

Pearson New International Edition

**Strategic Management
in the Hospitality Industry**
Olsen West Tse
Third Edition

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Pearson Education Limited

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Strategic Management in the Hospitality Industry

Learning Objectives

Upon completion of this chapter you will:

1. Understand the concept of strategic management as applied to the service and hospitality industry.
2. Be able to describe the coalignment model and its application to the hospitality industry.
3. Appreciate that strategic management is a way of thinking, not a process to be performed annually and then forgotten for a year.
4. Understand the supply-and-demand and technology relationships that exist in the service industry and how they affect strategy.
5. Understand the unique elements, especially quality and value, of the service industry and how they affect strategy making.
6. Develop an appreciation of the forces driving change in the hospitality industry and what impact they will have on the manager of the future.
7. Understand the importance of leadership to the strategic management process.

Key Concepts

Strategic management

Coalignment model

Leadership and strategy

Strategy in the service industry

Supply-and-demand relationships in the service industry

Technology in the service industry
Managing quality service
Forces driving change in the hospitality industry
The value-adding manager

Chapter Purpose

This chapter will prepare you to understand our position that hospitality leaders of the future must be proactive in adapting their firm to the forces driving change in the environment to achieve sustainable competitive advantage over their competition. This chapter provides you with the theoretical underpinnings and the practical knowledge to compete successfully in a complex and dynamic environment. We begin the chapter with the concept of strategic management and the manner in which it has evolved in modern times. It must be recognized that in developing a strategy and a set of competitive initiatives, managers attempt to respond to the external forces of the environment. This principle is introduced by the coalignment model, which describes and explains how successful hospitality managers respond to the external environment and make strategic choices to attain sustainable competitive advantage. The importance of leadership in strategic management is discussed in the chapter to emphasize that strategy is all about leadership. In addition, you are introduced to the unique characteristics that differentiate the service sector from the manufacturing sector and require special strategic focus. We then explain the importance of strategic management in the hospitality industry as the chapter evolves from a discussion of general strategic principles to focus on the distinctive characteristics of the hospitality industry. Finally, the chapter concludes with a discussion of the challenges facing the hospitality manager of tomorrow.

Overview of the Concept of Strategic Management

The Concept of Strategy¹

The concept of “strategy” was first presented formally to the world by the Prussian general Carl von Clausewitz² while he was serving as the officer in charge of the Prussian Military Academy in the 1840s. He defined strategy as “The use of engagements for the object of the war.” However, his writings were not applied to the business environment of the time, for he lived and wrote at the end of the First Industrial Revolution, which covered Europe and America from 1750 until 1850. This period marked the end of cottage industries where products were made by craftsmen who mainly serviced the area in which they were located and the beginning of the introduction of machines and large-scale manufacturing that served markets beyond the local area. This period was characterized by intense competition among the industrial firms with international trade focused on a few commodities such as cotton. Most of the firms were small by today’s standards, and the markets were chaotic with no government oversight or regulation. It was during this period that Adam Smith published his thesis on the nature of market forces, which he conceived were guided by an “invisible hand” and did not allow individual firms to exert control on the market. As one would suppose if the leading economic

thinker of the period espoused the idea of market forces being guided by an invisible hand, managers would not worry about formal planning and strategy during the course of their battle for market share.

The Second Industrial Revolution, which began in the 1850s, endured until the early 1900s. It was born when the expansion of railroads enabled manufacturing firms to develop mass markets for their products. Items that were made in the garment district of New York City could be shipped by rail to markets in California much quicker and less expensively by rail than by ships, which had to sail around South America (before the construction of the Panama Canal in the early 1900s). Suddenly firms in the eastern United States had markets in the West and Midwest. Firms in England had markets all over Europe, and large quantities could be inexpensively shipped to distant markets. This prompted large-scale investments in production and distribution systems that forced managers to consider concepts such as economies of scale, vertical integration, and multidivisional organizations. The concept of strategy to shape competitive environments gained favor along with the idea of the “visible hand” of professional managers.

It was during this period that managers realized the need for a formal approach to corporate strategy. Two highly successful corporate leaders of this period—Alfred Sloan of General Motors and Chester Barnard of Atlantic Telephone and Telegraph (AT&T)—successfully built their firms to preeminence in the early 20th century, even though this was one of the most turbulent periods in U.S. business. Sloan was able to overcome Henry Ford’s dominance in the auto industry when he developed a strategy of offering the automobile buying public a variety of choices. Whereas Ford developed the low-cost strategy of mass producing one model and one color (black), Sloan differentiated his products with different brands, models, and colors. Ford’s famous quote of “People can have any color they want as long as it is black” did not ring true to a car-buying public whose choice of car turned from basic transportation to status.

Barnard,³ as CEO of AT&T in the 1930s, wrote that managers must pay close attention to “strategic factors” that depend on personal or organizational action. This was one of the first instances of the term *strategy* being introduced into the literature of business.

During World War II, businesses had to compete in an economy of scarce resources because most goods were manufactured to advance the massive war effort. During this period the emphasis was on attaining enough materials to remain in business if the firm was not supporting the military. There were some significant strategic insights gained by managers during the massive economic explosion of World War II. Formal strategic thinking was introduced to guide managerial decisions. The concept of the learning curve where production costs decrease by a constant percentage as quantity doubles was introduced during the mass production of aircraft in the years leading up to World War II and refined during the war. Solving the problems of “zero-sum games” (where there are insufficient resources and there must be a winner and a loser) and “non-zero-sum games” (where there are sufficient resources and there can be multiple winners) were confronted by industrial managers. It was during this time that Peter Drucker⁴ espoused that management is not passive and that managers must take actions to bring about desired results. Thus was introduced the rationale for business strategy: *By consciously using formal planning, a company can exert some positive control over market forces.*

At the conclusion of World War II, the military-industrial complex was fully developed and in position to rebuild the world, which had been ravaged by global conflict. In such a scenario, demand exceeded supply, which created an environment in which there was no need for strategy because everything a firm manufactured it could sell somewhere at a profit. This was true for civilians but not so for the military. After the war the government had no need for such a powerful military and began to dismantle the massive war machine. This downsizing created an interservice competition for scarce resources and led to the U.S. Navy developing the concept of “distinctive competence.” Under this concept, the U.S. Army became manpower-centered with large divisions of soldiers while the U.S. Navy became machine-centered, engineering-based, with sophisticated weapons platforms able to reach any theater of operations. The concept of distinctive competence soon found its way into business strategy as firms fought for sustainable competitive advantage.

Academic Underpinnings

The Harvard Business School was founded in 1908 and was one of the first schools to suggest that managers should have more than just a functional focus. In 1912 the faculty introduced a course on business policy. This course integrated the functional areas for a broader perspective of strategic problems faced by corporate managers of the time. In the 1950s they began examining the basis on which one company can compete with another in a specific industry. During this period they also examined the benefit of the firm having a defined set of goals to guide the decisions of top management.

In the 1960s Harvard’s Business School faculty member Kenneth Andrews,⁵ in his book *Strategy Framework*, introduced business managers to SWOT analysis. This concept examined the firm’s strengths and weakness versus the opportunities and threats (risks) it faced in the marketplace. One problem with this framework was that the SWOT analysis did not define a firm’s distinctive competence.

Following the U.S. Navy’s introduction of distinctive competence, business scholars began to explore the concept’s applicability for use in the development of business strategy. They found that distinctive competence was important but could present significant problems because some strategic decisions are long term and may outlast some distinctive competencies, thereby enhancing risk. It became important to recognize which distinctive competencies were enduring and unchanging over the long term and which responded to changes in the marketplace and other environmental pressures. Ansoff⁶ wrote that managers of the firm should ask whether new products have a common thread with existing products. This common thread could be either an existing market or the mission of the company. He warned that a specific type of customer was not a common thread because customer needs changed over time.

Strategy Consultants

The 1960s and 1970s ushered in the rise of strategy consultants. These consulting firms attempted to discover why one competitor is able to outperform others in their market. The early pioneer among these consultants was the Boston Consulting Group (BCG), which posited that good strategy must be based on logic. They also held that the experience curve explained price and competitive behavior in extremely fast-growing industry segments, where total costs could decline 20% to 30% due to economies of scale,

organizational learning, and technology. Other researchers then began to question what happens to a competitor when another competitor enters the segment late and benefits from the experience curve.

To answer these and other questions, BCG introduced the concept of portfolio analysis. Under this analysis after experience curves are drawn, diversified units are analyzed for potential investment and divestment. Strategic managers were expected to balance “cash cows” with “stars” and allocate more resources to “question marks” while divesting “dogs.” By the end of the 1970s, every major consulting firm used some type of portfolio analysis.

Also in the 1970s, McKinsey and Company introduced the idea of “strategic business units.” These were natural business units that were unique in the diversified firm. It allowed a firm such as General Electric (GE) to compete in many unrelated industries from turbines to home appliances to medical equipment. With GE, McKinsey introduced the concept of “industry attractiveness.” The top management of GE did not want to take action based on two performance measures as characterized by portfolio analysis. They worked with McKinsey to develop a matrix that used 12 measures to screen an industry for attractiveness and 12 more for competitive positioning.

