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**THE ECONOMIC RECESSION AND TRENDS IN HOTEL RENTAL IN  
MALAYSIA - AN INSTITUTIONAL PERSPECTIVE**

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*Abstract*

The economic recession had caused oversupply of hotel accommodation in Malaysia. The worst level of occupancy rate for hotels and resorts was recorded at about 50% in 1997 to 1999. In general, the occupancy rates for hotel were at 47% in 1997 and reduced to 32% in 1998. The rentals for hotel outside city areas were severely affected by decreasing tourist arrivals, almost by 20% to 30% from 1998 to 1999. However, measures taken by the government to promote tourism industry has shown some improvements with rental improved by about 30% to 75% in 2000 as a result of sharp increases in tourist arrivals, tourism activities and promotions. The paper seeks to examine reasons for the changes in the dynamics of rental trends during economic recession from 1997 to 1999 using the institutional economics analysis framework. The selected case study on hotel accommodations is chosen in Kuantan, Pahang in the eastern coast of Peninsular Malaysia. The causes and consequences of economic crisis were discussed in the light of the demand for and supply of hotel accommodations along Kuantan beaches and within Kuantan Town Center. Interviews were carried out with hoteliers and tourists as well as tourism professionals to examine the causes and implications of economic crisis on trends in hotel rentals in Kuantan. Data collected were analyzed using qualitative and quantitative analysis to produce findings on factors affecting trends in hotel rental

market. The main finding shows that there are correlation between economic recession and hotel rental level. As such, the paper evaluates the explanatory power of institutional economics analysis in the study of trends in hotel market in Kuantan.

*Keywords – economic recession, hotel vacancy rates, tourism industry, institutional analysis*

## **1.0 Introduction**

The general equilibrium of demand and supply proposition is based on neoclassical theory which explain that when there is over supply of hotel property in the market, the demand from users will exist to take advantage of the lower price offered in the market. In this way, positivist considers a rational economic man whose aim is to maximize profit through demand and supply relationship of the tourism industry. The exchange of economic activities will be matched by market forces and leads to the state of equilibrium which sets the rental of the hotel in the market.

Therefore, neoclassical approach to the hotel property market process emphasis the importance of price mechanism and resource allocation. It was obvious that during economic recession due to financial crisis from 1997 to 1999, tourism and hospitality industry were severely affected as a result of decreasing tourist arrivals. This resulted in dropped in rental rates of hotels up to 40% in some locations. In fact, financial crisis had weakened the value of Ringgit Malaysia (RM) which suppose to encourage tourist arrivals. In contrast, the slower economic climate had weakened the tourism and hospitality industry. This shows that the hotel property market during the period of instability and fluctuation is highly affected by factors such as financial, national and international economic environment, attractive hotel accommodation packages and behaviour of tourist and related agents in the hospitality sectors. Part of the reasons for this is because the nature of the tourism industry itself. The uniqueness of the hotel property market is considered mainly in terms of the tourism and hotel industry, low level of financial affordability due to economic crisis and hotel heterogeneity. Therefore, the equilibrium model is not satisfactory in addressing the effect of economic changes and market instability in explaining the tourism industry and hotel property market process.

Instead, the institutional economics theory concentrates on the wider institutional arrangements of the market. The institutional relations within the market will influence decisions made by different actors therein. This means that, in general, apart from the price mechanism, institutional economics considers institutions and their institutional relations among agents which govern the economic activity. The market is seen to comprise a number of different types of institutions. These institutions, or the real life actors in the property market, are responsible for coordinating the economic activity (Ball *et. al.*, (1998)). In other words, institutions may operate to facilitate and/or constrain human activities (North, 1996). It is, therefore, the role of institutions or 'rules of the game' which are important in all economic situations (North, 1996). As a result, institutions are both initiating and/or constraining the land market process. In explaining the institutional environment for property analysis, Keogh and D'Arcy (1998) assert the existence, importance and implications of broader political, economic, social and legal frameworks which are embedded in various institutions governing the land and property environment. The formal institutions are to include written rules such as economic policy and regulation which may constrain or facilitate human decisions in tourism industry and hotel property market. The unwritten or informal rules, on the other hand, is to include culture, values, traditions and perception which may affect the supply of and demand for land in property market (Ismail, 1999, 2000a, 2000b). In this context, the economic crisis in the region had an adverse affect on the tourist arrivals and related parties involved in tourism industry.

