STRATEGIC MANAGEMENT IN THE HOSPITALITY INDUSTRY

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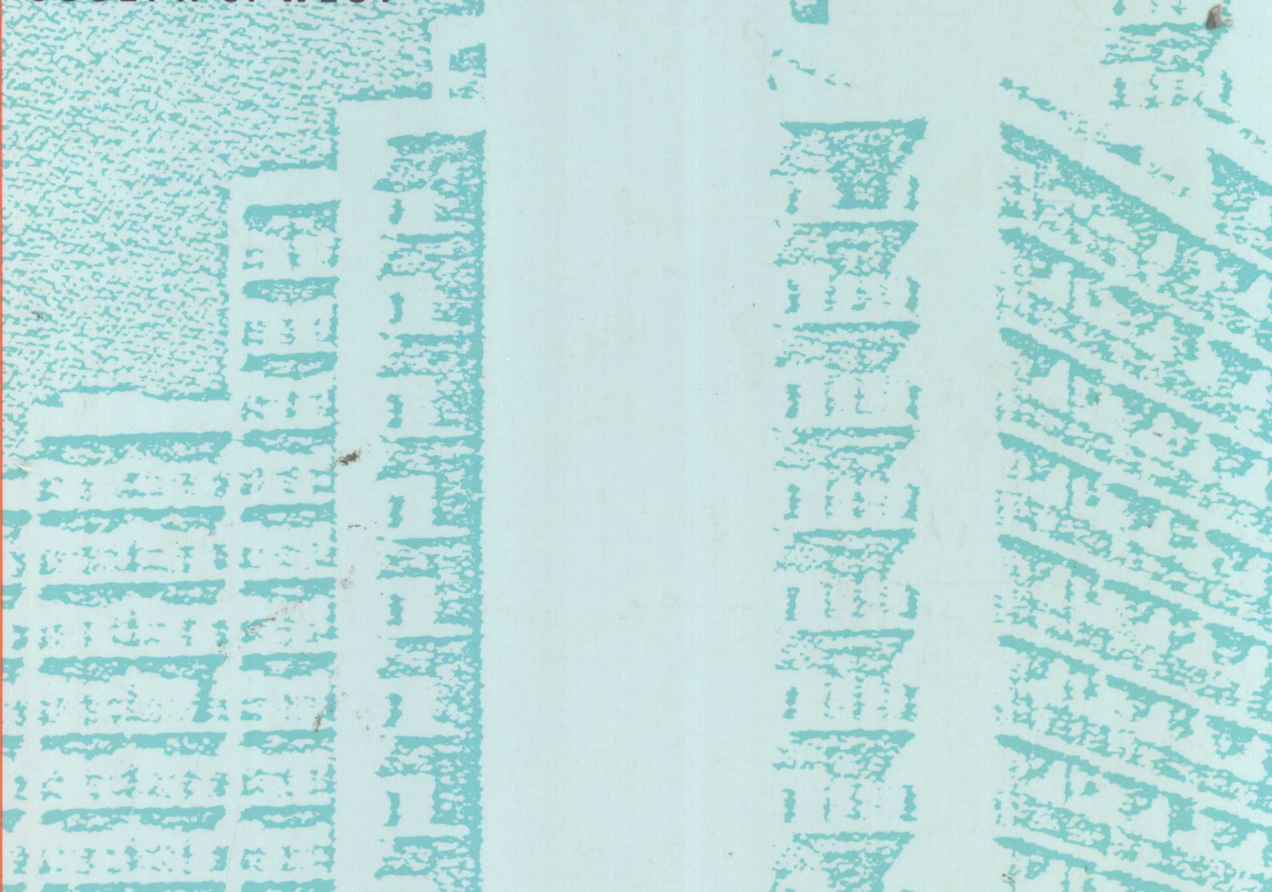

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This text is dedicated to Sandy, Kelly, and Mike Olsen Jr., who provided support and encouragement and were willing to share family time in the completion of this endeavor; to Mary Beth West, who has made her dad's life rich and interesting; and to Sung-Chi Chu and Diana Hoi-Tay, for their love, patience, and support.

