Strategic management in tourism

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in: Witt, Stephen F./Moutinho, Luiz, editors, *Tourism Marketing and Management Handbook*, New York etc.: Prentice Hall International, 1989, pp. 425-432.

Introduction

This chapter applies the latest theory of business strategy to the specific requirements of the tourist sector. The article analyzes the principal purpose of strategic management – the development and the enhancement of sustained earnings potentials, as the prerequisite of long-term business success. Further, it identifies the determinants of earnings potentials, namely market position, experience, customer problem, problem solutions and other factors which determine competitiveness. The key parameters of strategic business management and their interrelationships are addressed. We will show that some concepts, already well established in industrial strategy, are also relevant to tourism. Of course, not all factors relating to tourism can be fully covered here; however, the theoretical explanations will be supplemented by numerous practical examples from the tourism and leisure sectors.

In the 1970s great progress was made in the theory and practice of strategic management. A reliable knowledge of the nature of long-term patterns in business processes, and their underlying causal structures, has emerged (see especially Gaelweiler, 1987; Porter, 1980; 1985). The concept of 'strategy' is misused frequently nowadays, and the extension of its meaning has led to misunderstandings and errors. Strategy is not the same as procedure, although this is often believed to be the case: normal procedures in an organization are not strategies.

The old Greek origin of the concept of strategy leads us towards an understanding of this term. The word is derived from 'stratos', something comprehensive and superior, of higher importance. The word strategy is also derived from the Greek 'agein' which means to act or guide. Strategy means thinking, decision making and actions towards superior long-term goals, without being deflected by short-term advantages, disadvantages or variations.

Orientation parameters

Increasingly, over the last few years strategic and operational management have been separated. This differentiation is not just theoretical. As the complexity and uncertainty faced by organizations have increased, an understanding of this differ-

ence has become essential to maintain the effectiveness of top management.

Traditional management science more or less equated profit with 'the ultimate purpose of business'. As a result, even now the error is made of using short-term data to produce wrong long-term conclusions. It is often forgotten that last year's profit has little bearing on the future prospects of a business; less, for example, than sales growth has on profits.

Meanwhile, we have learnt that profit is not the main goal of an organization, but forms only part of the hierarchy of target and control parameters relevant for management of a business (Fig. 1). The shortest-term objective of management is solvency, which is determined by operating income and expenditure. Anybody who understands even a little about accountancy knows that solvency and profit are different things. This difference is due to the timespan between the occurrence of costs and revenue on the one hand, and of income and expenditure on the other. It follows that expenditure and profit will not necessarily have an immediate effect on solvency.

The longer profit is lacking in an organization, the more difficult it becomes to maintain solvency. Profit exerts a causal effect on liquid assets, and thus plays the role of an advance warning with regard to the solvency of an organization. This has been known ever since double-entry bookkeeping was invented by Luca Pacioli in about 1500. But only in relatively recent times have we gained a more precise understanding of the fact that solvency and profit alone cannot be the ultimate business objectives.

The customer, the competitive situation in the tourist industry, and general economic conditions, have become much more difficult. The timespans available for adapting to changes in external circumstances have become much shorter. On the other hand, timescales required for implementing long-term effective projects cannot be arbitrarily reduced, for example the development of new products and services, the creation of extra capacity, organizational changes and improvement of human skills. It becomes problematical to control an organization exclusively for profit, because the indications derived from profit accounting change more quickly than adaptive procedures can be taken. The controlling mode in profit-oriented management is based on desired-from-actual deviations. It has to be complemented by a controlling mode, which focuses on the long-term causes of profit and loss.

Figure 1 Hierarchy of target and control parameters in management (Gaelweiler, 1980a).

Solvency and profit are operative control parameters, but they are overshadowed by other control parameters on the strategic level: earnings potentials, in other words the capability of producing earnings (profit) at a future date and over long periods. The core task of strategic management is to build and maintain sustained earnings potential; this corresponds to systematic creation of the prerequisites of future earnings and liquidity. This task includes the consideration of long-term liquidity effects derived from a strategy. Again, control of earnings potential is not an object in its own right, but only supports the primary objective of any business: to ensure its continued viability and development in terms of enduring prosperity and vitality.