In the context of tourism industry, institutional economics concerns on the effect of economic rules and changes which will have an impact on a collective behavior and decisions of tourists upon going abroad for traveling purposes. Therefore institutional economics analysis covers the tourism industry and hotel property market process extensively by looking at a much richer insight into the formal and informal rules within institutions-agency relations and agent attitudes in the tourism and hotel property market process. The theoretical framework of the institutional economics analysis is, therefore, able to address the whole ranges of factors affecting the dynamics of tourism industry and

hotel property market in relation to the potential significance distortions by various actors in the process, the policy and organizations of agents especially tourists and their intermediaries, the flows and forms of finance capital and other external factors to the tourism industry and hotel property market process. Therefore, it could be impliedly contended that the institutional economics analysis is generally, and indirectly covers the whole range of formal and informal institutions affecting the trends in the tourism and hotel property market.

## **2.0 The Economic Recession – Malaysia Experience**

Even though the Malaysian economic has witnessed nine consecutive years of prosperity and stable growth since 1989, it was unexpectedly faced a financial crisis in 1997. This financial crisis has led to economic recession from 1997 to 1999. The financial crisis in the Asian Region was caused by several reasons. According to the International Monetary Fund (IMF), the problem arose from the weak monetary administration system in those countries, especially lack of control in the banking system. In addition, when banks and financial institutions borrowed huge amount of money from overseas for less quality development projects, less contractual and controlled privatization by the government, less transparency in handling corporate account and less informative financial administration (Yong, 2000).

According to the World Bank, financial crisis is due to less controlling standard and weak financial management and high risk taking in handling risky projects. External funding had weakened the financial administration. Last, monetary devalued and dropped in foreign exchange rate had bad nightmares to investors who have to make a higher repayment to the financiers. The financiers were financially assisted by money speculators. As a result, these investors or borrowers went burst.

As institutional economics analysis refers to the existence, creation and implication of ‘the rules of the game’ which affect ‘players or actors’ in the hotel market, the government has taken steps to improve the economic climate especially the tourism

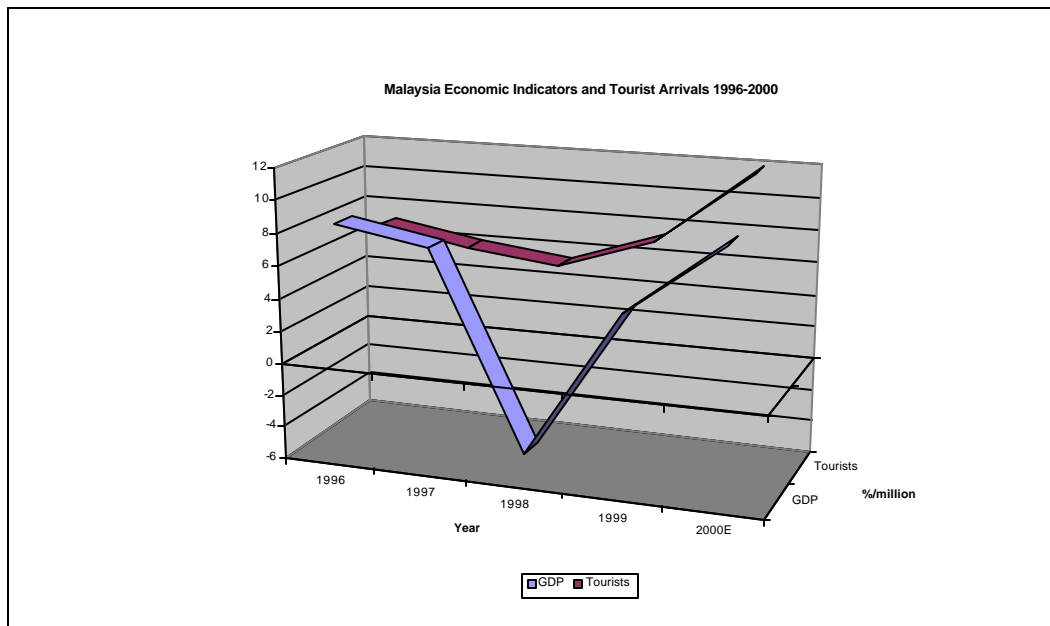
industry. More specifically, the government has taken steps to regulate formal measures either financially or fiscal by establishing the National Economic Action Council (MNAEC) in 1999 to propose plans to improve the economy. Steps taken by MNEAC include the proposal to stabilize the value in Ringgit Malaysia (RM), to reestablish confidence on the market, to stabilize financial market, to strengthen the economic fundamentals, to continue socio-economic and equity agenda and to improve the weakened sectors within the economy. In so doing, MNEAC has taken radical approaches such as to improve credit control on foreign exchange in order to stabilize the ringgit. In addition, the Central Bank has imposed control on foreign capital to restrict the out flow (Central bank Annual Report, 1998). Moreover, the Central Bank has injected about RM34 billion to the banking sector to improve the lowest interest rate in 1997. In 1998, the government has established Danaharta, the asset management fund agency to take over non-performing loan from the banking system. At the same time, Danamodal, a capital management fund agency was set up to inject fund to the banking system. Other than these measures, the Corporate Debt Restructuring Committee (CDRC) was set up to restructure the banking system. In the property market sector, the government has taken steps to improve the property slump by the establishment of the National Property Information Center (NAPIC) to provide an up-dated and accurate property information. Among other things, the purpose of NAPIC was to ensure that the oversupply in property sector will not be repeated.