Preface

This book not only introduces the subject of strategic management in the hospitality industry to the advanced student, it is also intended for the experienced hospitality manager who desires greater insight into the strategic issues currently influencing the industry. Thus, the emphasis of this text is upon the concept of the strategic management process as it applies to the hospitality industry. This application is based upon over ten years of research by the authors and others into the practice of strategic management. It is our belief that strategic management in the service industry differs significantly from strategy in the manufacturing industry. Strategic management is in many ways industry specific; key issues such as technology, localized demand curves, and multiple-unit operations differ in application from industry to industry. This book demonstrates that belief.

We have written more than just a descriptive "how to" textbook. We have designed this book to provide insight into the strategy formulation/implementation process, as well as insight into the various strategies currently utilized by hospitality firms in their attempts to attain a competitive advantage. This book also offers insight into how the relationships of the firm with the business environment are influenced by such factors as strategy and organizational structure. Firm performance is seen as being the result of the confluence of the firm's strategic formulation-implementation process, its organizational structure, and the forces of the environment in which it exists. Additionally, in order to further enhance the study of the strategy management process, problems associated with integrating a successful strategy throughout the organization are examined and discussed.

As the hospitality industry has changed dramatically over the last two decades, so has the typical firm. Most hospitality firms are now multi-unit organizations that face many issues that are different from their single-unit "Mom and Pop" competitors. This book addresses strategic management as it applies to these multi-unit firms—especially as the firms mature through their product/concept life cycle. Issues regarding firm structure, maturation of entrepreneur into strategic executive, as well as the evolution of management responsibilities from single- to multi-unit operations are presented.

The strategic management process provides a total framework for the management of hospitality firms. Thus, this text not only has applications in formal courses in strategic management and general management courses, it can also be utilized in many different types of formal training programs designed for the various levels of management in hospitality firms.

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Contents

1 *Overview of the Concept of Strategic Management*

Strategic management can be thought of as a consistent pattern of decisions made by an organization's management as it pursues its mission and objectives. These decisions include the types of products to offer and their appropriate markets, the allocation of resources to that end, the establishment of policies and procedures, and the control of, and responsibilities to, employees. This decision-making process is influenced by events occurring in the internal as well as external environments of the firm. Management's goal in employing the concept of strategic management is to match the resources of the firm to the threats and opportunities in the environment so as to achieve long-term viability for the firm (Hofer and Schendel 1978; Bracker 1980). It is the purpose of this text to demonstrate how an understanding of this concept can be applied and utilized by students and managers in the hospitality industry.

This concept of strategic management presently consists of four basic elements: environmental scanning, strategy formulation, strategy choice, and strategy implementation. To apply the strategic management concept in an organization there must be a synergy among all four components—a synergy that must be understood for the application to yield fruitful results for the organization. To clarify this synergy, we will begin by considering each element as a separate concept.

For management to appropriately direct the resources of the firm it must have a complete and thorough understanding of the activities occurring within its operating environment. This activity is most often referred to as **environmental scanning.** To be effective at this activity, management must correctly define the environment or operating domain in which it operates. This definition requires a broad perspective from management for it must accurately perceive its environment in order to make the right strategic choices. Management's perception of the environment is often shaped by its personal and impersonal sources of information. From this information, management must determine the threats and opportunities to the firm that exist in the environment. It is, in all cases, imperative for management to understand the dynamism and complexity of the environment in order to evaluate threats and opportunities as they exist.

Strategy formulation is a process often referred to as "strategic planning." It constitutes a number of steps designed to guide organization managers through a thought process that allows them to effectively determine the strengths and weaknesses of the firm. This is done so that correct decisions can be made regarding how to meet the threats and opportunities presented by the environment in which the organization functions. Strategy formulation helps to generate a mission statement that indicates what the organization is about, often answering the question "What business are we in?"

Guided by the mission statement and the analysis of the environmental threats and opportunities, organizations begin to develop a pattern of decision making that reflects these factors. In turn, these decisions yield objectives about product and market opportunities, resource allocation, and organization design that take into consideration the need to capitalize on strengths and improve on weaknesses. This part of the strategy formulation process then results in decisions concerning how to compete in the organization's market area. The choice of competitive methods (most organizations utilize several methods simultaneously) then begin to guide the actions of the firm. The combination of methods result in what is commonly referred to as the **choice** of the organization's strategy.

The choice of the organization's strategy is nothing less than the sum total of all its competitive methods. Examples of these methods include such activities as: extensive advertising, rigorous cost control, new product innovation, standardization of procedures, and searching for new market opportunities. When organizations use a number of these methods and they are consistent in that use, they are said to be employing a pattern of decision making that leads to an effective strategy. There is considerable interest by researchers and managers alike as to which strategies are most effective in assisting the organization reach its objectives. As might be imagined, everyone wants to have the best strategy. Unfortunately, even the best of strategies will fail if they are not implemented properly.