Unfortunately, each of these concepts and strategic tools was found to possess significant weaknesses. In their pursuit of strategic dominance through the experience curve, managers found that their focus on a cost reduction strategy reduced their ability for innovative change and response to competitors. This was readily seen by the success of Sloan’s (GM) innovation over Ford’s low-cost focus. Portfolio analysis was found to leave businesses vulnerable to unexpected moves by new competitors entering the market. Also its focus was on minimizing risk versus investing in new opportunities requiring long-term commitment. A strength of portfolio analysis is that it did focus management’s attention on industry attractiveness and competitive advantage. Bain,⁷ in a study of the return on equity of various industries, found that some industries seemed to be inherently much more profitable or attractive than others. Porter⁸ introduced his “five forces” in an attempt to understand the attractiveness of an industry.

In the mid-1990s Brandenburger and Nalebuff⁹ introduced the concept of “value creation” as a strategic tool. Value creation was a process for creating value in the marketplace that would provide the firm with a competitive advantage over its competition. The idea was that there were four constituents in the marketplace: customers; suppliers; competitors; and complementors. The idea was for the managers of the firm to discover these complementors—firms from which the firm’s customers buy complementary products and services—and form strategic alliances and partnerships with them. The idea of Disney partnering with rental car companies and airlines to market the destination is an example of value creation through complementors.

As we proceed into the globalization era of the 21st century, one thing is certain: Successful strategies and sustainable competitive advantage are moving targets. Managers and researchers must be constantly alert to changing market decisions and competitor initiatives. We present this text as a guide for hospitality managers as they fight for competitive advantage on a global stage. In the rest of this chapter we introduce the coalignment model for strategic analysis and implementation in the hospitality industry. We examine the impact of leadership on strategy, strategy and value creation, strategy in the service industry, and finally, the forces driving change in the global hospitality industry.

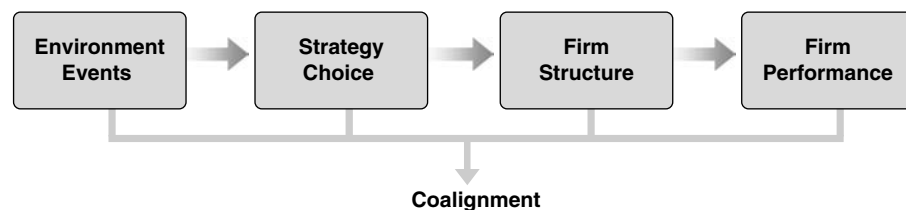
The Coalignment Model

The authors and their colleagues have conducted extensive research on firms in the hospitality industry and their attempt to gain sustainable competitive advantage. As a result of our studies, we posit that the concept of strategic management refers to the ability of the management of the firm to properly align the firm with the forces driving change in the environment in which the firm competes. This alignment requires that management invests in competitive methods that yield the greatest overall financial value to the firm. To accomplish this, managers must create a business structure that consistently allocates resources to those competitive methods that provide the best value over time. If the firm is able to identify opportunities that exist in the forces driving change, identify competitive methods that enable the firm to gain competitive advantage through these opportunities, and allocate sufficient financial resources to the competitive methods that will create the greatest value, the financial results desired by the owners and investors have a much greater chance of being achieved. This relationship is referred to as the *coalignment model*. Exhibit 1 is a simplified model of this relationship.

As the directions of the arrows indicate in Exhibit 1, the business environment of the firm is where the concept of strategic management begins. The business environment is defined as the domain in which the customers, competitors, suppliers, and regulators of a firm exist in a context of rapid change and increasing complexity in the broad global environment. In this context, opportunities and threats exist that are both immediate and long term. Management's challenge is to identify the forces that will drive change, and, within those forces, to seek opportunities that will add value to the firm in both the short and long term. Exhibit 2 illustrates the basic elements of the concept of the environment in relationship to the coalignment model.

Once management determines what it considers to be the best opportunities for the future, it must then invest in competitive methods that will match those opportunities. Competitive methods in the hospitality industry are made of portfolios of products and services designed to bring the unique resources and capabilities of the firm together to achieve advantage in the marketplace. A firm's overall strategy is the reflection of all of the competitive methods in which management has invested. Each competitive method must be viewed by the firm as an important value-adding dimension of the enterprise's overall strategy. Management must be constantly aware of the fact that each competitive method, with its portfolio of products and services, has an increasingly shorter effective lifespan in the context of today's dynamic business environment. Thus, if the firm's management is to be successful long term, it must regularly scan the

EXHIBIT 1 Coalignment Model



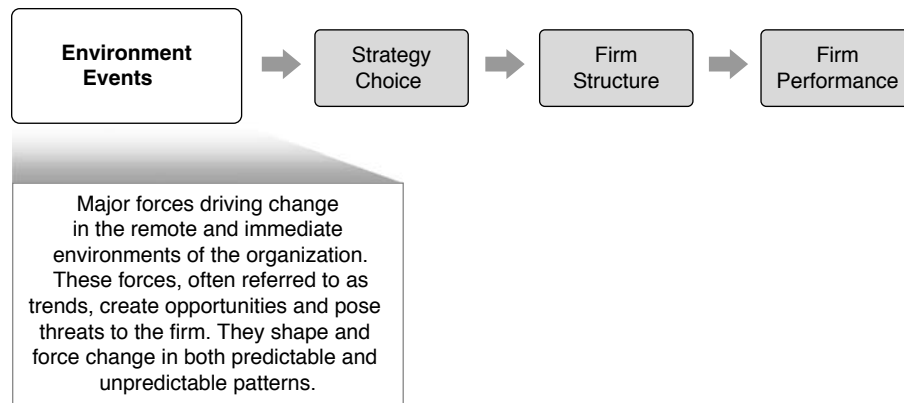


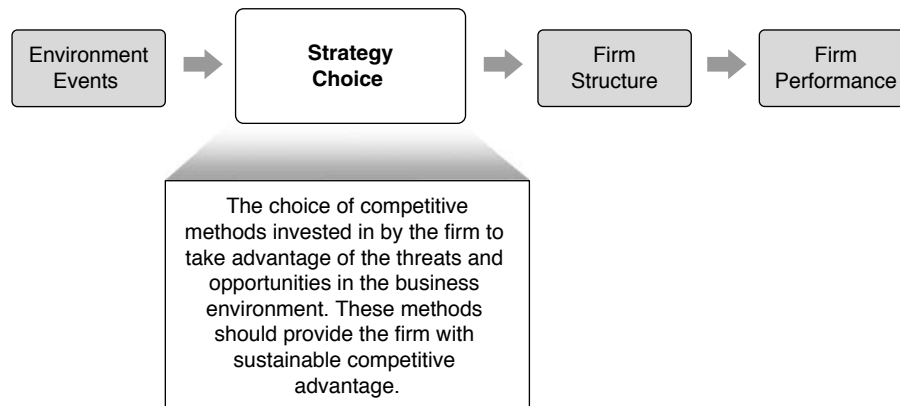
EXHIBIT 2 Coalignment Model—Environment Events

business environment to ensure that they are able to identify and adapt to the changes that are constantly occurring. Exhibit 3 provides a closer look at this important element of the coalignment model: strategy choice.

Subsequent to management's identification of opportunities and investment in what they consider to be the best value-adding competitive methods, they consistently allocate sufficient resources to ensure their successful implementation. This activity is referred to in the model as *firm structure*. Structure is defined as the methods by which the managers of the organization choose to group tasks and activities together to accomplish their objectives. It refers to how organizations are governed and responsibilities defined by the resource allocation process.

The resource allocation process requires managers to identify the core resources and capabilities that are essential to the successful implementation and execution of each competitive method. In addition to this important activity, management must create an internal environment that supports these core resources and capabilities. This

EXHIBIT 3 Coalignment Model—Strategy Choice



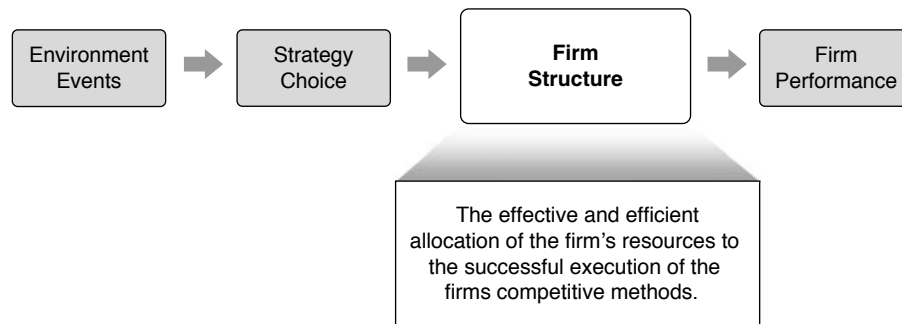


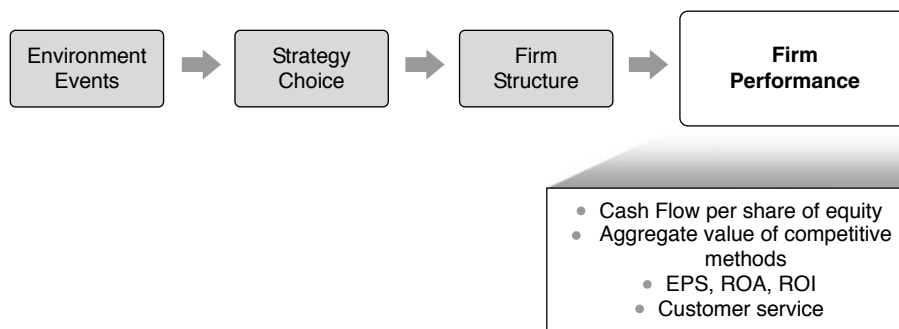
EXHIBIT 4 Coalignment Model—Firm Structure

internal environment consists of the appropriate structure, processes, and culture. The internal environment must be in alignment if it is to support the correct allocation of resources to the best value-producing competitive methods. Exhibit 4 provides a more detailed examination of this component of the model.