### **3.0 The Importance of Tourism Industry in Malaysia**

With reference to the period from 1985 to 2000, the Malaysian economy had experienced an up and down scenario. In other words, the economic environment influencing the general property and hospitality industry, has restricted tourist arrivals and, thus, lowering rental for hotel accommodation. From 1985 to 1987, the recession had affected the property market and rental prices, and oversupply rose further in all property sectors. However, towards the end of 1988, a massive foreign investment was encouraged into the country. As a result, there was a turn around in 1989 which marked the beginning of another boom in the property market. This continued until mid-1997 with a steady

economic growth of more than 8.0% per annum. In the late 1997, however, the economic growth had a slower pace of 7.4% due to financial crisis in the far eastern region (Property Market Report, 1998). In 1998, the gross domestic product (GDP) indicated a negative rate of growth between 2.8 to 6.8%.

The financial crisis and economic recession from 1997 to 1999 had a negative impact on tourist arrivals and hospitality industry as a whole. In 1997, some 6 million tourists arrived in Malaysia. The total arrivals declined by 13.0% compared to 1996. As shown in Figure 2.0, Malaysia lost about 2 million tourists from 1997 to 1998, during economic recession. This indicates the impact of economic recession which brought a drop of about 1 million tourist arrivals in 1997 and 1998. However, due to promotional and campaigning activities to lure tourists, an increase of tourist arrivals was experienced from 1999 to early 2000. As shown in Figure 1.0, it is expected about 11.5 million tourists will arrive in Malaysia by the end of the year 2000. Figure 2.0 shows a clear trends of tourist arrivals from 1998 to early 2000.