Parameter relationships

The relationship between control parameters on the strategic plane on the one hand and the operational plane on the other has to be elucidated further (Gaelweiler, 1987, Chapter VII):

1. As shown in Fig. 1, control of the earnings potential involves in much longer-term view than control aimed at earnings or profit requirements.
2. Large positive earnings are always a better basis for the control of solvency than low or negative earnings. Similarly, a large and secure earnings potential is a better basis for later profits than a small, uncertain earnings potential. However, neither is profit in itself a guarantee of adequate solvency at a later stage, nor can earnings potentials produce assur-

ance of later profits. Earnings potentials create favorable conditions and good chances of future profit, but they cannot guarantee such profit in the future.

3. Positive or negative earnings in the sense of profit accounting will occur in every organization, irrespective of the actual use of such accounting. This thought also applies to earnings potentials. The existence or nonexistence of earnings potentials and of their actual effects with regard to a specific firm will arise quite independently of whether or not management understands the importance of such parameters.
4. Under the same circumstances, different control parameters can change in opposite directions, e.g. solvency could be negative in spite of good earnings. Further examples are found in organizations or business divisions having great profit potential which, however, can only be realized if several years' negative returns are accepted. Just as profit and solvency must be separately managed at all times, control of earnings potential requires individual and independent attention.
5. The objective of the creation and maintenance of earnings potential is usually incompatible with the maximization of present profit. In view of the hierarchy of objectives stated above, achievement of profit is not an objective in itself, but rather a derived objective.
6. In simple words, operative effectiveness is based on 'doing things right', while strategic effectiveness results from 'doing the right things'. The choice of markets, creation of competitive advantage, development of products, resources and skills are issues of strategic business management. Opera-

tive management is concerned with the efficient use of these prerequisites.

7. Strategies can be described in terms of operative criteria (profit, solvency), but not decided on the same criteria as operative measures. Profit is a standard of operative management, competitiveness of strategic management. A similar pattern applies to the relationship between the strategic level and normative levels of management, which cannot be illustrated in detail here (see Schwaninger, forthcoming). On the normative (or 'corporate policy') level, viability and development are the comprehensive criteria of effectiveness. The perspective of normative management, which involves values, ethical and esthetical considerations, will often shed a different light on a decision than criteria of the 'lower levels' do. A project, for example to adapt a new product, can perfectly make sense from the profit and earnings potential perspective and yet, the broader outlook may qualify it as inappropriate. The product may be unacceptable from a corporate policy perspective, because it is incompatible with ethical standards or the social responsibilities of management. Managers are increasingly aware not only of the fact that they can't do all they want (strategic perspective) but also that they should not do all they could (normative perspective).

Coming back to the strategic level, we should further elaborate on strategically relevant indicators. The present state of knowledge in the field of strategic management allows us to identify the crucial factors affecting the earnings potential and long-term solvency by a method which is similarly systematic, just as double-entry bookkeeping allows us to calculate business profit. In recent years, the control parameter 'earnings potential' has differentiated between extant and new earnings potentials.

Extant earnings potentials

Extant earnings potentials are determined by the market position and the business specific experience of the organization. Experienced managers understand the importance of a strong market position (competitive position) as a requirement for long-term profit. 'Strong market position' is not just a term important for large companies. For example, in a holiday resort it is not only the Grand Hotel which can be a market leader (i.e. in the luxury class), even a small business can be the leader in its market sector or segment, or can at least achieve a strong position. We all know of small hotels having the reputation of 'the friendliest medium-price family hotel in the region'.

The good relationships between such firms and their customers allow them to survive through crises and hard times. Other examples are found among the relatively small travel businesses which have become leading specialists for certain customer groups (e.g. senior citizens, youngsters) or products (e.g. theater journeys, hiking tours, travel to particular destinations). One can gain a strong market position by achieving one or more specific competitive advantages, which can be defined partly in quantitative and partly qualitative terms.