As the coalignment model suggests in Exhibit 1, if management is able to identify the correct opportunities in its competitive environment, invest in the best value-adding competitive methods, and create a structure that supports effective implementation and execution of these methods, they will achieve the desired level of financial performance expected by investors. The measure of financial performance most commonly utilized today is cash flow per share of owner's/investor's equity. It must be recognized that this is a future-oriented measure of cash flow. Therefore management must seek to maximize future value. To do this, they must estimate the cash flows to be generated by each competitive method over its expected useful life.

Although other measures of financial performance have been used for decades, they have been only able to report on past performance. They have no ability to reflect future performance and are therefore of no use to managers who must make resource allocation decisions based on their judgment of which competitive methods will yield the best value in the future. This is why it is so important for managers to concentrate on scanning the business environment for future opportunities. This future-based orientation is the basis of the coalignment model. Exhibit 5 provides

EXHIBIT 5 Coalignment Model—Firm Performance



an illustration of the firm performance component of the model and includes both the historical measures of performance and the future-oriented measure of cash flow per share.

Note that in today's business environment there are many different measures of firm performance other than financial. It is our assumption that no matter what other arguments are presented for other performance measures, the long-term survival of any business organization will depend on management's ability to generate value for ownership. If they cannot successfully accomplish this, the organization will cease to exist. Moreover, the value generated must exceed the cost of capital invested to create the value. If it does not, the owners will place their funds in more attractive investments. This is a simple, basic rule of business today.

Our second assumption in this regard is that a firm will only be able to accomplish this value-adding objective if it is meeting the demands of its customers both today and in the future. Thus performance measures such as customer satisfaction can be of great value in evaluating performance; however, the firm could not be adding value unless the customer was satisfied. Therefore these other measures are useful in assessing how well a strategy is being implemented through proper resource allocation and are good diagnostic tools. However, the ultimate test remains how value is being added today and into the future.

Strategy Is a Way of Thinking

Achieving coalignment does not result from a single onetime strategic planning activity. Management must view strategic management as a way of thinking and not an annual process. It must be imbedded in every decision, every activity, and every service encounter with the customer. It must be the fabric woven into every management decision regarding the acquisition and transformation of all resources used by the firm to achieve its objectives. Strategy making must be future oriented, dynamic, and interactive at all levels of the firm. This is because planning is the easiest component of strategic management. It is the implementation and the realization of the strategy that demands the time, energy, and commitment from all members of the firm if strategic objectives are to be achieved.

Leadership and Strategy: Inseparable Concepts

In dynamic and uncertain times, people need leaders not only to guide them in their day-to-day life but to help them see what they can become in the future.¹⁰ There have been many failings in leadership in the early 21st century. Simply ask the employees of Tyco or Enron or any other of the disgraced multinational firms whose tomorrows were ruined when the top management team neglected or failed to recognize their duty of leadership.

Peter Drucker, in his book *Leader of the Future*,¹¹ holds that good leadership must be learned and that effective leaders understand four very important truths:

1. *Leaders have followers:* Without followers there is no leader. Effective leaders must communicate a message that resonates with people; in other words they have a vision that people understand and accept as theirs. Leadership is about attaining goals. If no one clearly understands the goals, there is no need for leadership.

Ritz-Carlton is very clear about their mission: “*Ladies and Gentlemen Serving Ladies and Gentlemen.*” This vision is simple and communicated daily through gatherings that all employees must attend prior to commencing their tasks. How effective are the leaders of Ritz-Carlton in communicating their vision? In a survey conducted by J.D. Powers and Associates, 96% of employees surveyed were able to identify the mission of the company successfully. Once the vision is clarified and shared, the leader can focus on serving and being responsive to the needs of the people. The greatest leaders have motivated others by energizing those around them with their vision.

2. *Popularity is not leadership:* Results are what define effective leaders. Their followers do the right thing. This is essential in the hospitality industry where customers purchase goods and services on promise. If hospitality employees don't do the “*right thing*” in the countless daily service interactions with the firm's customers, the organization will not be able to compete successfully regardless of the strategy implemented. Effective leaders may not be loved, but they will motivate their followers to succeed.
3. *Leaders are highly visible:* They set the example. Jonathan Tisch, chairman and CEO of Loew's Hotels and Resorts, requires that he and his top management spend time each year working in all of the hourly positions in the company. This sets the example to the employees that all jobs and the people who hold them are important and that management understands the hardships and rewards of each position. Tisch is very involved in leading what he considers to be the family business. Growing up he held most of the positions in the company, and he thoroughly understands its values. He is the public exhibit. Appearing on popular television shows and being interviewed by the press, he defines the values and goals of Loew's Hotels and Resorts for not only the general public but also his employees.
4. *Leadership is responsibility:* In the end the leader is judged by the success or failure of the organization. When leaders stop realizing that they are responsible for all of the actions of the organization, it is the beginning of the end. As Ken Blanchard and Jesse Stoner note,¹² when leaders forget their responsibility, the organization soon evolves into a self-serving bureaucracy where all of the money, status, recognition, and power move up the hierarchy away from the people serving the customer. Leadership soon begins to cease serving the employees and the customers and begins serving the leaders with the ensuing degradation of the organization's purpose and goals.

Leadership Defined in a Strategic Context

Bardwick,¹³ in his essay “Peacetime Management and Wartime Leadership,” discusses the conflict between those who want to lead others through major changes as though it was wartime and those who refuse to become followers because they are convinced it is peacetime. That is the challenge of today's strategic manager. If one is to define peacetime as a state of constancy, then managers in the hospitality industry are in a state of war. To harken back to the origin of strategy, hospitality leaders must lead their organizations in an environmental state of constant change with intense competition from well-organized competitors (wartime leadership). Among other drivers of

change, globalization has destroyed any peacetime illusions. Unfortunately, peacetime managers are comfortable in a stable environment that is highly predictable, an environment in which few hospitality firms exist. Therefore, to be successful, strategic leaders must convince peacetime managers in the hospitality industry to become wartime leaders.

What are wartime leaders? They are leaders who embrace major change because they are able to see the opportunities presented in a dynamic environment. Strategic leaders understand that to be successful they must:

1. *Define the business of the business:* They decide where and how the firm will compete. Strategic leaders define the firm's competitive domain;
2. *Create a winning strategy:* They accurately designate what the firm will do better than any other firm in order to achieve competitive advantage. In order to accomplish this they determine and develop the distinctive competencies and competitive methods necessary to successfully implement their strategy in the industry segment in which the firm competes. These are the most important components of successful strategy creation;
3. *Communicate effectively:* Strategic leaders limit the number of their communications and they simplify the message. They determine what people need to know and then they state it simply and repetitiously. This is reflected in the previously mentioned Ritz-Carlton Hotel company's simple yet effective message: "Ladies and Gentlemen serving Ladies and Gentlemen" and the daily transmission of it to their employees;
4. *Behave with integrity:* The best leaders are transparent and live what they espouse. They do not manipulate people. They are also honest with themselves; they understand their strengths and weaknesses and work within their capability. Strategic leaders are predictable in their behavior and personal life because they follow their own publicly held truths.
5. *Respect others:* Strategic leaders are comfortable receiving input from those around them. They encourage debate among the leadership team and remember that hearing others' views is a sign of respect. Most importantly, they understand when to make a decision and understand the importance of the environment when making decisions;
6. *Act:* When conditions are ambiguous and decisions are difficult, they decide and act. In today's dynamic, complex, and uncertain environment, strategic leaders must be decisive and action oriented. The environment offers opportunities to those who understand the forces driving change and the distinctive competencies necessary to implement the strategies to take advantage of the opportunities available. As we stated earlier, leadership is based on action and achieving goals. Today's strategic leader must clearly understand this.

Strategic leaders understand that leadership is, above all else, emotional. It falls to them to create a passionate commitment in other people. It is up to them to develop the "want-to" attitude in their followers. They remember that their grand strategy must be implemented by people who believe in them and their message. Strategic leaders know that without the commitment of their followers, no matter how good their strategy, they will fail.

The Leader of Tomorrow

Many authors and researchers hold the idea that the question of what the leader of the future should know and understand is not new. It is one of the oldest questions of history. People have been striving to understand the critical aspects of leadership since the days of Alexander the Great, arguably the world's greatest leader. Alexander¹⁴ changed the history of civilization and shaped the present world. He accomplished greater deeds than any other leader in history. Today, over two thousand years after his death, business leaders are still using his ideas as a guide.