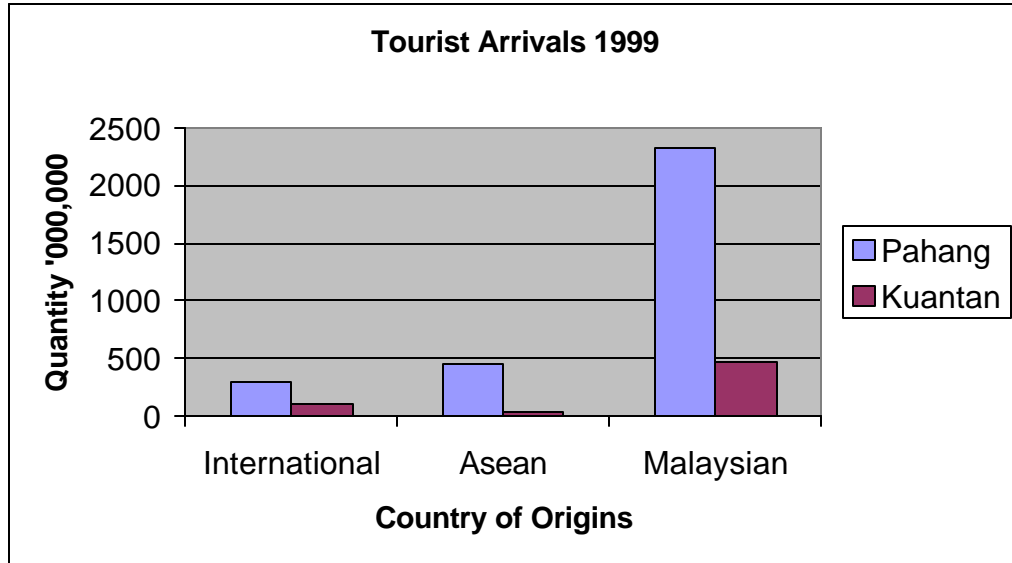


**Figure 1.0: Economic Performances and Tourists Arrivals in Malaysia 1996-2000**

**Source: Malaysia Tourism and Economic Reports (1996 – 2000)**

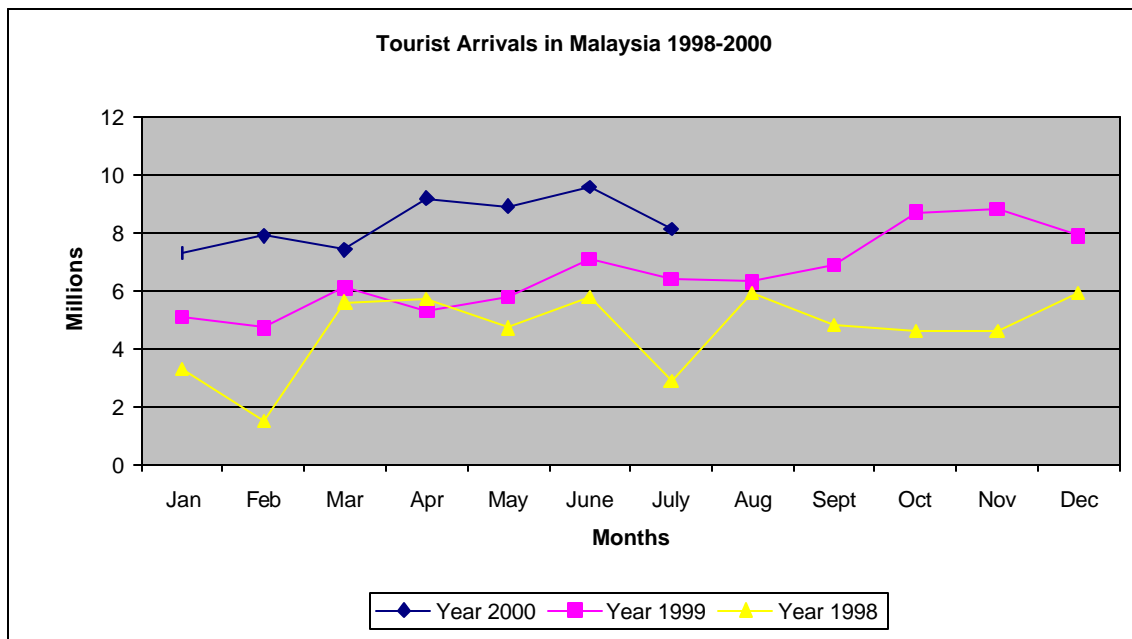
The trend in tourist arrivals in Pahang (one of the states in Peninsular Malaysia), was about 1.5 million tourists have arrived from January to June 1999 and about 1.6 million arrivals from January to June 2000. This indicated an increase of about 15% during the period from January 1999 to June 2000. In Kuantan (the case study area), about 0.47 million tourists have arrived in 1993 and increased to about 0.83 million in 1996 before declining to 0.6 arrivals in 1997 to 1999. This indicated an increase about 75% of tourist arrivals in Kuantan from 1993 to 1995 but in contrast, the trend was declined about -25% from 1996 to 1999 (Pahang Tourism, 1999). This was an implication of financial and economic recession which was started at the end of 1996 and it was severely affected tourist arrivals to Kuantan by mid 1997 and early 1999.

As shown in Figure 3.0, local tourists were the majority of the holiday makers in Pahang and Kuantan during economic recession in 1999. While during the same year, foreigners were reluctant to arrive. The decreasing trends in foreign tourists was a continuation from 1997 when it was reported that the total arrivals compared to 1996 to Peninsular Malaysia was about 13% (Tourism Development Board, 1997). It was also reported that in 1996, the tourist arrivals fall in Peninsular Malaysia was highly influenced by the other tourists generating markets in the region. For example, in 1996, Singapore led other market by capturing 56.2% of the market share, followed by Thailand, Japan, Indonesia, Taiwan, Brunei and United Kingdom (Tourism Development Board, 1997). It is, therefore, the market share of the tourism industry has played a more important factor to attract tourists compared to attractive foreign exchange rates.