Strategy implementation requires the organization to be designed so that it has facilitating structures that permit success. These facilitating structures include: appropriate incentive and reward systems; comprehensive communication systems; effective decision-making activities; commitment and support of top management; an organizational culture that supports the implementation of strategies; procedures, rules, and regulations consistent with implementation needs; and the appropriate inclusion of environmental information into the strategy formulation process. These components must be carefully developed if strategy implementation is to be effective.

The activities of **environmental scanning, strategy formulation, decisions about what strategy to choose,** and **strategy implementation** often occur simultaneously and synergistically. It is essential for these activities to be coordinated and for attempts to be made to bring about their alignment with forces in the environment. Existing evidence at present suggests that if firms are able to reach this alignment among environment, strategy, and organizational design, they will be more successful in reaching their performance objectives than those that cannot (West and Olsen 1989; Dev and Olsen 1989).

The application of the concept of strategy in any organization represents a challenging and dynamic process. If done thoroughly and correctly it will enable the organization to compete effectively in its environment. To accomplish this, organization managers must understand the entire concept and the unique characteristics presented by different industry environments that affect application. This text is designed to accomplish such a result. It is structured to provide an overview of the four basic components of the concept of strategy and to identify and provide an overview of the unique characteristics and issues of the hospitality industry affecting strategy use.

STRATEGY IN THE SERVICE INDUSTRY

The service industry accounts for approximately 72 percent of the nation's gross national product and employs approximately 75 percent of the nation's labor force (Bureau of Economic Analysis 1988). Hundreds of thousands of businesses, not only across the United States but throughout the world as well, are part of this vast and often fragmented industry sector. Organizations, both profit and nonprofit, which operate in such diverse settings as banking, health care, and hospitality, have diverse needs, markets, and competitive situations that they must address on a daily basis. These organizations are in need of models to help them compete and maintain effectiveness. However, up until recently, they have had to rely solely upon models developed in the manufacturing sector.

What is presently considered to be the body of literature in strategic management has resulted from the considerable research and writings of managers and scholars who have looked at this subject in the context of the manufacturing industry. However, as noted by Davis (1983), "using industrial models to manage service-based corporations make as little sense as using farm models to run factories." Similarly, it must be recognized that while these efforts have contributed considerably to the understanding of the concept of strategy, it must be accepted that this knowledge cannot be applied directly to an industry, such as the hospitality industry, whose attributes are notably different. However, they should not be ignored. Whenever possible, elements of the body of knowledge in strategic management, although developed in this manufacturing context but with proven application, either through research or actual successful use in the industry, should be explored and understood. A growing contingent of managers and scholars agree and are encouraging, or have developed, management models reflective of the unique attributes of the services industry (Mills 1986; Levitt 1972; Heskitt 1986; Lovelock 1988). This perspective will be followed by this text.

What are these attributes that make the service industry different from manufacturing? They have become well known to scholars and practitioners and include descriptors such as: intangibility, simultaneity of production and consumption, customer participation in the production and delivery of the service, heterogeneity, and perishability (Mills, Chase, and Margulies 1983; Sasser, Olsen, and Wycoff 1978). Each will be described briefly below.

Intangibility is an attribute that refers to the fleeting nature of services—that is, they are difficult to describe, measure, or standardize. Services are experiences, as opposed to tangible products. As such, they are judged by the standards of the receiver of those services and these standards are subject to the perceptions of those receivers. A firm's efforts to tangibilize the service product often revolve around the culture of the organization. For example, ACCOR, the French hospitality conglomerate describes the service in its hotels as the "French Way." Similarly, Swissotel, the lodging unit of Swissair describes their hotels as the "Swiss Experience," and Hyatt refers to the "Hyatt Touch." In each case, these firms have tried to create a common set of service values for management and staff to facilitate the creation of a culture to follow in order to give some tangibility to an overall experience.

The concept of **simultaneous production and consumption** suggests that the service experience is produced and consumed at the same time. Continuing with the example in the above paragraph, when you check into a hotel operated by Hyatt, you are experiencing the first in a series of events that constitute the total "Hyatt Touch" service experience. This experience is not produced ahead of time and stored waiting for your arrival, only the physical assets are. You are usually unable to check the experience ahead of time since it cannot be inventoried and made available for your review. You receive it as it is produced.