Quantitative indicators

Quantitative indicators for many types of tourist businesses (e.g. travel agencies, mountain railways and restaurants) are determined by market share. Having obtained a large proportion of the market, the organization is likely to have gained specialized experience in the particular field; this leads to potential cost advantages and makes it less vulnerable (exceptions to this rule occur in those cases where large market shares are attained entirely by financial investment – 'buying of market share'). The greater the experience, the better are the chances (not always utilized) for producing cost-effective products and for efficient organization of the various functions. Market share and experience are approximate indicators of the product- and -market-specific know-how gradually accumulated in a particular business area. The absolute levels of these indicators do not say anything accurate about the strategic situation of the business, but they become more significant when compared with the corresponding levels of the relevant competitors. Hence, two factors to assess our own competitive position are as follows:

1. Relative market share = $\frac{\text{Own market share}}{\text{Marketing share of strongest competitor}}$
2. Cost advantages and disadvantages.

Cost advantages and disadvantages which can be derived from the relative market share can be quantified approximately on the basis of the experience curve, derived from the 'learning curve'. The experience curve is defined as follows: each time the cumulative experience (i.e. the cumulative volume of output) is doubled, a cost reduction potential of the order of 20–30 per cent per unit (i.e. of the per item cost) is created, at least for those cost components which constitute their own value-added*, and based on constant money value (Fig. 2). This feature applies as well to an industry as a whole as to individual businesses.

The experience curve has been studied empirically (Henderson, 1972) and is substantiated by the PIMS (profit impact of market strategy) studies by the SPI Institute which also show a strong positive correlation between relative market share and long-term profitability. This means that there is a potential for higher profitability as the organization's own market share and, in particular, the relative market share, grow. Schwaninger has shown in an empirical study that the learning curve model can be translated to tourist businesses. This does not preclude the possibility that its application to specific cases may be problematical (Schwaninger, 1984a; cf. Hart *et al.*, 1984).

Qualitative indicators

There are further important indicators for assessing the existing earnings potentials, apart from the relative market share and the experience curve (see also Buzzell, 1987). These are mainly qualitative factors which determine the competitive position but it is to some extent possible to quantify them. Parameters

* Value-added in this connection is taken in a simplified form as the difference between total costs and purchased material costs.

Figure 2 The experience curve plotted on linear axes (Gaelweiler, 1986).

which are likely to affect market share and therefore the propensity to make profits, will include factors such as: the attractiveness of the product offered to the customer, the quality of the product, utility of the product to the consumer, the price/performance ratio, technological and informational skills, service level and the marketing effectiveness, always in relation to relevant competitors.

In many tourism businesses, profit achievement is not necessarily linked to high market share and learning curve levels. Here the key factor which determines the competitiveness of an organization is the attractiveness of the service offered, which itself depends on items such as locality, quality of natural and sociocultural factors, tourist infrastructure etc.

The above qualitative factors, just like market share, must not only be assessed in an absolute sense but also compared to relevant competitors. All assessments should be based on customers' views rather than on an inward looking perspective.

Application of indicators

Applications of market position and learning curve as indicators for strategic management and planning, require an understanding of the following further connections:

1. The experience curve does not occur necessarily like a law of nature. Instead, it is the result of taking full advantage of cost-reduction possibilities. This, of course, is a major task of effective management. It follows again that the learning curve is not necessarily discernible in every individual business. Empirical results have shown, however, that there are competitors in each industry which succeed in realizing their available cost-reduction potentials, thus creating an earnings potential, at least in the long run.
2. A firm having the best cost ratios should also, other things

being equal, have the best profit potential. It is well known that prices vary in the form of step functions and can practically change overnight. However, cost reductions take much longer to achieve, because there are always remnant costs which cannot be so quickly controlled. A competitor who succeeds in gradually reducing his unit costs in accordance with the experience curve, achieves a better starting position and gains pricing leeway which facilitates maintenance, or even an increase, in market share.