**Figure 2.0: Tourist Arrivals 1999**

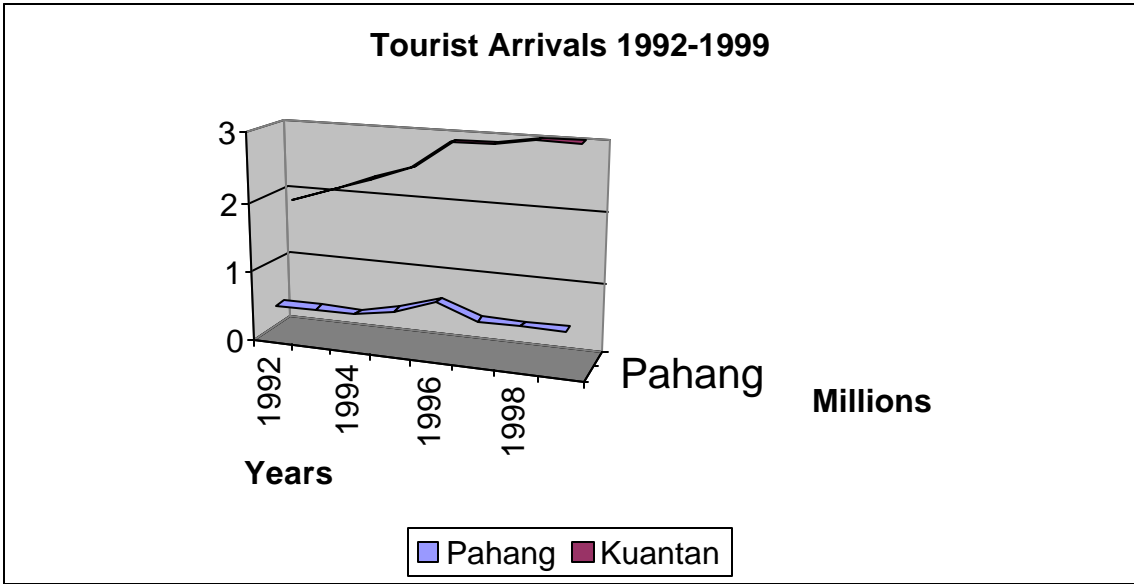
Source: Own Analysis 2000



**Figure 3.0: Tourist Arrivals in Malaysia 1998-2000 (forecasted)**

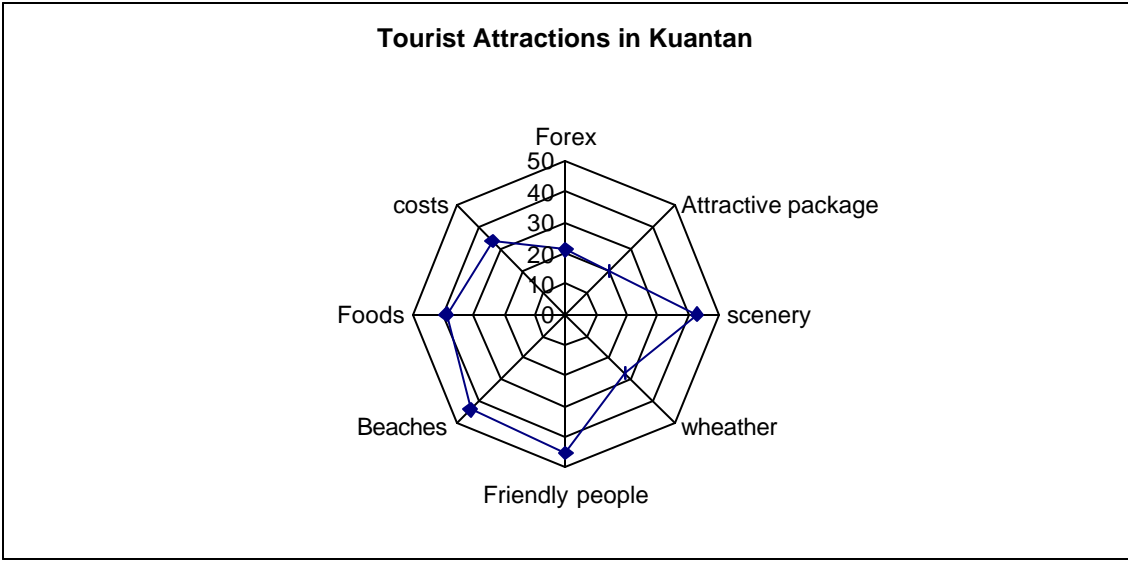
Source: Malaysia Tourism Development Authority (1998-2000)





**Figure 4.0 Tourists Arrival in Pahang 1992-1999**  
**Source: Pahang Tourism Authority (2000)**

There are factors attracting tourists to Kuantan, the case study area. As shown in Figure 4.0, attractive foreign exchange rates, traveling costs and attractive travel packages were less significant compared to other factors such as foods, friendly people, beautiful beaches and good scenery.



**Figure 4.0: Tourist Attractions in Kuantan 2000**  
**Source: Own Analysis 2000**

#### **4.0 Overview of the hospitality industry in Kuantan from 1992 - 1999**

In the mid-1997 when the financial crisis occurred, there were economic implications to the Malaysian economy and the property market scenarios as a whole. According to Bank Negara Malaysia (1998), the Malaysian Gross Domestic Product (GDP) was drastically reduced to 6.1% in the mid-1997. This was the dramatic influence of drop in aggregate demand by about 26.5%. As a result, the rate of inflation rose to 5.3% and employment rate dropped to 3.4%. More disastrously, when the foreign exchange rate dropped by 40.0%, construction sector was downed by 24.5% in 1998.