We must remember that leadership is about people—it is personal. Although people respond to different stimuli over the years, the secret of the effective leader is to understand what Alexander did:

1. *Have a compelling vision that speaks to the collective imagination*—followers respond to a leader who possesses a vision, is totally focused on it, and is able to clearly communicate it to them.
2. *Develop a creative strategy that is responsive to enemy strengths*—business strategy requires that effective leaders understand themselves, their organization, the environment, and the competition. With this knowledge, the leader is capable of responding innovatively to the competition to achieve competitive advantage.
3. *Create a well-rounded executive team*—strategy must be implemented and supported by the top management team. Leadership is a team function. The best team with the best leader wins.
4. *Model excellence*—it is not necessary to reinvent everything about the organization. Effective leaders recognize excellence in others and work to develop it in themselves and their organization.
5. *Encourage innovation*—the future will not be the same as today or yesterday. Effective leaders recognize that innovation is a requirement for success and it can come from anywhere in the organization.
6. *Manage symbols to foster group identification*—people like to belong to groups, especially groups that reflect their personal values. Awards, benefits, actions of the leadership demonstrate the values of the organization to the followers and either help in developing a group identity or destroying it.
7. *Encourage and support followers*—effective leaders realize that without dedicated followers they are doomed to fail. They take time to recognize the accomplishments of others positively, and they pay attention to the needs of their followers.
8. *Invest in training and development*—without a well-trained organization, no leader will be able to compete in tomorrow's dynamic environment.
9. *Consolidate gains*—understand when it is time to stop and strengthen the organization. Too many leaders continue to expand the organization at a time when they possess insufficient support services. The failure to consolidate gains has been the demise of many organizations as well as armies.
10. *Plan for succession*—the effective leader recognizes that the organization will outlast them. They groom followers to succeed them.
11. *Create mechanisms for effective organizational governance*—leaders have the responsibility to put proper mechanisms of organizational governance in place. There must be a system of checks and balances.

The leadership demands of the future will not change that dramatically from today or the past. The history of the world has always been dynamic in the time of great leaders. If we examine the past we will find it is the environment that defines the leader regardless of the time and place. We can safely say that leadership depends on the particular situation. Effective leaders of tomorrow will be required to supply energy, vision, and a strong personal conviction to their organization. They will be the role model for their followers, building an organization with similar-minded people. Effective leaders will be capable of changing the organization to meet the requirements of the environment. The leaders of the future must prepare themselves to lead effectively. Leadership is a learned art that requires dedication and intelligence. In the end it all comes down to vision—that is the difference between the ordinary and the extraordinary.

Strategy in the Service Industry

Manufacturing Industry versus Service Industry

The service industry continues to overwhelmingly dominate the U.S. gross product and has the largest percentage of the labor force. Increasingly, manufacturing companies are cutting costs by shipping jobs to low-wage countries such as China, Russia, and India. India is becoming increasingly important because its universities graduate more English-speaking scientists, engineers, and technicians than the rest of the world combined.¹⁵ There are few industries where outsourcing will not be felt, but hospitality is an industry that appears to be safe from this trend. It is difficult to outsource a beach-front hotel or a golf course. Hundreds of thousands of businesses throughout the world are part of the vast service industry sector. Organizations, both for profit and nonprofit, that operate in such diverse settings as financial services, health care, and hospitality have different needs, markets, and competitive situations they must address daily. All of these organizations are in need of models to help them compete and maintain effectiveness. However, until recently, they have had to rely solely on models developed in the manufacturing sector to guide their competitive decisions.

What is presently considered to be the body of literature in strategic management has resulted from considerable research and writing of managers and scholars who have examined the concept in the context of manufacturing firms. It has become obvious that using these industrial models to manage service firms makes as little sense as using agricultural models to run multinational corporations. Similarly, it must be recognized that although these research 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 hospitality whose attributes are notably different. Nonetheless, they should not be ignored. Whenever possible, elements of the body of knowledge in strategic management, although developed in a manufacturing context, should be explored and understood. A growing contingent of managers and scholars agree and are encouraging, or have developed, management models that reflect the unique attributes of the service industry but that have been built on the body of knowledge developed from the manufacturing sector.

What are the attributes that distinguish the service industry from manufacturing? They have become well known to scholars and practitioners as intangibility, simultaneity of production and consumption, customer participation in the production and delivery of the service, heterogeneity, and perishability. Each is described next.

Intangibility refers to the immaterial nature of service—that is, it is difficult to describe, measure, or standardize. Services are experienced and customers have difficulty readily appraising their value and nature. They are judged by the standards of the receiver, and these standards are subject to their perceptions. Management's efforts to make the service product tangible often revolve around the culture of the organization. For example, Outback Steakhouse, a leading casual restaurant chain, emphasizes “No Rules, Just Right”; Swissotel describes their hotels as the “Swiss Experience.” Hyatt Hotels in earlier advertising campaigns referred to the “Hyatt Touch.” In each case, these firms attempted to create a tangible concept of their service product to their customers. They also communicated a common set of service values for management and staff to facilitate the creation of a “culture” that will provide some tangibility of the overall experience to their customers.

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 preceding 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 of the property are. Customers are unable to investigate the experience ahead of time. They receive and experience it as it is produced. Errors in service are readily apparent and require immediate recovery. This is not the same with a manufactured product whose manufacturing defects were repaired prior to delivery and are unknown to the customer.

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 coproducer* in most service experiences in the hospitality industry and must be present to receive it. This participation of the customer in the service delivery process makes it difficult for the service provider to exert maximum control over the quality of the service experience. 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 know that installing “in-room” checkout facilities has helped improve the speed and level of service of this aspect of the service experience. In these examples, the customer is being relied on 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. It is also complex because it is usually included in a portfolio of products and services that come together in different bundles for each 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 on 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 Marriott International approaching 3,000 hotels and McDonald's over 30,000 units worldwide, it is easy to see how extremely difficult it is for both firms to guarantee equal levels of service quality continually in each and every unit every day. Although 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 because 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 or 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 you can see from these attribute descriptions, the problems associated with producing a service can be quite different than those of manufacturing a product. These differences suggest that strategy in service businesses require models relevant to the industry. Creation of these models will require a thorough analysis and understanding of the relationships already existing within the industry.

Demand, Supply, and Technology Relationships in the Service Industry

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 supply-and-demand relationships as well as the technology dissimilarities that exist between manufacturing and service enterprises. The attributes of service firms identified earlier create the underpinning needed to explain the supply-and-demand relationship and the technology used to produce services and to help differentiate them from manufacturing enterprises.

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, changing 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 ensure there will be sufficient numbers to meet the total demand. Items produced in excess of current demand are usually inventoried to buffer against unexpected changes in the demand curve and/or sold later. Seldom are these inventory items considered highly perishable.

These features of the demand curve for manufacturing industries are seldom present in the service industry. There are several reasons for this. First, it is difficult to aggregate total demand 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. For a quick-service restaurant chain such as McDonald's, with over 30,000 units, there are over 30,000 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 30,000 separate manufacturing units that must be located near their markets. And they cannot store finished products for much longer than 15 minutes before they become unacceptable to the customer. 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 contains characteristics not similarly found in the large-scale consumer durable goods businesses.

The supply of manufactured goods can be somewhat homogeneous and produced in large quantities in relatively few locations and inventoried for later sale. Thus supply can be produced to meet total aggregate demand. This is not the case in the service industry where the supply of services can be very heterogeneous and originates from a few—to potentially thousands of—physical units. This is because, as stated earlier, services are produced and consumed at the same time. Therefore, the supply of all services must be produced at the point of customer contact. This must be done by service personnel who face, in some instances, a fair amount of task complexity in delivering exactly the level of service the customer wants.

Another point of difference between manufacturing and service has to do with the management of inventory. As stated earlier, the total supply of products produced by manufacturers can be inventoried if it is not sold immediately. Inventory is also created to buffer firms from wide swings in the demand curve of the business. If finished products remain too long in inventory, management can alter their prices to reduce inventory. As pointed out, the products and services produced by service firms such as those in the hospitality industry have little to no inventory life. If a restaurant does not fill its supply of seats on any given day it can never sell them again. The same can be said for hotel rooms, airline seats, and other forms of service industry inventory.

In other words, this inventory is highly perishable with almost no shelf life. The same can be true of the physical products sold by hospitality enterprises. Fresh products have only a limited life, with some products like french fries and hamburgers having a life of relatively few minutes. Thus service firms have unique challenges in determining how much of any product or service to produce. This problem is not easily tackled in a consumer marketplace where consumer demands are changing all the time.

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. 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, whereas 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-to-service mix creates a need for technologies that reflect services as well as goods. This relationship is illustrated in Exhibit 6.

