The future of small and medium size enterprises in tourism

Prof. Peter Keller, President AIEST

The AIEST at its 54th Congress will address itself to a fundamental question, how can small-to-medium enterprises (SMEs) that depend on tourism survive in hotly contested markets. The discussion will focus on how to overcome the disadvantage of insufficient size, on the basis of an analysis of existing structures. In this context strategic aspects including market strategies, innovation and co-operation, as well as the increasing of productivity of the existing offer will be seen as the main factors determining success. We shall also look at the question whether or not tourism-dependent SMEs can help to stimulate development in economic problem areas and if so, in what way. Finally we shall consider the conditions which make state incentives for the promotion of SMEs necessary in tourism.

Heterogeneous branch of the economy with dual structure

Tourism is a sector of the economy that can only be defined in terms of demand. The money spent by domestic and foreign visitors goes to a variety of different companies in various branches. These range all the way from industrialised sectors with large companies to small retailers and service providers.

A tourism industry as such does not exist. Structures in tourism are fugitive. They begin to exist only in the presence of visitors in search of a bundle of tourism services. Moreover there is an important distinction to be made between the type of tourism where the travel and stopover arrangements are made on a collective basis by tour operators, and individual tourism organised by the visitors themselves.

The Tourism Satellite Account as part of the national account is a concept which helps us to see beyond the heterogeneous nature of tourism producers, on the basis of a theoretical-statistical construct. Satellite accounts bring together the branches that depend mainly on the spending of visitors, branches which are the components of what we call the “tourism industry”. Tourism includes industrialised sectors such as
tour operators and the airlines as well as branches dominated by small-to-medium enterprises (SMEs) such as the hotel and catering sector.

In practice tourism has acquired a dual economic structure. It involves big companies that organise travel, transport and stopovers in an industrial manner. They have their headquarters in most cases in the agglomerations of the countries from which the visitors come. Applying global or international strategies they take advantage of local tourism potentials and offer standardised products (Figure 1).

In contrast to the big companies of the international travel and tourism industry, the destinations of traditional tourism countries are hives of small-to-medium enterprises (SMEs), which produce tourism services at the retail level. These are mainly active in service sectors beginning with accommodation and catering service as well as arranging the cultural and sporting activities of visitors.

**Strengths and weaknesses of industrial and retail tourism production**

A glance at production and company statistics shows that in all of the developed tourism countries there are relatively few medium to large tourism enterprises (OECD, 2004). Micro-corporations with between one and nine employees on the other hand account for between 60% and 90% of all companies in the OECD

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Travel and Tourism Industry</th>
<th>Destination oriented SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tourist functions</td>
<td>Organisation Information Transport</td>
<td>Welcome Hospitality Leisure</td>
</tr>
<tr>
<td>Tourism related industries</td>
<td>Travel agency Airline industry Others</td>
<td>Accommodation Food and Beverage Cable cars Others</td>
</tr>
<tr>
<td>Corporate Organisation</td>
<td>Large companies</td>
<td>SMEs</td>
</tr>
</tbody>
</table>
countries in leading tourism sectors such as travel agencies and the hotel trade (Figure 2). However it is the few medium to large size companies which generally account for the lion’s share of turnover – more than half of the total.

Micro-structured accommodation sector in developed countries

![Graph showing the distribution of hotel sizes across various countries.](image)

The fact that so many of the companies that depend on tourism have the structure of a small business reflects the preferences of the consumer and the need for personalised services in tourism. Many visitors want the freedom to make their holiday as individual an experience as possible. This means high quality and personalised services. The small-to-medium enterprises (SMEs) that make up the bulk of the industry are potentially flexible enough to be able to satisfy the rapidly evolving requirements of these individual visitors with unique services of quality. Or, in practice many of them have lost this ability.

It is increasingly difficult for SMEs to survive and prosper in markets where competition is fierce. The marketing strategy most of them adopt, focusing on repeat business, makes it difficult for these companies to change, adapt and innovate. The
potential for rationalisation moreover is limited due to their small size and the highly personalised nature of their services.

The larger tourism corporations such as the airlines and hotel chains are able to take advantage of their size to penetrate and dominate new tourism markets. Standardised products and services enable them to keep costs down and increase profits. High economies of scale make it possible to increase productivity and growth.