It was reported that:

‘A complete rebound to the pre-crisis days for the leisure property market may appear unlikely in the near future as the industry is tied to the global economy and further, the local economy has not regained enough to drive domestic tourism. However, aggressive overseas marketing and intensified campaigns to promote local tourism coupled with the two Saturdays off each month for civil servants, would see this sector on its way up again’ (Property Market Report, 2000, iv).

However, the government comprehensive measures to improve the economy has shown a gradually regain of confident on the property market. Transaction in the property market for the first nine months of 1999 was increased by 22.8% in the value transacted and about 59.7% in property volume sold.

As a comparison, the leisure property market in Malaysia is dependent on the economic development of the country. The economic downturns have dampened further the hospitality industry. In Kuala Lumpur, the hotel occupancy rates dropped to 49.2% from 56.5% from 1998 to 1999 (Property Market Report, 2000). Although the holding of international and national events in 1999, most of the hotel occupancy rates in capital cities declined despite some increase in tourist arrivals. The hotel industry showed a slower growth as a result of declining in golf activities, the emergence of serviced apartments and the supply of rooms from conversion of office or retail units (Property Market Report, 2000). However, rooms tariffs and rentals have shown slight

improvement in some capital cities due to an increase in tourists arrival when an aggressive overseas marketing and intensified campaigns to promote local and overseas tourism.

In Pahang, a negative growth rate of 1.8% was reported in 1998, and it was improved to 2.0% in 1999. In general, however, the economic growth is still slow due to sluggish in construction and forestry sectors (Property Market Report, 2000). In relations to tourism industry, tourist arrival dropped by 39.1% compared to 1998. As a result, the average hotel occupancy rate declined to 41.5% from 47% in 1998 (Property Market Report, 2000). Moreover, the added of newly constructed hotel has worsened the existing over supply of hotel rooms. This oversupply has forced hoteliers to compete between one another. Unfortunately, the undercutting on hotel tariffs among the hoteliers in Kuantan could not improve occupancy rates.

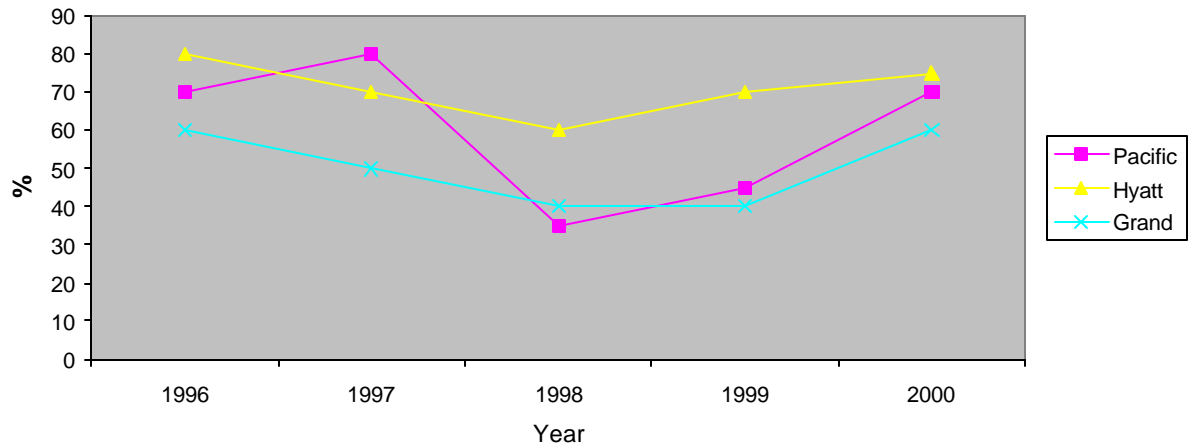
<b>Hotel / Resort / Chalet</b>	<b>Type of Rooms Tariff (RM/night)</b>	<b>Occupancy (%) 1998/99</b>	<b>Occupancy (%) 2000</b>
<b>Town Areas</b>			
Grand Continental	Standard (70-150)	40	60
	Deluxe (151-300)	40	60
Hyatt Hotel	Standard (151-300)	68	70
	Deluxe( > 300)	68	70
M.S. Garden	Standard (151-300)	60	65
	Deluxe (>300)	60	65
Luxury Hotel	Standard (<70)	20	45
	Deluxe (71-150)	20	45
Pacific Hotel	Standard (70-150)	35	70
Sri Malaysia	Standard (70-150)	54	60
Shahzan Inn	Standard (70-150)	51	60
	Deluxe (>300)	51	60
Citiview	Standard (70-150)	62	70
Mega View	Standard (70-150)	65	70
Swiss Garden Resort	Standard (151-300)	53	65
Vistana Hotel	Standard (115-250)	55	70