3. Relative market share contains significant information value. It is a figure which expresses, in a highly condensed way, the relative strengths of competitors, as well as possible cost levels, and therefore gives pointers relating to the prospects of surviving in a particular market or in a particular market segment. The experience curve indicates, as a logical consequence, that organizations having only a small market share are particularly vulnerable in the long term. On the other hand, a high relative market share represents a good starting position for generating earnings.
4. The concept of the learning curve does not necessarily demand growth in a business, although this is often mistakenly assumed. Market share and the experience curve are indicators specific to individual markets and product groups. Therefore, accurate definition of the relevant market/product units is imperative. It should be noted that the competitive game is played less on the level of the company as a whole than on the level of individual business systems. These can be defined as specific configurations of customer-problems, customer-groups, products/services, technologies and distribution channels, within the context of certain competitors and, eventually, under consideration of regional aspects (Schwaninger, 1987). Quite often, a segmental subgrouping (for example in customer groups, or price classes) can be helpful in differentiating diagnosis and in determining strategy.
5. Since the experience curve only applies to homogeneous market/product units, it furnishes a rational foundation for the principles of concentration and variety reduction in business. The principle of concentration of effort states that one's efforts should not be split across too many customer groups and products. Since fixed costs generally rise exponentially with increased product range, it is important to control both product range breadth and depth. In short, we have to avoid dealing with too many products. The method of trying to compensate decreases in turnover by enlarged product range (for example by increasing the number of items on the menu) is usually dangerous because it is likely to have a severe negative impact on profit.
6. It is often mistakenly believed that the experience curve only applies to lower price-group businesses. The favorable long-term profitability achieved by some market leaders in upper end class segments of travel, as well as the higher price levels of some leading hotels, were not only obtained through above-average quality and value offered to customers. These profits are also a result of unit costs maintained and controlled carefully along the experience curve. The corresponding per item cost reductions can result from cutting cost elements (rationalization), from productivity increases

and also from an improved ability to match capacity to demand or from better capacity utilization. The last aspect is particularly important for the capital-intensive hotel businesses. The two possibilities of cost reduction do not refer to separate 'laws' but to partial aspects of the experience curve. Successful long-term reduction of per item costs, whether by capacity matching or by better utilization of extant resources, are results of long-term learning processes.

7. Accurate calculation of the experience curve is not always feasible. Nevertheless, the fundamental rules defined by this curve are valid in principle and can form useful guidelines for strategic planning at the business level.

Wrong conclusions to be avoided

It would be wrong to conclude from these remarks on market position and experience curve that all good strategy must aim at increasing market share, or that it should always be possible to achieve profit increases by increased market share. For one thing, market-share increases cannot be achieved economically in many start-up situations (e.g. in stagnating markets, or when faced with powerful competitors or the inability to install innovations). Secondly, increases in market share do not usually have an immediate effect but only produce increased profits after some time, especially if they are based on true competitive advantage, and not purely on price wars. Thirdly, the strength of market position is not entirely defined by market share but, as shown above, by other factors. In some cases, an increase in market share can even reduce the attractiveness of the services offered which, in turn, could dampen demand in the long term. (This applies, for example, to holiday resorts where ecological and sociopsychological resources are subject to excessive strain.) The fourth consideration is that profit can be increased not only as a result of current, but also as a result of earlier market growth if cost-reduction potentials are implemented retrospectively where this potential is available from the past. Finally there is an upper limit beyond which increases in market share will have an unfavorable effect on a business because they generate increased resistance of governmental institutions and the public at large (cf. the debates and regulations with regard to fusions of major US and UK airlines).

New earnings potentials

A strong market position and a high level of experience in a particular business area still cannot predict whether an organization will be able to remain in the market and be competitive in the future. Market share can be rapidly lost as a result of new and better products/services. Timely awareness of such events requires indicators which reach further than correct market position and learning curve.

Customer problem

The widest ranging strategic indicators are customer requirements or customer problems, provided they are defined inde-

pendently of particular solutions (Levitt, 1975). It is known that the way a certain customer problem is solved, can vary substantially, both in form and in timescale.

Thinking in these terms is still rare in the tourist industry. Frequently, the customer problem is defined on the basis of what the vendor of a particular solution offers. Management may not be aware that different solutions are available, or at least possible. For example, the requirement for 'active holidays' can be met by the following solutions: holidays at home; local holiday tourism; and activity holiday trips. Within each of these a number of suitable leisure activities can meet the stated requirements. For activity holiday trips, club holidays, or holiday packages in a hotel with a wide program of leisure activities may be employed. Another option might be hiking tours, where the activity itself consists of moving from one holiday accommodation to the next.