But even for the bigger tourism enterprises the world is not a safe place. The leading international tour operator TUI, which as a vertically integrated company offers a wide range of tourism services and covers most of the value added chain, today has more than 80 sub-brands. But any day now it may be forced to “downsize” and “spin off” parts of its empire that will become new SMEs (Figure 3).

Figure 3

TUI, The worldwide biggest tour operator

Imperfect competition as the dominant market structure

The international tourism market is increasingly being liberalised. The consequences for the international travel and tourism industry are not the same as for SMEs that depend on tourism. Situations of imperfect competition are found in both spheres however. Competition in tourism is not complete.
The international operators in travel and tourism are often “cherry pickers” in the worldwide market. They are in a position to differentiate their products and markets. They do not depend on individual destinations. These corporations are growth-oriented. As size increases so do the economies of scale. They push competitors out of the market.

The international travel and tourism industry is thus undergoing a shakeout. This could lead to the creation of structures of an oligopolistic nature, as can be seen from examples in key tourism sectors such as tour operators, airline companies and the offshore cruise industry, all of which are essentially oligopolistic (Figure 4).

Figure 4

Imperfect competition as a dominant market structure in tourism

\[ \text{Forms of competition} \]

- **Oligopolistic competition**
  - Between big corporations of the travel & tourism industry

- **Monopolistic competition**
  - Between destinations with fragmented SMEs industries

The situation is entirely different for SMEs dependent on tourism despite the apparently strong competition between a large number of service providers. As a rule these are part of a destination, which leaves its stamp on their products and services. It is the availability of natural, cultural and manmade attractions, which makes it possible to differentiate products and services. This product differentiation between destinations makes each of them unmistakably unique.

As a result there is a sort of monopolistic competition between destinations. Tourism dependent small businesses capitalise on the uniqueness of their destination. Each
destination has the characteristics of a marketable brand, with an economic value as important as any in the consumer goods industry. The price thus becomes a strategic variable for the entrepreneur, who can take advantage of the visitor's willingness to pay a premium on the market price as determined by cost. He has indeed only to choose from a wide spectrum of price policy measures in the context of “value based pricing”.

**Market strategies for destination oriented SMEs**

Indeed the natural market strategy for a destination is to highlight the uniqueness of its products and services. When it is successful, local tourism dependent SMEs can take advantage of the destination’s recognition factor and reputation. The *brand value* of the destination creates economic profits, allowing the price to increase above the marginal costs (Figure 5).

![Destination advantage of SME’s](image)

It is not yet entirely clear from the economic point of view how destinations emerge. One factor which is undoubtedly important is *that of increasing returns to scale at the corporate level of the enterprise*, leading to a geographical concentration. It makes little sense for example to have a five star hotel in each destination. Once the foundation stone has been laid however, there is a strong stimulus for further development.

The creation and operation of large numbers of installations and equipment produces *agglomeration effects*. These contribute to the emergence in the destinations of...
attractive infrastructure and tourism equipments such as wellness centres and shopping streets. This gives the individual tourists a highly desirable *variety of products and services from which to choose*. These destination-related advantages enable individual SMEs to increase profits and to reduce costs at the same time.

*Differentiation* is a strategy that works for destinations because of the consumer’s need for change. This love of variety enables the industrialised nations to engage in a profitable exchange of tourists. The *monopoly rent of the destinations* and their SMEs are compensated on the consumer’s side by *the much desired variety of options*. This explains the compatibility of the existing monopolistic destination structures with the principles of competition on which a market economy is based (Koch, 2004).

The differentiation of destinations does not only bring advantages with it however. The development of umbrella brands is difficult and expensive. The costs increase with the level of differentiation. Brand management requires constant investment in product improvement and quality assurance systems. A multioptional supply of products and services is clearly more expensive, since it requires a variety of infrastructural supports. A strategy of differentiation for FITs excludes the advantages of specialisation and standardisation.

**The need for co-operation**

Monopolists never produce with the most efficient structures, since producers limit the output so as to be able to raise prices higher than can be justified by the costs. In the longer run they face increasing competition from the international travel and tourism industry.