<b>Outskirt Areas</b>			
Club Med	Standard (151-300)	45	60
Coral Beach	Standard (151-300)	25	60
Jelai Beach	Standard (70-150)	20	45
	Deluxe (151-300)	20	45
The Legend	Standard (151-300)	60	65
	Deluxe (>300)	60	65
Resident Inn	Standard (70-150)	50	60
Cherating	Deluxe (151-300)	50	60
Homestead Inn	Standard (70-150)	35	65
Gloria Moris Resort	Standard (70-150)	40	60

**Table 1.0: Kuantan Room Tariff and Occupancy of Hotels 1999**

**Sources: Property Market Report (2000) and Own Analysis**

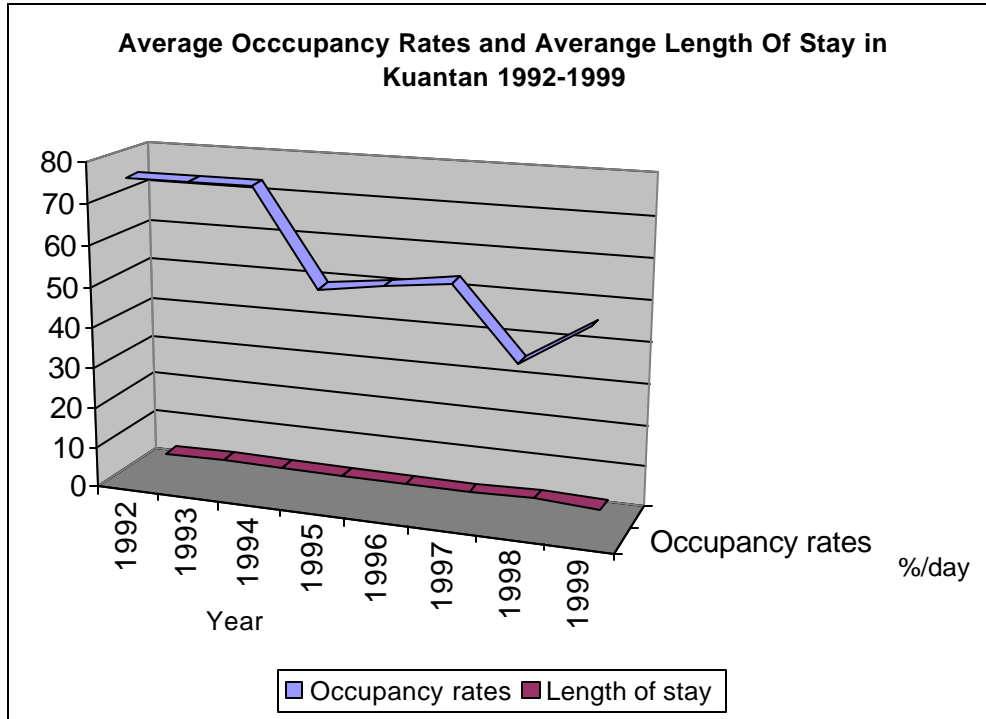
**Occupancy Rates of Hotels in Kuantan 1996-2000**