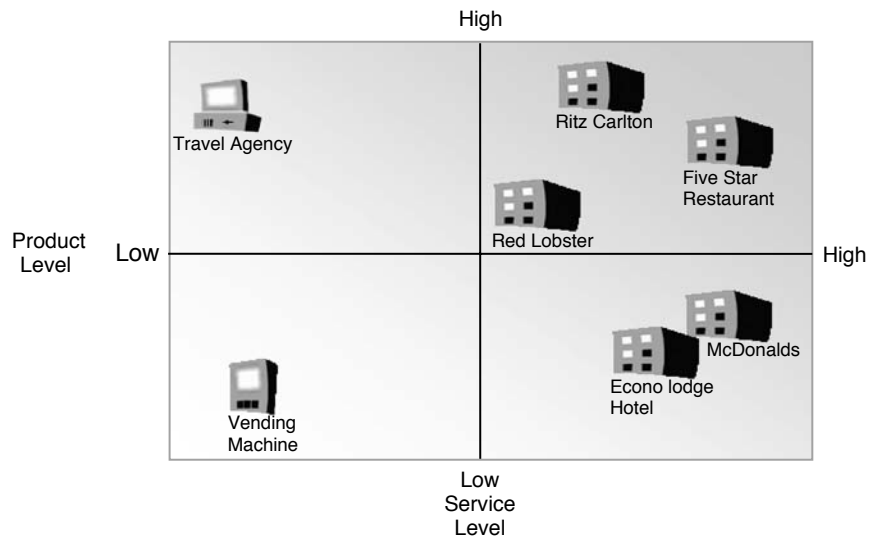


EXHIBIT 6 The Product Service Continuum

As indicated by the various shapes in the exhibit, some firms offer low levels of both products and services. A typical vending machine occurring in the lower left quadrant is an example of such a case. It offers only a limited number of products such as beverages or snacks and no personal service. In contrast, a full-service restaurant or hotel would offer high levels of products and services as indicated by the symbols in the upper-right-hand quadrant. A travel agent offers almost no product but does provide only services, whereas quick-service restaurants and limited service hotels are heavy on product but limited on services provided. What this graphic suggests is that a firm will require both manufacturing and service technologies with a number of different types of processes to meet customer demands for products and services. The firms that offer high levels of both are very capital and labor intensive and require an extensive array of competencies and resources to meet these demands. Creating strategies and implementing them for these firms is a very complex and demanding job. For firms appearing in other quadrants, this need changes depending on the levels of products and services provided. Regardless of level of services, the firm must invest in technologies to produce the desired output. Although it is less problematic to invest in processes and machines to produce goods, it is more challenging to invest in processes and machines to produce quality service, for all the reasons provided thus far.

As you can see from the forgoing discussion, the service industry has some unique strategy issues that require a different approach to strategy than that outlined in the classic literature on the subject. The uniqueness centers on the fact that each service encounter the employee has with a customer represents a complete manufacturing process where the product is intangible, heterogeneous, and the results difficult to measure. The outcome is based on the perceptual feeling of both the producer and the consumer of the final outcome. The nature of this encounter is more a craft, based on know-how, feelings, and emotions. This being the case, it requires the employee to

exercise a great deal of self-management to ensure 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 or 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 on employees and how well they are trained to provide high-quality service in a variety of settings.

The nature of the service enterprise and the hospitality enterprise, in particular, suggests 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 goods producing technologies, bring about the requirement 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 and is growing fast in the developing world. 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 900,000 food service establishments and 50,000 hotels in the United States alone. Third, the ownership of the assets deployed in this industry often does not belong to those who are managing them. Instead, real estate investment groups, private equity firms, hedge funds, 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 readers 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 just described. Support for this suggestion also arises from the patterns of industry growth. Although 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. The maturation and economic power of a workforce seeking new opportunities for travel, food, and entertainment drove these changes. 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—which 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. Today, this era is over. These once cash-rich firms divested themselves of their once proud acquisitions. General Mills Corporation spun off its restaurants into a separate company—Darden. PepsiCo, the parent of such chains as Pizza Hut, KFC, and Taco Bell did the same, creating Tricon Global, which morphed into Yum! The reasons are many, but the most significant one is the inability of these chains to produce the value necessary for these parent companies. This strategy seems to have benefited the shareholders of both firms because both Darden and Yum! are competing successfully in a mature, highly competitive market. Today, the cycle of investing in hospitality companies has now been taken over by private equity firms and hedge funds with recent acquisitions of Hilton Hotels and resort developer operator Intrawest. Outback Steakhouses and other restaurant chains are now targets by this group of investors. While the investment landscape has changed, the demands for value maximization have not.

The challenge continues to be to develop strategies that will interest both customers and investors in their future value. Over the next five to ten years, some of the key drivers of the restaurant industry will include the increased time demand on the American family, improving domestic economy, and increasing capital investment on the part of franchisers and franchisees.¹⁶ Today, approximately 46% of the consumer's food dollar is spent on food away from home. The National Restaurant Association estimates that this trend will reach 53% by 2010—a 14% increase in sales—or \$40 billion over 2005.¹⁷ As more and more of the food dollar in the United States is spent outside of the home, it becomes important to define the typical restaurant customer because the profile is that of a resident of the country. Therefore, if managers are to be successful they must understand the forces driving change in the marketplace because these for the most part impact all members of society.

Although lodging firms did not experience the same degree of acquisition interest as did foodservice enterprises, 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. For the decades of the 1960s, 1970s, and early 1980s, one could almost do no wrong in this industry. Little strategy was necessary: Just find a good location and build. 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. This is the primary challenge facing lodging executives today.

The 1980s represented a period of major change for the industry. The demand curve, although 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 good because supply was outpacing demand. 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.

When the industry looked at the challenges of the 1990s, it did 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 2004 the average sales of a restaurant was \$730,000, and seven out of ten were single-unit independent operations (Foodservice Industry Pocket Factbook 2004). There are approximately 50,000 hotels with approximately 4.4 million hotel rooms generating estimated sales of \$105 billion in sales. As is the case in the foodservice industry, the majority of the hotels and motels in the country are individually owned and operated but affiliated with national chains.

The revenue growth that generated all the expansion in industry capacity over the past three decades while dipping in the early 1990s experienced new growth in the latter half of the 1990s. 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 U.S. population, a phenomenon replicated in many European nations. This cresting suggested to us at the time that the demand curve would no longer rise in response to the increase in numbers of people entering the market. Although slight increases may occur, due to increased travel by individuals from other countries, demand can be expected to remain stable with growth being experienced in selective markets and nations. The early 2000s saw the burst of the expansion bubble with the double hit of both the economic recession of 2000–2001 and the terrorist attacks of September 11, 2001, at the World Trade Centers in New York. The domestic market is now rebounding, although unevenly, with growth in the luxury segment outstripping the overall growth. This suggests that firms will have to think through how they will maintain market share and tap new markets if they are to add value. This will require managers who think and act strategically.

Several other signs indicate that the competitive environment is heating up. Price discounting has become common practice along with—in some cases—permanent price reductions. Quick-service chains have led the way in the foodservice industry, and budget hotels have promoted it in the lodging industry. There has been a greater emphasis on service, with firms in both segments trying to implement improved service programs. There has been a proliferation of brands, especially in lodging. As marketing expenditures have increased, there have been significant efforts to create strategic marketing alliances where firms become linked together under varying forms of arrangements. For example, in the travel industry, car-rental firms, hotels, and airlines have blended their reservations and marketing programs to try to gain or protect market share.

Although competition has been heating up, the suppliers to the industry have either been cooling down or gaining power to affect business transactions. Obtaining financing for new hospitality projects was almost impossible as the decade began. Suppliers of capital such as banks, lending institutions, and investors in the capital markets became shy of any opportunities. Labor supply created additional problems because slow birthrates at the end of the baby boom of the 1940s and 1950s have resulted in fewer young people entering the workplace. Travel agencies, tour operators, and corporate travel managers have been concentrating purchasing power through consolidation and more sophisticated technology as they strive to create value for their clients. Interestingly, a recent study by American Express revealed that less than half of the luxury consumers questioned thought that their travel agent, personal assistant, or personal concierge added value to their trip. According to the National Leisure Travel Monitor, households with annual incomes of greater than \$100,000 are more likely to make reservations online. In fact, in 2003, 61% of travelers in this income bracket made reservations online.¹⁸ It is becoming evident that travelers are frequently using the Internet as a value-adding option, feeling it is a more convenient and cost-efficient method of booking lodging rooms. These efforts are forcing the lodging industry into a situation where it has less control over its capacity and thus must compete less on its own terms and more on the terms of these increasingly technology-driven, value-conscious customers.

Challenges Facing Tomorrow's Hospitality Manager

Throughout this chapter we have laid the groundwork necessary to understand the role of strategic management in the hospitality industry. The most important concept to achieve this understanding successfully is the coalignment model. We have suggested that this model is dynamic and future oriented. This implies that managers should be anticipatory and must think strategically about the future. They must be preemptive and anticipatory in their decisions about what competitive methods to invest in. Thinking and acting strategically also means viewing the role of the manager differently. It begins by attempting to identify what changes lie ahead to aid in this endeavor. In the following section we outline the major forces driving change in the hospitality industry and how they will shape the role of tomorrow's value-adding manager as he or she seeks to develop strategies for the future.

The forces to be outlined have been identified in research that has been conducted globally through the support of the International Hotel and Restaurant Association.¹⁹ Researchers conducted a series of "Visioning the Future" workshops across the globe to determine what industry leaders considered to be the major changes occurring in the hospitality industry. This research is currently still continuing and has now involved over 4,000 industry practitioners who have helped validate the forces driving change in this industry and their impact on the hospitality manager and organization of the future. A summary of these forces is provided in the following paragraphs. We have become convinced that these forces will have significant and long-term impact and will change the way hospitality organizations are managed and the strategies they will select to compete with in the future. In many cases, change is already occurring. The challenge is to stay ahead of that change.