The **customer** is a part of the service delivery process. He or she participates in the experience. In other words, the customer is involved as a co-producer in most service experiences. The customer must be present to receive the service. This participation by the customer makes it difficult for the service provider to have maximum control over the quality of the service experience. In order to limit the uncertainty associated with the customer's involvement, many organizations have tried to "engineer" out as much as possible the variability created by the customer's participation. For example, quick-service restaurant firms have developed menu-ordering devices with a touch-screen item selection to prevent a customer's possible indecisiveness—in choosing menu items— from slowing down the order-transaction process. Similarly, hotel firms are finding that installing "in room" checkout facilities has helped to improve the speed and level of service of this aspect of the service experience. In these examples, the customer is being relied upon to help produce the service while aiding the service provider to assure a more consistent and smooth flow to the entire service delivery process.

Service is said to be **heterogeneous** because the quality of the service experience is measured in the perception of the customer. Thus, it can almost never be the same for two different individuals. Nor is it often the same for the same person twice. It is too dependent upon the emotional ups and downs of both the customer and the service employee. Consequently, it is very difficult to standardize. This problem creates a considerable challenge for service firms that have many units throughout the organization each trying to provide consistent quality service. To illustrate, with Holiday Inns having over 150,000 rooms and McDonald's with over 12,000 units worldwide, it is easy to see how extremely difficult it is for both firms to guarantee equal levels of service quality on a continual basis. While they may be able to standardize the physical assets, it is very difficult to match that level of standardization for each customer transaction.

The service product is perishable. It is impossible to inventory services since they are produced and consumed simultaneously. It is difficult even to recover from a lost service opportunity. A guest who waited too long for a food or drink order to be taken, and the guest needing assistance with luggage handling and not finding a bellman in sight, are lost service opportunities. They will never become available again. Lost opportunities can accumulate quickly in service businesses.

As can be seen from these attribute descriptions, the problems associated with producing a service are quite different than those of manufacturing a product. These differences suggest that strategy in service businesses requires models relevant to the industry. Creation of these models will require the analysis of relationships already existing within the industry.

DEMAND, SUPPLY, AND TECHNOLOGY RELATIONSHIPS IN THE SERVICE INDUSTRIES

In order to further support the concept that manufacturing models cannot be directly applied to the service industries, it is important to understand the basic differences in the demand and supply relationships as well as the technology dissimilarities that exist. The attributes identified above create the underpinning needed to explain the supply and demand relationship and the technology used to produce services and to help to differentiate it from manufacturing.

In the manufacturing industry, the demand for durable consumer products such as housing, appliances, and personal items is reasonably constant and partially determined by the demographics existing in the market at the time. Thus, for manufacturers of these consumer products, it is a reasonable task to estimate how many units of a product will be sold. This is done by looking at previous demand, demographics, competing products, and other variables and then deciding how many units to manufacture in the coming planning period. It is also the case that these products will be produced in one of a few manufacturing facilities strategically located to take advantage of access to raw materials, transportation systems, and nearness to market. These products are likely to be produced in economical quantities to insure that there will be sufficient numbers to meet the total demand for the product. Items produced in excess of current demand are usually inventoried to buffer against unexpected changes in the demand curve.

These features of the demand curve for manufacturing industries are seldom present in the service industry. First, it is difficult to aggregate total demand in order to predict how many products will be sold by a service provider over a specific planning period. The nature of the demand curve in the service industry is local in nature. For a quick-service restaurant chain such as McDonald's, with over 12,000 units, there are over 12,000 separate demand curves. Second, the products produced by McDonald's do not come from a few manufacturing plants strategically located to take advantage of raw materials sources and transportation systems. Instead, McDonald's has over 12,000 manufacturing units that must be located near their markets. And they cannot store finished products for much longer than 30 minutes. The supply of individual products produced in each unit must be sold almost immediately. Thus, the demand curve can be said to be very temporal, fluctuating from hour to hour, day to day, week to week, and month to month. It is not influenced as much by macro features such as demographics but more by local economic conditions, local competition, and even weather. As can be seen here, the demand curve for service businesses exhibits few of the characteristics found in consumer durable goods businesses.