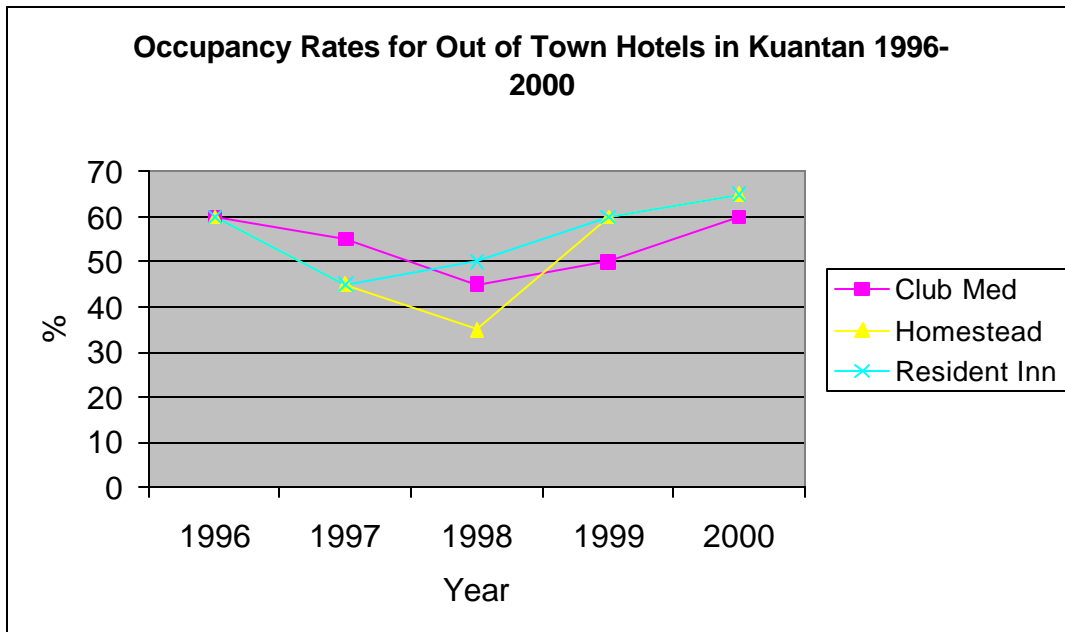
**Figure 5.0:**

**Selected In Town Hotel Occupancy Rates in Kuantan 1996-2000**

**Source: Own Analysis 2000**



**Figure 6.0:**  
**Average Occupancy Rates and Length of Stay in Kuantan 1992-1999**  
 Source: Pahang Tourism 2000



**Figure 7.0:**  
**Selected Out of Town Hotel Occupancy Rates in Kuantan 1996-2000**  
 Source: Own Analysis 2000

Based on the responses from interview schedules conducted with tourism professionals, tourists, businesses and hoteliers in Kuantan, almost all respondents referred to the financial and economic crisis as the main reason for decreasing tourist arrivals in Kuantan during recession from 1997 to 1999. In explaining this reason, foreign tourists cited the weakened Ringgit Malaysia (RM) influencing tourists coming into the country by way of their expectation of degrading quality services within the hospitality industry. In actual fact, weakened Ringgit Malaysia (RM) has made tourist were more affordable to go overseas. On the other hand, local tourists cited the weak Ringgit Malaysia (RM) has made their financial situation getting worst. Even though, the government has undertaken promotion and campaigning to lure visitors, excursionists and tourists during recession period from 1997 to 1999, it was reported that the price war among hotels in Kuantan were not strong enough to attract tourists. As a result, massive oversupply of hotel accommodation with almost 40% vacancy rates had been obviously experienced from 1997 to 1999. These economic and financial formal rules to improve economy and informal perceptions and behavior of tourists were the institutions which influencing the tourism and hospitality industry as well as the hotel sector in Kuantan.

Considering the institutional factors affecting the hospitality industry in Kuantan, all respondents referred to the financial and economic crisis which brought about negative perceptions towards tourism. Reduction in the value of Ringgit Malaysia (RM) meant the purchasing power is weakened. Beside exchange rates, though, competitions and lures from other Asian markets like Thailand and Indonesia have had an impact on the Malaysia and Pahang tourism and hospitality industry during recession in 1997 to 1999. Economic recession from mid 1997 to 1999 had caused declining in excursionist arrivals when firms and government agencies limit formal conferences, seminars and formal visits. Moreover, it was difficult to get financial assistance from banks for recreational and holiday purposes during financial crisis. Only recently developed and completed high international standard hotels and resorts were facing less problems by the economic crises. In contrast, less quality and local and national type hotels and resorts were facing stiff competition from internationally recognized and higher rating hotels which were still

offering affordable and quality services during recession. This was evidenced from the report that the economic recession has degraded the hotels and resorts occupancy level to 40.7% from about 70.0% from 1996 to 1999 (Property Market Report, 2000). Therefore, the economic crisis had evidently caused the changing significance of the different players in the hospitality and tourism in Malaysia.

## **5.0 Conclusion**

As a result of the measures taken by the government, there was a sign of economic recovery in the mid-1999 when the economic growth has shown a positive sign. Agents in the hospitality industry such as tourists, hoteliers, businesses and investors were able to decide upon hotel and tourism investment and development in a more affordable, informative and efficient manner. It seems that by establishing and introducing formal rules or measures in the economy, property sector is more informative, hence, agents can make better decisions to utilize the certainty in hospitality investment decisions. In other words, measures taken to improve the tourism and hotel industry using institutional measures were able to improve the industry such as by using electronic tourism (e-tourism) network by various hotels and resorts. This means that, related authority has to ensure the provision of readily available quality services and tourism products to fulfill the hospitality industry in the country. More importantly, hotels and resorts have to provide and improve their quality services to lure tourists beside promotion and intensive campaigning envisage by the government. This shows the way in which the institutional economics analysis is able to explain the existence and implication of economic recession upon the oversupply of hotel accommodations in Kuantan from 1997 to 1999. As a result, the hospitality industry is improving towards a more informed and improved to nourish the overall economic environment in Malaysia.

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