Experts in tourist marketing have analyzed this aspect, and have coined the phrase 'substitution competition'. Studies up to now have been more concerned with substitution from a static perspective, taking account only of already available, and competing, solutions. The solution-invariant definition of the customer problems enlarges functional and temporal horizons, so that the following types of solutions can be matched to specific customer requirements (Gaelweiler, 1987):

1. Solutions available at the moment, whether they are offered by one of the tourism sectors or not. An example would be a new leisure center at the edge of a large city which can meet the need for a change of atmosphere and for recreation. The same requirements can be met by several nearby tourism resorts. As these various solutions for the same customer problem are in different phases of the life cycle, this perspective shows the dynamics of substitution competition.
2. More recent solutions, still under development in one's own business but also in competing businesses and in other sectors. Examples could be the new forms of restaurants still under study to meet growing customer requirements for integral and organic food products.
3. Potential problem solutions which are still at the research stage. These are fundamentally new but rather uncertain in their probability of achieving success, and are still a long way from commercial realization. Until a few years ago, teleconferences and the home shopping of tourist services were included in this category.

Substitution processes

The role of new, and potentially new, solutions to problems is to completely or partially replace old solutions. This phenomenon is termed a substitution process. The tourist industry has not paid enough attention to the replacement of old by new services, processes and technologies. We should remember that lifestyle and change of values during the past several decades have led to substitution processes which are clearly discernible and, in some cases, still going on:

1. Appreciable sections of the hotel industry have been substituted by other kinds of accommodation. In Switzerland, for example, the proportion of nights spent in hotels and

similar establishments fell from 58 to 48 per cent of total accommodation nights between 1970 and 1984.

2. During the last 30 years, 'parahotels' have gained in importance. In addition, new forms of accommodation similar to hotels, such as holiday clubs and those offering extensive leisure and sports facilities, as well as active support from social contacts among the guests, have increased their market shares.
3. Products have also been developed where the innovation is based on new financing and utilization models (for example apartment hotels and new forms of apartment timesharing).
4. A change, which will have enormous effects on the hotel and catering sector, is taking place in the restaurant industry. System catering is taking further market share from traditional gastronomy and will engender new 'species' of restaurants. ('System catering' refers not only to fast food chains such as MacDonalds and Burger King but also to networks of more sophisticated operations such as the Swiss Moevenpick group.)

It is a characteristic of substitution processes that a new problem solution never achieves 100 per cent penetration of the total market, but manages only a partial market penetration. As an example, package tours which have reached a substantial share of the total travel market (34.5 per cent in West Germany in 1986 [StfT, 1987]), will probably never arrive at an overall market penetration even close to 100 per cent, although the substitution process is still going on.

In product substitution, only that part of the market is replaced for which the new problem solution is more suitable to requirements than the traditional solutions. Therefore, innovations tend to split the market, since some of the customer problems continue being better met by traditional solutions (Gaelweiler, 1987).

Experience shows that totally or partly new customer problems arise in the course of time, which require the development of new solutions. For example, newer kinds of restaurant have not only replaced part of the traditional restaurant market, but also largely satisfy customer requirements which were previously only latent or just beginning to appear.

The structuring of customer problems

In service industries, the definition of customer problems, and therefore of the appropriate solutions, is considerably more difficult than in many industrial sectors. The intangible, emotional and value-associated aspects of marketing in the service industries are particularly significant and wide ranging. The method of structuring customer problems, which differentiates between original and derived customer problems, is substantially due to experience in industry (Gaelweiler, 1980b). Schwaninger has applied this rationale to several service industries and it can also be applied to the tourism and leisure industries.

Original customer problems tend to be long lasting. As far as can be judged with our present knowledge, it is very unlikely that they will disappear. Derived customer problems, however, are liable to change. The existence of these derived problems was only caused by the characteristics of specific problem solu-

tions. Therefore these 'derived' problems themselves are liable to change as new problem solutions emerge. 'You run the risk that you will innovate away, integrate away or rationalize away, the very customer problems you wish to satisfy' (Gaelweiler, 1987).

Fig. 3 shows an example of the structure of a customer-problem in the tourist industry. This indicates clearly that different solutions can be threatened by integration to a higher level, or by fundamental changes of the problem solutions on their corresponding levels.