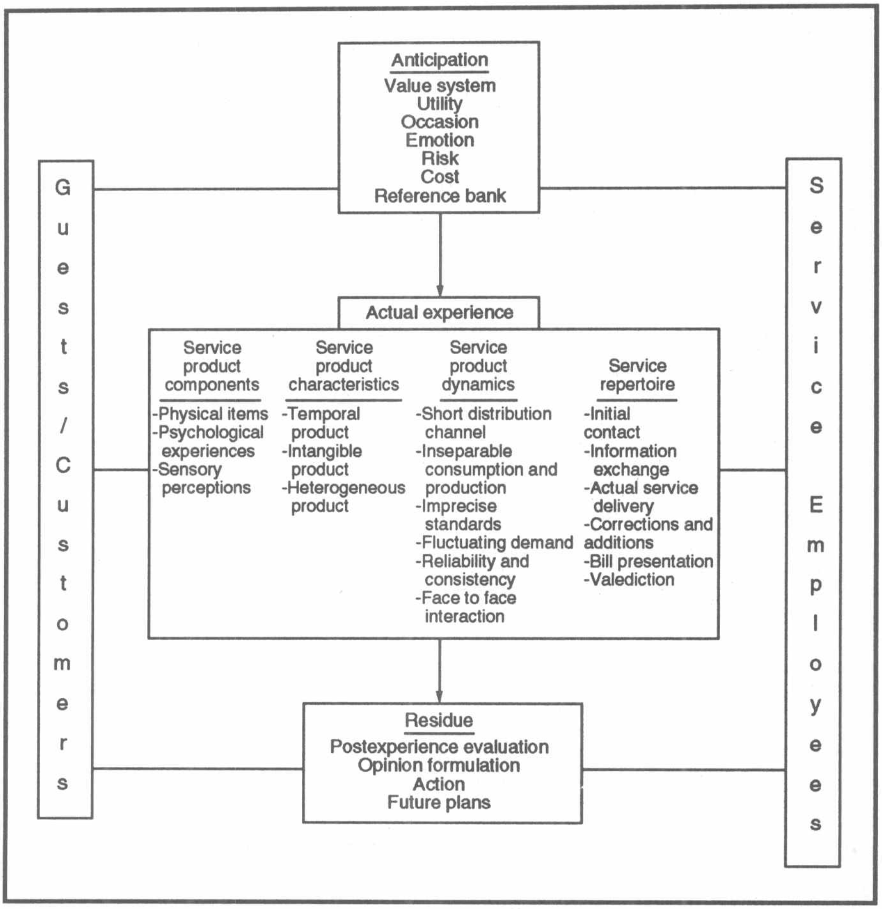
While the supply of manufactured goods can be produced in large quantities in a relatively few locations and inventoried for later sale, the supply of services originates from the physical unit where services are produced. Thus, as in the case of McDonald's, total supply is contingent upon how many actual restaurant units it has constructed throughout the world. While manufacturers can use various pricing tactics to reduce supply from inventory, it is not so easy for service firms to lower inventory. If the product of the service firm becomes dated, a simple price reduction alone will not solve the problem. Instead, the service provider may have to spend considerable dollars in improving the physical unit in which the service is provided or on improving the level of service and variety of goods offered. This is an important strategic variable for hospitality service firms, since they must spend considerable amounts on assets used to produce services that are often widely dispersed.

Another way of recognizing the need for different strategy models of service businesses is to consider the nature of the goods and services provided by an organization and the technology used to produce them (Lovelock 1980). In some cases, service firms provide only information as their output; in other cases, a mixture of goods and services is provided. In the hospitality industry, there is substantial variation from firm to firm in the degree of goods and services offered. The quick-service restaurant firm can be said to provide a greater proportion of physical product to service product, while the full-service elegant restaurant may have a more nearly complete balance between goods and services. Similar mixtures exist in the lodging industry as well. The specific nature of this goods/service mix creates a need for technologies that reflect service as well as goods.

In considering a service technology, the framework that has specific application to the hospitality industry is the service-delivery system. The service-delivery system is a concept used to describe how the customer and the service provider interact from the point when the customer first enters the service-delivery process. Figure 1-1 is a model developed to help describe the service-delivery system in the hospitality industry (Barrington and Olsen 1987). The model represents the complete chain of events from the point at which the customer begins to consider where to go to purchase the services of a hospitality firm to when the service has been completed and the customer has left with only memories remaining. The service-delivery system is the core of the model and calls for the integration of the concepts of service. The actual delivery system is outlined under the heading of "Service repertoire."