*Destination-oriented individual tourism is expensive.* The price of the services offered by individual SMEs add up to a truly grand total. There are few “all-in” offers. As a *fragmented industry made up of small businesses tourism produces at a high cost*. The tourism and factor markets are less and less competitive. The capacities of destination-dependent SMEs are therefore poorly utilised in many cases and do not have a lot of earning power.
The economic situation of destination-dependent SMEs can only improve by offering services in partnership with others and marketing these as a package. Co-operation is vital for the positioning and marketing of the services offered by SMEs. It is also a way for these companies to increase productivity and bring down their costs.

Before considering co-operation however SME entrepreneurs should first think about taking full advantage of any unused potential for internal growth. Additional rooms for a hotel, additional seating for a restaurant or additional carrying capacity for cable car companies help to lower the average costs. In this way SMEs can begin to grow to an optimum size.

Co-operation should be considered only in cases where a company’s own products and services are insufficient and/or supplementary products and services cannot be purchased on the market. Co-operation only makes economic sense if it increases profits and reduces costs. The extent of the co-operation will be greater in certain specific areas which ask for intensive transactions (Keller, Koch 1996). The development and operation of an information and reservation system at the level of the destination requires relatively intensive co-operation for example (Figure 6).

Market coordination mechanisms for SMEs

In the case of tourism-dependent SMEs co-operation seldom functions in accordance with the criteria of an industrial economy. Even vertical co-operation in market communication at the level of the destination, which has long existed, is rarely
effective enough. Considered a part of *destination marketing* this task has been entrusted to the local, regional or national tourism organisations.

One possibility that is currently being discussed, in view of the increasing competitive pressure, is whether or not SMEs should approach the market as a single competitive unit with their own *destination management*. This approach calls for a hierarchic type of management, and *integration* of the destination’s service providers. There are of course vertically integrated destinations such as the "consolidates“ of North America’s winter sports resorts in the Rocky Mountains as well as in the seaside resorts of the southern hemisphere.

From the macroeconomic point of view the destination is a fragmented segment of mainly small businesses *in a marketplace* where the offer is great on both the supply side and the demand side. Here too it is important to make the best of the existing potential for co-operation.

In fact as well as vertical co-operation through the tourism organisation *horizontal co-operation* plays a prominent role. There is increasing horizontal integration at the level of the branches, which for individual SMEs means to give up independence. SMEs in the accommodation sector need to seek additional economies of scale through co-operation at the local level. Freely constituted hotel chains that in some cases span the world are increasingly making efforts to co-operate in the area of marketing. There is an ever greater number of integrated hotel chains, particularly in fast growing destinations.

**Overcoming the cost disease**

A major problem of the mainly micro-structured tourism industry is insufficient productivity. Tourism-dependent SMEs suffer from the *cost disease*. Their productivity is below the average of other sectors of the economy. This lack of productivity has to be compensated for by increasing the price. This process is doubly harmful to the SMEs. Their services become so expensive that they risk being priced out of the market. And because of their lack of competitiveness compared to
other branches of the economy they find it increasingly difficult to obtain production factors such as labour and capital.

Curing the cost disease requires new and above all innovative solutions in the production and marketing of tourism services. In this context the dissemination and gradual implementation of innovative applications plays a major role. Today efforts are being concentrated on transforming tourism from a purely service industry to an “experience industry”. It is also necessary to make greater use of information technology, a basic innovation which applied to tourism can increase the productivity of the sector (Figure 7).

Tourism is a kind of dream factory. Suppliers who manage to fabricate unique experiences increase the value of their services and find their sales shooting up. To increase the experience value of a tourism resort it is necessary to create new bundles of services, to provide a welcoming atmosphere and to put on stage the services like in a theatre. In contrast to the international travel and tourism industry with its standardised products SMEs have no choice but to create personalised and unforgettable experiences for each individual visitor.

Tourism-dependent SMEs have already begun to make use of information technology. It is possible for even the smallest companies today to be virtually present in markets around the world and around the clock thanks to the information
highways. Direct booking at little cost is no longer a problem. This can be either via email or through the destination’s sophisticated information and reservation system. The Internet and “online” services have helped tourism-dependent SMEs and traditional destinations to regain market muscle.

Information technology above all helps the smaller type of tourism-dependent company to increase productivity. Today for example it is possible to outsource many “back office” services, allowing company management to concentrate on the core duties of caring for the customer, ensuring the quality of services and improving the value of the experiences provided.