Forces Driving Change

The participants in the “Visioning the Future” workshops identified seven major forces driving change. Space here does not permit a complete and thorough review of each. The forces and a brief explanation are presented in this list:

- *Marketing, Distribution, and Capacity Management:* As the information superhighway increasingly exerts its influence on the sale of the inventories of hotel rooms (as well as airline seats, car rentals, tickets to attractions, and seats in restaurants), the hospitality industry will lose control of the sale of that inventory. What this force suggests is that the industry will be marketed differently in the future. Technology will begin to determine how this inventory is advertised and promoted. It will influence pricing. The customer can be expected to gain more control over all decisions regarding the selection and booking of the travel experience. As previously stated, the majority of travelers consider that the use of the Internet provides them with a convenient and cost-efficient method of booking hotel rooms, restaurant reservations, and other services of the hospitality industry. There is a continuing move away from brand-based marketing to destination marketing as consumers first decide where they want to travel and then make their decisions on travel and lodging. As technology enables destinations to consolidate portfolios of hotels, restaurants, and attractions into a single distribution center (i.e., convention and visitor’s bureau website), brand will become secondary.
- *Safety and Security:* With today’s traveler being increasingly confronted with potential risks to personal safety and health, the industry must assess the impact of such major issues as: terrorism, the AIDS epidemic, the spread of new and old diseases such as so-called mad cow disease, avian influenza (bird flu), and *E. coli* as well as a growing gap between the haves and the have-nots of wealth and information across the globe. These risks have now become the number-one concern of travelers as well as domestic residents. This problem is compounded by the fact that governments all across the globe are struggling to obtain sufficient funds to protect their own citizens and travelers in this post 9/11 world. This is putting increasing burdens on hospitality enterprises to meet the challenges of this force.
- *Assets and Capital:* The global shift to market economies has resulted in tremendous competition for available capital for investment in productive assets, especially from China and India. This competition has resulted in the flow of funds to those investments that provide the highest level of return for the funds invested. This puts pressure on all firms to focus on *value-adding* strategies that will be sustainable over time. This does not bode well for the hospitality industry where in mature markets the returns on capital have been recognized by many investors as insufficient. Thus attracting capital to support industry growth in the future will be a significant challenge for managers, putting greater pressure on effective strategic management practices. Managers must focus on competitive methods that generate the best future cash flows for the organization.
- *Technology:* It is no secret that technology is influencing almost every part of life today. The convergence of telecommunications, the computer, and information is making it possible for firms to compete in new ways. Whether it is in marketing the industry, managing resources, or investigating the future, one thing is clear: Technology will be the most important competitive method that hospitality firms

will employ in the future. As long as advances in information technology continue at a rapid pace, it will continue to drive change and have significant impact on the hospitality industry.

- *New Management:* The study made one thing very clear. No matter where in the world the researchers worked, the old way of learning the business is out. Managers are expected to be masters of the business world more so than masters of the craft of hospitality. There will always be a need for those with the necessary skills to provide the customer with the desired products and services, but tomorrow's manager must be a strategist. The skills necessary to succeed will demand that the manager know how to use technology, be capable of analyzing and synthesizing large amounts of information from a variety of sources, and capable of functioning in an uncertain environment. These and other challenges will require the manager to think in an interdisciplinary manner. This thinking will have to be future oriented. In addition, leadership will be based on performance not seniority. This change in the leadership paradigm will be driven by the increasingly complex relationships among the customer, employee, and manager. Customer expectation of value and quality and employee need for enlightened leadership will continue to drive change in hospitality management.
- *Sustainable Development:* As the world continues to grow closer economically and populations continue to accelerate in growth rate, sustainable growth becomes a significant requirement. It is becoming apparent that emphasis on sustainable development is becoming increasingly important for public and private economic activity. Governments are already developing policies that favor sustainable economic development. Various tax incentives for green projects is a ready example. The challenge for hospitality leaders is to recognize the full range of issues that must be addressed to execute environmentally sound activities and ensure the highest standards in operations and development.
- *Social Issues:* In view of its impact on development especially in job creation, we anticipate that industry leaders will be called on to address the gap between the haves and the have-nots of the areas in which they conduct business. This will require that managers effectively develop and utilize the local labor force as well as the physical environment in which their employees live. The private sector will be expected to bear an increasingly larger share of the social costs related to their role in the community.

What these forces suggest is that there is no more business as usual in the hospitality industry. It is a more competitive, dynamic, and complex industry subject to global forces. Even the smallest most rural of enterprises is now subject to competitive forces from across the world. To meet these challenges, Exhibit 7 outlines the skills necessary for tomorrow's managers if they hope to be successful in this changing environment. These skills were identified in the research project previously described and have been presented to the international sample of managers indicated earlier. Although there were some differences from one region to another globally, they were mostly differences of timing as opposed to skills. In other words, there was general agreement that these were the required skills, but when they would become important in different parts of the world would depend on the level of economic development in that region. To validate this list, we encourage you to read the industry trade literature over the last several years and take note of how each of these issues has become more a part of the fabric of the industry like never before.

- A strategist—less craft skills, more business skills
- A multifunctional manager
- A change agent/boundary spanner
- Visionary
- Technologist
- A Knowledge worker—information manager
- Marketing on the information highway
- How to buy and sell your way into the information highway
- Evaluating and maintaining the best strategic alliances
- Recognize, interact with, and utilize the resources of those who will own the information systems (information highway)
- Capable of receiving, analyzing, synthesizing incredible amounts of information regarding: guest, internal operations, external data from capacity controllers
- Utilize information to adjust to the speed of change
- Monitor changes in an increasingly diverse/complex demand curve
- Provide information to guest to satisfy their needs for safety and security
- New leadership skills to motivate a more diverse workforce consisting of more knowledge workers



EXHIBIT 7 Tomorrow's Hospitality Manager

A close look at the skills identified in Exhibit 7 suggests several important differences in the skill and capability inventory of tomorrow's hospitality manager compared to what has been viewed as important in the past. Historically, the skill training that was done focused on topics like food production, cost control, layout and design, front-office management, food and beverage management, catering, sales, merchandising, and accounting. This body of knowledge reflected the importance of internal operations and pleasing the guest. Without a doubt, these skills are still very important to the success of today's hospitality firm. However, although they may have been sufficient for decades, they no longer meet the needs of today's competitive environment. The emphasis must now be on the making of the hospitality enterprise a viable long-term investment. It means addressing the need for managers to know and understand how to add value strategically in a complex, dynamic business environment.

The Value-Adding Manager

A value-adding manager recognizes that every product and service combined into a portfolio to create a competitive method must be thought of as a value-adding investment, one that will yield value over and above the firm's cost of capital for as long a time as is possible. This view of management recognizes that each competitive method has a distinctive lifespan that is becoming increasingly shorter in the context of heightened competition. This view also supports the notion that any investment will create risk and this risk must be considered and managed. For the investor, the value-adding manager is expected to provide the owner with a return on capital equal to, or in excess of, alternative investments. This return must also compensate the investor for the risk taken and the inflation over the life of that investment. Considering these requirements reinforces the

idea that managers must be future oriented and think strategically about what to invest in to be able to add future value.

Becoming a value-adding manager means being a change agent, constantly spanning the boundaries between the firm and the business environment, seeking new opportunities to invest in. This spanning activity becomes a very important role in bridging the gap between the internal craft orientation required to deliver products and services and looking externally for opportunities and threats. It requires managers to monitor their environment regularly looking for changes in a demand curve that is becoming increasingly diverse and complex. This will require from every decision maker the need to receive, analyze, and synthesize incredible amounts of information that is being generated today about the guest, internal operations, and those who are increasingly gaining control over the inventory of the industry's total capacity. Tomorrow's manager will be an information manager who uses information to adjust to the speed of change.

The future will require a *multidisciplinary* approach to decisions. Thus the manager must become multifunctional. What this implies is that managers will have to be able to combine their knowledge in several disciplines as they approach investment decisions. This will also require managers to become leaders in situations where they will have to rely on the advice of internal and external experts more than ever. This is because the body of knowledge associated with the disciplines essential to hospitality management is expanding exponentially as the knowledge revolution continues to sweep across the globe. Put another way, tomorrow's manager is not expected to have all the answers. She or he will have to rely on others who possess greater knowledge and then synthesize this input into the decision-making process.

The *multifunctional manager* role means that the education and learning associated with careers in this field will also have to change. At present, learners and managers are both given education and training in narrowly defined capsules of knowledge. These can be specific courses in a hospitality curriculum or specific training programs. What often happens is that the learner digests the information to earn the appropriate reward for going through this experience (usually a grade or certificate). Unfortunately, this knowledge is not always transferred and/or combined with other capsules of knowledge when it comes to putting it to work in a real-world setting. This is not the fault of the learner; it is most likely the fault of the learning process being used. Educators and trainers reward individuals for mastering a unit of knowledge but do not reward them as effectively for demonstrating the successful transfer of that knowledge to a new setting. This must change because adding value requires that the manager understand operations, finance, marketing, the business environment, and leadership and can bring these functional areas together to make the most effective investment decisions. In other words, we need to change our thinking by teaching people to be multifunctional managers where the learning process begins with the decision to be made and then adds the necessary functional expertise. Presently, it is done the other way around, which is insufficient in creating tomorrow's multifunctional, *value-adding* manager.