Innovation and long-range perspective

If there were such a thing as an Archimedian point for strategic management, then this would be the customer problem. This is the reference basis with the largest material and timescale horizons. It provides impulses for innovations. It yields the most meaningful reference points for development and for marketing of new problem solutions including the necessary quantitative assessments of market potential. One should not equate 'new problem solutions' with 'new products'. New problem solutions with increased innovative effects are generally not limited only to a new product. On the contrary, they involve changes to several, or all, components of a business system (services marketed, technology, distribution channel, target groups and customer problems) and to their interplay (Buaron, 1981; Schwaninger, 1984b).

A long preparation time must be allowed for the creation of new earnings potentials; they create immediate key requirements for personnel, intellectual, financial and material resources which are not matched, at this time, by appropriate inflow of cash and which will not provide profits initially. Consider for example the time required to design completely new hotel or restaurant formulae and to develop these commercially. Other examples are the long lead times required before a resort can establish a reputation as a golfing center, or the effort to be made before a town creates a name for its theater festival.

On the other hand, it can be shown that wrong strategic decisions can have long-term and even irreversible consequences:

1. High capital intensity is a fundamental characteristic of the hotel industry. Therefore, if a hotel has been badly planned, then it is extremely difficult to change strategy at a later stage.
2. In a holiday resort the original (natural) facilities are of prime importance as a long-term prerequisite for profit. Environmental spoiling or damage of local culture does not lead to an immediate fall in turnover or profit, but in the long run they can have enormous effects on the regional ecology and on the socioeconomic vitality of a resort. Thus short-term maximization of profit can lead to long-term failure. Krippendorf's fear that tourism will itself be destroyed by tourism has become well known and has, in fact, been substantiated in several cases (Krippendorf, 1981). Referring to ecology, the changes are long term; for example, we know that a forest, once destroyed, may need decades to grow again or even be lost for ever.

Figure 3 Original and derived customer problems in part of the tourist industry.

Conclusion

The purpose of this chapter has been to apply the basic concepts of business strategy to the tourist industry. It concentrates on strategy at the business level. In large, diversified companies, the integration of business strategies to overall corporate strategies involves further reflection on portfolio-management, synergy, economies of scope and sharing activities etc. (Hax and Majluf, 1984; Porter, 1987; Rowe *et al.*, 1985).

The earlier the management of individual tourism companies, or of holiday resorts or regions start to deal with the long-term issues discussed in this article, the better they can address strategic challenges. The examples of several innovators show that it is not always necessary to be a large and powerful company to be able to cope with change.

Long-term market developments and substitution processes

can, in most cases, be identified long before they result in reduction of business for the organization involved. The earlier the corresponding warning signals are analyzed and understood, the more latitude may still be available for adaptive action. The essence of strategic thinking is to recognize early how to act from the start, in order to ensure long-term and enduring profitability.

The considerations put forward show that the data from operative accounting (balance sheets, profit and loss accounts) tell us relatively little about the long-term opportunities for an organization. Profit is the wrong indicator by which to assess or justify future strategies. Wrong strategies usually cannot be corrected by economically justifiable means once their negative effects show up in the current profit and loss statements.

The management of holiday resorts must learn to take a long-term view, especially in respect of the natural environment and

its sensible development, as well as of the visual amenities of villages and of the countryside. In view of the diminishing natural resources, there is a growing awareness in the tourist industry that nature and the countryside are integral components of the solution of customer problems, which deserve a high degree of care. Tourism, more than any other business, depends on the quality of natural resources. The conservation, protection and upgrading of the ecological and sociocultural resources must be first priority issues of strategy, because these are critical factors of success.

The interactions on the strategic plane are often hard to recognize because of the long time intervals between cause and effect. To understand these requires not only a deep, business-specific knowledge, but also a high capability of abstract thinking.

The associated mental discipline is absolutely essential for effective strategic management. Without this discipline, those responsible will find it difficult to take decisions involving the sacrifices necessary at present to ensure future earnings. For example, an environmentally responsible attitude to the countryside, the critical resource in a holiday resort, will only be accepted if the people involved understand the priority of strategic objectives (e.g. avoidance of further random building development) and are not diverted by the glance of short-term advantages (for example, profits from change of zoning, or sale of land).

Strategic thinking also requires that 'weak signals' announcing future events should not be ignored just simply because those appear to be still far away. We must not forget that long-term causal interactions occur whether or not we are aware of them.

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