An all-important question for the future of tourism-dependent SMEs is how to make the best possible use of information technology systems to reinforce their presence on the market and increase productivity. It is a question that is not always properly resolved, due to a lack of know-how. The quality of the tourism organisations also has a role to play in this context, since these are in a position thanks to their size to develop costly management, information and reservation systems at the level of the destination.

Making the best use of endogenous growth opportunities

Tourism is increasingly seen as a way of solving the economic problems of remote regions, traditional industrial zones and delapidated city centres. Another factor is the misconception that the small-to-medium enterprises (SMEs) that are the backbone of tourism can be developed without any particular know-how or funding.

Experience has shown that tourism can indeed be successfully developed, but only in certain conditions. Tourism can be developed in locations that have the necessary attractions. These are the raw materials of tourism, which bring visitors and their value is determined by the visitors’ willingness to pay. The location and potential of source markets also plays a major role as does accessibility in terms of transport and time costs. Neither entrepreneurs nor policy makers can create these exogenous factors where they do not exist (Figure 8).
Research shows that it is the agglomeration effects in combination with economies of scale at the level of the companies that increase the competitiveness of tourism centres (Krugman, 1991). They enable enterprises inside a tourism centre to produce with greater efficiency and at lower cost than competitors outside the centre. They give rise to competition inside and outside the destinations and create *endogenous growth*.

**Endogenous growth opportunities**

![Diagram of growth factors](image)

The role of SMEs in the development of tourism has changed in this age of globalisation. Tourism centres have become poles of growth in the industrialised nations. Due to the increasing competition and maturity of destinations a *concentration of tourism in the best locations* is now underway. Within these locations the size of the companies is on the increase. In this context bigger destinations are a prerequisite for the growth of companies, to ensure the necessary returns to scale.

Such tourism centres cast an *agglomeration shadow on the hinterland*. They can endanger growth in smaller destinations, leaving SMEs with no choice but to cater for niche markets, with constant returns to scale that limit their ability to grow. Indeed they can only grow in places where bigger destinations cannot develop because of lacking economies of scale or which have no interest for them. An example of such niche activities is the “bed and breakfast” trade or the sustainable development of nature park tourism.
New markets are being cultivated in the emerging economies and developing countries by tour operators. Most of the investors are foreign. They are setting up large tourism complexes with standardised services with the help of the State and the international community. These new players focus mainly on the international market. In the first stage of this industrial approach to development there is often little room for the development of SMEs, despite the best intentions of government tourism policy. SMEs generally begin to emerge at a later stage of development and in particular with the arrival of internal tourism.

**State incentives for tourism-dependent SMEs**

Another question is whether or not the development and survival of tourism-dependent SMEs requires specific state incentives. And as a corollary, what value does SME promotion have in the context of tourism policy.

The basic aim of tourism policy is to create favourable framework conditions for the tourism industry as a whole. Training in tourism-related fields, assistance with infrastructure, destination marketing and the development of competition, innovation and co-operation as well as the conservation of intact natural and cultural landscapes are not linked with the size of a company (Figure 9).

Figure 9

Promotion of SMEs as part of a overall tourism policy

<table>
<thead>
<tr>
<th>Favorable framework conditions for the tourism industry as a whole</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limit the disadvantages of SMEs</td>
</tr>
<tr>
<td>Avoid distortions of the market</td>
</tr>
</tbody>
</table>

Tourism policy should not concern itself with specifically private sector activities. Measures that operate at this level are exceptional. In a number of countries for
example financing has been provided for the renewal and development of new firms in the accommodation sector. There is a need for action in this area, since the granting of credit facilities results in market distortions that harm the smaller companies.

The fact that the tourism industry is mainly structured along the lines of small-to-medium enterprises (SMEs), is in itself seen as sufficient justification for State intervention through tourism policy. Thus for example the promotion of co-operation is justified by the existence of transaction costs, which are high in tourism as a fragmented segment with mainly small businesses. When it comes to the promotion of innovation the usual justification given is that the structures found in tourism limit the opportunities for research and development. Indeed there are no innovations that can be protected by patents in tourism, making it possible to earn monopoly profits that can pay for covering the R&D costs of a tourism project.

The quality of tourism policy can be measured by the extent to which a government is able to limit the disadvantages of small business structures, without having to adopt measures in favour of individual companies.

References


Keller, P., Koch, K. (1996), Innovation et Coopération dans le domaine du tourisme, La Vie économique (6)