The information highway metaphor is now well known to many. It suggests that an information society is developing. Many believe this change is similar to that brought on by the Industrial Revolution. As signs continue to point to this becoming a reality, it suggests that tomorrow's manager will have to develop significant capabilities in this

regard. This we have already pointed out in the preceding paragraphs. This is important because hundreds of new businesses are developing that were unheard of just five years ago. Data warehousing and data-mining companies did not really exist a few years ago. Yet today, they promise to revolutionize how we obtain and use information to make better decisions in marketing, finance, human resources, and for many other purposes. To meet the challenges brought about by these changes, the manager not only needs to know how to be an effective knowledge worker but also how to interact with those who will be owning and managing that knowledge. Thus they will need to know how to buy and sell their way into this information revolution if they are to be the most effective value-adding manager.

The information revolution is partially brought about by technology. In particular, the convergence of the computer, telecommunications, and knowledge industries has brought about the realization that to compete in tomorrow's world, the managers of the future will have to be able to understand how this convergence will impact their jobs and firms. Therefore tomorrow's managers will find it necessary to become technologists, in the most generic sense of the word. Technology is not just machines. It is information, processes, and ways of doing business. The managers of the future must know how to use it to best gain a competitive advantage and value-adding capability.

Tomorrow's value-adding manager will also experience the need to change leadership styles. It will no longer be possible to give lip service to human resources management or to adopt a "my way or the highway" approach to managing the workforce of the future. The changing workforce, brought on by the knowledge revolution and free flow of information, no longer is willing to tolerate the old-fashioned control-oriented style of the industry's former leadership.

The industry has and will continue to experience labor shortages that will demand from them a more behavioralistic approach to human resources management if it expects to attract qualified labor. The labor shortage will also require them to employ individuals from diverse backgrounds demanding a much greater understanding of what motivates individuals who are uniquely different but must still function as a team. Not only will tomorrow's labor force be diverse based on personal physical and behavioral characteristics, they will also be diverse in level of education and knowledge level. Additionally, they will also be different regarding their ability to access information. This growing level of diversity in the workforce as well as in the marketplace will create many challenges for tomorrow's manager as he or she seeks to become a value-adding one.

Perhaps the most interesting challenge facing tomorrow's manager will be the need to be a *visionary* and possess the *creativity* to see opportunity where others will see threats and to invest in competitive methods that will lead the firm into advantage over its present and future competition. Many argue that one is born with vision and creativity and that it cannot be learned. Although the answer to this argument must still be determined, the need to possess these capabilities is no longer in doubt. In a fast-paced changing world, to stay ahead of competition the manager of tomorrow must think ahead of the competition. She or he must look for opportunity and develop the ability to see how the forces driving change will ensure that that opportunity will provide long-lasting *value-adding* investments for the firm. Strategy tomorrow will demand more vision and creativity in this context. Coalignment will not occur without it.

SUMMARY

Strategy has been defined here in the context of the coalignment model. This model suggests that hospitality enterprises of the future will only succeed if their managers are able to see opportunities in the environment of the business, invest in *value-adding* competitive methods, and allocate resources to those methods that add the greatest value to the firm. The underpinning of success begins with the business environment, which is filled with change and complexity. Thus the manager of tomorrow must know how to use information, human, physical, and capital resources to take advantage of the opportunities presented by this turbulent environment.

To achieve successful coalignment the manager must recognize that strategy in the service industry is different than in manufacturing. It is different for several important reasons. These include the supply-and-demand relationships, the nature of services, and the technologies used to convert inputs into desired outputs. In many cases these differences present far greater challenges for the hospitality manager because the products and services are so immediate, transparent, and perishable. Additionally, it is probably easier to copy or duplicate products and services in this industry than in any other, adding additional challenges to the hospitality manager. These differences suggest that strategy making and implementing in this industry is different than in others, and that it is important that managers know this if they are to compete successfully in the future.

Change is the way life today. Knowing what forces are driving change is essential to achieving coalignment. The major forces driving change in the hospitality industry are capacity control, technology, assets and capital, new management and safety and security, social responsibility, and sustainability. These forces are creating ripples throughout the globe and changing the way the industry competes. These changes are also changing the job of the hospitality manager. Although craft skills are important, they no longer are sufficient for success. Tomorrow's manager must possess a whole new conceptual toolbox. The most important tool in that box is knowing how to be a *value-adding* manager. Using that tool requires creativity and vision. This in turn results in the investment in future-oriented *value-adding* competitive methods that meet the customers' and owners' needs. This new role for the hospitality manager means thinking strategically about all decisions. The job is becoming more complex.

DISCUSSION QUESTIONS

1. Why is it important to consider the management of a hospitality enterprise in the context of the coalignment model?
2. How does the service industry differ from the manufacturing industry?
3. Why is strategy viewed as a way of thinking and not a process?
4. What is meant by the concept of adding value and how is it applied within the coalignment model?
5. Describe the key concepts within the coalignment model.
6. How is leadership different in the hospitality industry vs. the manufacturing industry?
7. What is unique about the hospitality industry within the context of the overall service industry?
8. What have the forces driving change done to the requirements for today's hospitality manager.

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C A S E S T U D Y

Turnaround at McDonald’s

MCDONALD’S AROUND THE WORLD

Founded by Ray Kroc in 1955, McDonald’s has built its success not so much on the taste of its food as on its solid standards of consistency of product, cleanliness of operations, and good service. Today, McDonald’s has more than 30,000 restaurants in 121 countries, serving 46 million customers daily (Rogers 2002). It generates revenue from 9,000 company-owned restaurants and franchisees and

license holders (*The Economist* 2004). McDonald’s possesses a 43% market share of the quick-service hamburger market. With earnings of over \$1 billion in international profit, the chain is considered the largest restaurant operator in the world, thus the primary competitor internationally. Not only is it the best known American icon, it is also one of the most recognized brand icons around the world. Measured by sales, McDonald’s is

about twice as large as its next global competitor, Yum! Brands, operator of Kentucky Fried Chicken (KFC), Pizza Hut, and Taco Bell (*The Economist* 2004).

Outside of its domestic market in the United States, McDonald's has more than 16,000 units internationally. Approximately 85% of its restaurants are located in 11 major markets: Australia, Brazil, Canada, the United Kingdom, France, Germany, Hong Kong, Japan, The Netherlands, Taiwan, and the United States. McDonald's first outlet in Japan opened in 1971. Since then, more than 2,400 restaurants have opened in Japan (Rogers 2002). McDonald's opened its first restaurant in London in 1974. Today the chain has 1,200 UK outlets in almost every town and city across the United Kingdom employing 68,000 people (Rogers 2002). After building on its American heritage using U.S.-originated advertising, McDonald's has in recent years adopted a localized marketing strategy for the United Kingdom (Rogers 2002). It has developed menus for British tastes such as Anglo-Indian food and has produced commercials featuring icons of British culture (Rogers 2002). In 1990 it opened its first McDonald's restaurant in Russia on Pushkin Square, which continues to be the world's busiest McDonald's. The company opened 79 other restaurants across Russia (Rogers 2002). In 2000, 35% to 40% of McDonald's operating income came from Europe. In China, McDonald's entered the market in 1990, after Yum! Brands. Yum has 1,500 restaurants and enjoys a broader geographical coverage in China than McDonald's.

DISAPPOINTING FINANCIAL PERFORMANCE AT MCDONALD'S

The U.S. market, although mature, provides half the revenues of McDonald's corporation. Approximately 18% of the U.S. population are McDonald's customers, and it is focused on changing consumer tastes (Rogers 2002).

For decades, McDonald's has been one of the blue chip stocks, and it has been a component of the Dow Jones industrial average since 1985. For many years, McDonald's was the representative growth stock guaranteed to deliver 12% to 15% earnings. However, this growth phenomenon began to change in the 1990s. Beginning in the late 1990s, McDonald's earnings per share grew just 4% (Stires 2002). The tipping point came in 1996 when McDonald's had four consecutive quarters of declining same-store sales and lost significant market share to Burger King and Wendy's (Stires 2002).

It appeared that the mass market for quick-service restaurants was gradually losing its public appeal. As a result, McDonald's sales growth diminished to 2% annually instead of the norm of 15%. It faced a dilemma—its needs to open a certain number of stores to continue to generate 10% to 15% profit growth, demanded by shareholders, while the mature markets domestically and internationally could not support more unit growth indefinitely. Even though McDonald's opened more stores, profit margins were declining. Some critics thought that McDonald's should slow down its growth rate and close some stores to boost corporate returns and share price, avoiding cannibalization. In 1998 McDonald's posted its first-ever decline in annual earnings (Pallavi and Arndt 2003).