"Service repertoire" suggests that the customer/employee interaction follows a series of distinct steps. In each case, the service firm must decide what style and range of services will be available at each step (Riddle 1990). In addition, factors such as consistency of delivery, degree of attentiveness, ability to recover from conditions of high task and workflow uncertainty, and balanced capacity at each step of the process are all important factors in the design and management of the service delivery system. In addition to these more tangible elements of the system, it is also suggested by the

Figure 1.1
A model of the hospitality service transaction



model that the service employee possess a repertoire of possible responses to all potential uncertainties created by the customer in this delivery equation. This does not mean that a contingency response must be available for every possibility but certainly for those that have a high probability of occurrence. This calls for the employee to have a high degree of communication skill so that he or she can quickly process information communicated by the customer in order to provide an appropriate response when it is needed.

It is easy to see from this discussion that the technology employed in the service industry is focused upon the point of customer and employee interaction. It is, in its nature, a craft. This being the case, it requires the employee to exercise a great deal of self-management in order to insure that the level and quality of service is appropriate for the need. It suggests that this quality control is in the hands of the employee and thus not subject to a quality control inspector who, in a manufacturing setting, can review products before they are delivered to the customer. Because of the simultaneity of the production and consumption process, the only quality control inspector is the service employee in combination with the customer. If the product is substandard, it cannot be held back nor returned. It can only be remembered by the customer and used as the basis for the decision in the future regarding another purchase of this service. Thus, service technology is highly dependent upon employees and how well they are trained to provide high-quality service in a variety of settings.

The hospitality industry also has a significant investment in physical technology. Each restaurant or hotel has considerable capital tied up in assets designed to complement the service experience. These assets include the aesthetics of the facility plus the design of all the elements of the hospitality enterprise. From hotel bedrooms, meeting facilities, and front-office operations to kitchens and dining rooms, the actual technology of goods and services production must be considered when crafting the technology of the firm.

The nature of the service enterprise, and the hospitality enterprise in particular, suggest that each unit in each location is a small manufacturing operation that provides a varying range of goods and services. As such, the demand and supply relationships and the need to create service technologies, as well as manufacturing technologies, bring about the need for a specific understanding of the strategic management process in the hospitality industry.

THE IMPORTANCE OF STRATEGY IN THE HOSPITALITY INDUSTRY

The hospitality industry is a significant and distinctive economic force in the service economies of most western nations. It is distinctive for several reasons. First, it is both capital- and labor-intensive. Second, it is considered to be a fragmented industry with more than 600,000 food service establishments and 45,000 hotels in the United States alone. Third, the ownership of the assets deployed in this industry often do not belong to those who are managing them. Instead, real-estate investment groups, insurance companies and pension funds, along with international business venturists have expended considerable amounts of capital to acquire assets of the industry and have employed specialized hospitality companies to manage them. Fourth, a considerable amount of real estate across the globe is devoted to supporting all types of hospitality organizations. Fifth, innovative ideas for hotels and restaurants have little protection from being immediately copied by competition and thus are subject to competitive forces that create an environmental dynamism and uncertainty unique to this industry. Sixth, the industry has been a fertile field for those pursuing the American dream of owning your own business and exercising the entrepreneurial spirit. Seventh, it is part of the service-industry phenomenon with unique demand, supply, and technology relationships. It is these principal attributes that have made the study of strategic management an important subject for hospitality managers and students alike.

Is there a need for the study of strategy in the hospitality industry today? This question can, in part, be answered affirmatively by considering the industry characteristics above. Support for this suggestion also arises from the patterns of industry growth. While the industry has existed in one form or another for centuries, its present structure has developed over the past three decades. Well-known lodging chains and foodservice companies emerged in the 1960s as a result of the changing demographics of the United States. These changes were driven by the maturation and economic power of a workforce seeking new opportunities for travel, food, and entertainment. Well-known chains such as Holiday Inn and McDonald's resulted from needs in the marketplace for their types of products. These firms were founded by visionary entrepreneurs who were propelled by one principal goal, growth. Growth meant numbers of new units and subsequent profits. Not only did these entrepreneurs build huge enterprises during the 1960s and early 1970s, they inspired others to do the same.

