On the one hand, commercial credit requires less information about the company, allows greater flexibility in terms of credit data and has less direct financial costs. However, more agency problems may arise, such as information asymmetries that are reduced in bank credit, since banks control managers opportunistic behaviours, and usually only give finance to profitable investments (Lau & Schaede, 2020).

The first question that arises is whether companies evaluate the impact of the chosen financing sources on shareholders' return. In other words, is the effect of the financial leverage positive? To answer this question an analysis model is proposed to help managers to analyse whether investment return is enough to cover financial expenses due to financing sources decisions. Starting by the DuPont decomposition of return on equity, an alpha (α) and a financial leverage ratio (FL) are calculated to give specific information about whether the use of liabilities contribute to improve the shareholders wealth.

Another relevant issue is to understand whether there is a change in the financial leverage effect due to cyclical factors not controlled by the market, such as the current pandemic caused by the Coronavirus (Covid-19). Therefore, this chapter also aims to understand the historical trends of financial leverage, and to analyse the impact of macroeconomic factors on it. For it, mean values of several ratios for the accommodation sector in Portugal for the period of 2006 till 2019 are analysed. With this sample period we cover the financial crisis of 2007/2008 that help us to understand the impact of economic downturns on hotel companies' financial leverage, and to give insights about covid-19 impact on these companies.

The Portuguese accommodation sector – hotel industry, is an interesting case study. In 2019, the tourism sector was responsible for 52.3% of services exports and 19.7% of total exports in Portugal. Moreover, employment in tourism represented 6.9% of the Portuguese economy, and its revenues contributed 8.7% to national GDP (Turismo de Portugal, 2020). Additionally, this sector was one of the sectors with highest impact of Covid-19. Compared to the same period, the number of guests decreased 62.6% (March), 97.4% (April) and 95% (May) (INE, 2020a). Moreover, the overnight stays have decreased 98.1% (April). In the 2nd quarter of 2020, only 57% of this sector was working. In the 2nd half of June 82% of the companies were operating, 16% temporarily closed and 2% permanently closed.

The information provided in this chapter will help managers to make decisions based on the impact that the use of liabilities on return on equity. Naturally, the option for different types of financing at different costs is important, but the more relevant is to understand whether the average cost of debt improves shareholders' return, without jeopardizing the financial equilibrium and the sustainability of hotel companies. Moreover, managers can understand the impact of economic downturns on companies' return, information relevant to adapt financial sources in the way to minimize costs and increase return.

This chapter is organized into eight sections. After this first introductory section, the tourism sector in Portugal is introduced to explain its relevance and evolution. Then, a theoretical context about financial sources is presented, following by the proposed model. The section five explains financial leverage trends in the hotel accommodation in Portugal and show the relevance of the use of the proposed model.

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