From 1998 to 2002, McDonald's spent \$10 billion in capital expenditures and opened many new units. Consequently, McDonald's outlets have grown from 27,500 to almost 30,000. McDonald's expanded so fast it ran out of room to grow (Stires 2004); sales had not increased since 1999 while costs kept rising. In 2002 the company slowed its expansion by opening 300 new restaurants in the United States, a fraction of the 1,130 restaurants it added in 1995 (Stires 2004). However, McDonald's did not address the issue of slowing

international growth. The chain continues expanding at a faster pace internationally. However even internationally, where growth rates tend to be more pronounced (Stires 2004), it is not a consistent profitable operation. Sales in Europe rose only 1%, and the chain plans to add only 200 units to the existing 6,070 (Pallavi and Arndt 2003). The company had 30% fewer openings in 2003 than the year before. It closed 176 of its 2,800 stores in Japan due to slow economic growth. McDonald's planned to add only 250 new outlets in the United States in 2003 (Pallavi and Arndt 2003), 40% fewer than in 2002.

McDonald's same-store sales were flat in 2001, and according to the consulting firm, Interbrand, the value of the name "McDonald's" dropped by \$2.5 billion that year (Stires 2004) while the S&P Restaurant Index was up 18%. Meanwhile, Wendy's and Yum! both experienced increases in stock price. In 2002 McDonald's same-store sales for the United States dropped 2%, and sales in the United Kingdom and Germany, McDonald's two biggest European markets, were also weaker than forecasted (Rogers 2002). The company recorded disappointing profits for the sixth consecutive quarter. Investors were selling the stock while analysts downgraded it. Some analysts stopped covering the stock because their clients were not interested while analysts at Salomon Smith Barney downgraded its forecasts for McDonald's stock to "underperform" (Rogers 2002). Its 2002 share price of \$17.90 stood at a seven-year low. Profit margins were no more than half of what they were 30 years ago. In 2003 McDonald's reported its first quarterly loss since 1954. By June 2003 McDonald's same-store sales had fallen for each of the previous 12 months (Enz 2005). Both external and internal factors led to McDonald's decline in sales after 40 years of growth.

EXTERNAL FACTORS IN THE BUSINESS ENVIRONMENT

Within the past decade, fierce competition has led large restaurant firms to aggressively engage in tactics to retain market share resulting in discounting. Recently, in an attempt to regain profitability, firms have begun to move away from price discounting and are now focusing on site locations, upgraded menus and decor, investment in staff training programs, and customer-loyalty programs (Enz 2005). Mass market is no longer the formula for success. Management knows there is a need to make McDonald's more relevant to today's consumers.

McDonald's early expansion in the 1950s was linked with the golden years of U.S. society (Rogers 2002). The restaurant industry progressed through its growth stage in the 1970s and the 1980s and is now entering the maturity phase of its life cycle. The U.S. marketplace is saturated and extremely competitive. Slow same-store sales and a sluggish economy have negatively impacted quick-service restaurant chains in recent years.

Demographic Shift

The first Americans to grow up with fast food, the baby boom generation, have matured and are seeking alternative dining options of fresher and more nutritious food. Customers who used to prefer meat and potatoes only have become increasingly sophisticated. Today, they are more willing to try once-exotic foods such as sushi and burritos, as well as quick meals from supermarkets, convenience stores, and vending machines (Pallavi and Arndt 2003). It is a necessity for any brand to evolve according to the customers' needs (Rogers 2002). The emergence and rapid growth of the "quick casual" segment is evidence of this trend. Quick casual restaurants that provide limited or self-service concepts, such as

Panera Bread Co., and Corner Bakery Co., are capturing the lunchtime meal period. These restaurants offer slightly more expensive menu choices, but customers find the food healthier and better tasting. Most fast-food chains such as Burger King and Wendy's have responded by altering their menu items, adding salads, and changing ingredients of existing items. McDonald's market share is unchanging as its customers turn to coffee shops and delicatessens as alternatives to their menu.

McDonald's had lost more than direction. Chains such as McDonald's are facing a rapidly fragmenting market. Not only does McDonald's have to compete with a revitalized Burger King and Wendy's, it faces many new niche entrants in an overcrowded fast-food arena (Rogers 2002). Arby's has introduced Market Fresh sandwiches. In addition, McDonald's also competes with coffee shops, sandwich bars, casual dining, pub-restaurants and even supermarkets, all of which are feeding the grab-and-go demand from office workers, students, shoppers, and travelers. McDonald's seems to have lost favor with its core market. The company has finished last among fast-food restaurants every year since 1992, according to a survey administered by the Michigan's American Customer Satisfaction index (Stires 2004). Critics wondered whether McDonald's has evolved quickly enough to keep up with consumers' changing tastes in the increasingly health-conscious and quality experience-driven society (Rogers 2002).

Unhealthy Image

Worldwide, a wave of anti-American feeling turned the famous McDonald's golden arches from an asset into a liability (*The Economist* 2004). McDonald's has been hit by fears of mad cow disease in Europe, damaged by the McLibel trial, negatively portrayed by the bestselling book *Fast Food Nation*, sued by vegetarians who ate its

beef-based cooking oil (Rogers 2002), and attacked by the documentary *Super Size Me*. There is also growing concern about obesity and junk food and their impact on health and disease.

INTERNAL CONDITIONS

Unsatisfied Franchisees

Ray Kroc's idea of franchising has allowed the company to become the industry's giant. However, the concept works best when the market is expanding and owners can be rewarded for meeting incentives. A study by Citigroup Smith Barney reported that the average McDonald's franchisee expected annual sales of approximately \$1.7 million and an operating profit of \$150,000 from their restaurant (*The Economist* 2004). The slowdown in McDonald's expansion has caused problems with its franchisees. For decades, there have always been a number of entrepreneurs lining up to become McDonald's franchisees. However, in 2002 a record number of franchisees either opted to leave the system for faster growing competitors or were forced out due to poor performance. McDonald's was forced to take a pretax charge of \$292 million in 2002 to close down over 700 restaurants and buy back franchises that could not be sold.

Quality Standards are Compromised

McDonald's was also confronted by the problems of poor unit-level execution and a menu lagging behind changing consumer tastes. The key philosophy of emphasizing QSC&V (quality, service, cleanliness, and value) that had set McDonald's apart was no longer working (*The Economist* 2004). Sales for McDonald's has been flat, with an increasing number of customers complaining about slow service, rude employees, dirty restaurants, and cardboard-tasting food. In the past, McDonald's sent out "mystery shoppers" to evaluate the service, cleanliness, and food quality of its restaurants (Stires

2004). During its expansion period of 1990s, the company stopped grading franchises for cleanliness, speed, and service. In fact, slow service is the biggest complaint from U.S. customers. McDonald's finished third in average service time (163 seconds), behind Wendy's (127 seconds) and Chick-fil-A Inc. (151 seconds). CEO Greenberg stated that saving 6 seconds at drive-through windows brings a 1% increase in sales (Pallavi and Arndt 2003). Training for McDonald's employees declined when there was a labor shortage in the industry, leading to a decrease in their skills.

TURNAROUND STRATEGY

Diversification through Acquisition

McDonald's has expanded its menu while diversifying within the operations of the restaurant industry. The company has been steadily buying chains that operate under different brands. As part of its strategy, McDonald's has diversified by investing in a variety of fast casual restaurants, including the acquisition of Boston Market in 1999, Chipotle Mexican Grill, Donatos Pizza, and a 33% stake in the British quality-sandwich chain Pret A Manger. These U.S. chains cater to the middle ground between limited service fast-food and full table service, or fast casual dining. The purchase of Boston Market, a quick casual concept in 2000, signaled that the days of mass media marketing are over. Later, the company decided to focus on its core brand and divested its interest in Donatos Pizza in 2003 and Chipotle in 2006.

Change of Leadership

By the late 1990s, the McDonald's system was exhibiting signs of poor planning. New menu items to attract new markets failed to increase sales. As a result, Michael Quinlan was replaced by Jack Greenberg, a McDonald's veteran of 16 years, as CEO in

1998 (Pallavi and Arndt 2003). Greenberg attempted to reverse the decline in sales by making operational changes in McDonald's management. He initiated a corporate restructuring in 2001 that cut the number of regional divisions in America and added a new layer of management to monitor quality and impose tougher standards on franchisees. Greenberg also started to trim back the U.S. expansion. His management style of decentralization was believed to have hurt the image of the McDonald's brand of service, quality, and cleanliness (*The Economist* 2001).

CEO Greenberg began testing a costly new "Made-For-You" food assembly system designed to improve quality, supported by a high-tech kitchen retrofitted across McDonald's outlets. However, the new system did not deliver and failed to boost sales. At the same time, it crippled service time and eventually backfired. The franchisees had to pay for the expensive system, which strained their relationship with the corporation. Some analysts suggested that the company should kill the "Dollar Menu," a promotion introduced to reverse traffic declines. They thought that it slowed down operations of new units and cut McDonald's store base by at least 10%. Greenberg's four-year tenure was marked by declining U.S. sales growth and mad cow disease concerns that crippled its European business. He was blamed for letting the burger business deteriorate, by running McDonald's more as an amalgamation of local businesses operated by local entrepreneurs from Indonesia to France than as one worldwide company (*The Economist* 2001). Greenberg also planned an aggressive expansion of 1,400 stores in 2002. However, investors wanted McDonald's to concentrate on the profitability of existing stores with a tighter, more centralized McDonald's. McDonald's stock slid by 60% in three years, and its shares were trading at a seven-year low of \$15.75 in 2002, which