The early success of such entrepreneurs brought about the inevitable interest of investors participating in the capital markets. Throughout the 1970s there was considerable activity by investors as they acquired ownership or control of these growing and profitable businesses. This activity was especially true in the foodservice segment where cash-rich firms from related industries sought to acquire growing hospitality organizations and use that acquisition to satisfy the demands of stockholders for more growth and higher returns. While lodging firms did not experience the same degree of acquisition interest as did food service, the top management of these organizations used capital generated through public offerings to grow their chains at a considerable pace. A favorable investment climate, facilitating tax laws, a "baby boom" generation flexing its buying power, and a good transportation system continued to fuel growth in this sector. With increasing interest from investors in the capital markets, it was inevitable that the management of these firms would have to respond to the demands of the investment community—which almost always translated into the need for more growth.

The 1980s represented a period of major change for the industry. The demand curve, while still increasing in the early half of the decade, began to level off. The rapid growth in the 1960s and 1970s resulted in the saturation of most primary markets by the close of the 1980s. Tax-law changes in 1986 removed incentives for investing in the lodging industry, which was probably a good thing. Otherwise, the overbuilding that went on throughout the 1980s might have continued. The investment climate changed as the high-flying hospitality firms of the 1970s turned into the poor performers of the 1980s.

As the industry faces the challenges of the 1990s, it does so with the least optimistic forecasts for the start of any decade. In the United States alone, there are over 600,000 foodservice operations that at the start of the decade were generating an estimated total of $248 billion in sales. These sales were mostly generated from small businesses where for example, in 1987, three out of four restaurants had sales of less than $500,000 and three out of four were single-unit operations (*Foodservice Industry Pocket Factbook* 1990). There are approximately 45,000 hotels with approximately

2.7 million hotel rooms generating estimated sales of $30 billion. As is the case in the foodservice industry, the majority of the hotels and motels in the country are individually owned and operated, with chains accounting for approximately one in four units (Schaffer 1987).

The revenue growth that generated all the growth in industry capacity over the past three decades is expected to be minimal over the next. The reason is that the earlier growth in demand resulted from the cresting of the maturation wave of the population segment known as the "baby boom" generation. This demographic group constitutes the largest proportion of the total United States population—a phenomenon replicated in many European nations. This cresting suggests that the demand curve will no longer rise in response to the increase in numbers of people entering the market. While slight increases may occur, due to increased travel by individuals from other countries, demand can be expected to remain stable.

However, the supply of restaurant seats and hotel rooms has been increasing (Dev 1989; Schaffer 1987). An understanding of basic economics would allow the interpretation that with supply on the increase and demand holding steady, competition would become more severe. This has been clearly pointed out in the following quote appearing in a recent article in *Business Week* (December 7, 1990, 92):

It's going to be eat or be eaten this year in the $246 billion foodservice industry. A restaurant shakeout triggered by debt-laden balance sheets, an excess of outlets, and stiff competition from food stores will accelerate in 1991.

Table 1.1

Chain Multi-Tiered Brand Marketing Strategies—Brand Names *(Table Continues on p. 11)*

Economy/Limited-Service			Middle Market	
Lower	*Middle*	*Upper*	*Limited Service*	*Full Service*
Motel 6	Red Roof Inn	Days Inn	Courtyard	Holiday Inn
Sleep Inn	Days Inn	Comfort Inn	Clubhouse Inn	Ramada Inn
Microtel Inn	Comfort Inn	Travelodge	Parksquare Inn	Sheraton
Regal 8	Travelodge	EconoLodge	Cresthil	Hilton
Sixpence Inn	Econo Lodge	La Quinta		Quality Inn
Scottish Inn	Super 8 Motels	Hampton Inn		Radisson
Alistar Inn	Knights Inn	Rodeway Inn		Viscount
E-Z 8 Motels	Budgetel Inn	Drury Inn		Days Hotel
Thrift Lodge	Rodeway Inn	Susse Chalet		Howard Johnson Lodge
	Shoneys Inn	Country Heath Inn		Park Inn
	Fairfield Inn	Shilo Inn		
	Exel Inn	Signature Inn		
	Arborgate Inn	Cross Country Inn		
	Best Inns	Dillon Inn		
	Luxury Budget	Country Hospitality Inn		
	Red Carpet	Lees Inn		
	Cricket Inn	Cypress Inn		
	Envoy Inn			
	Roadstar Inn			

Adapted from Simon, Crawford-Welch, 1990, unpublished doctoral dissertation, Virginia Polytechnic Institute and State University, Blacksburg, VA.