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Stuck in the middle: strategies for improving the market position of SMEs in tourism

Abstract. Changed market conditions and increased competition have radically changed the structure, conditions and performance of the tourism industry. In today's fragmented tourism markets small and medium sized enterprises are increasingly forced to pursue strategies which position them away from the middle market. For SMEs differentiation and niche strategies become the only able strategic options. Porter's third strategy – cost leadership – in most cases cannot be achieved because of small enterprise-size, inadequate production output and insufficient financing.

Keywords: small and medium enterprises, strategy of SMEs in tourism, the middle market

JEL codes: M13.

1. Introduction

Many mainstream Central European industrial and service companies have become stuck in the „middle market“ positions, which often means being placed in the market as medium quality and medium price suppliers. Using a market or environment based approach the paper explains Germany's and Austria's post-war rise to economic power based on what has become labelled as „Mittelstandspolitik“: an industrial policy aimed at strengthening middle-sized companies and everything associated with such policies, as e.g. production of middle level industrial qualifications and training and commensurate industrial relations and management systems.

2. The historical conditions of Austrian and German companies through „Mittelstands” – policy and associated public measures and system

In describing and comparing company structures and behaviour internationally it is first useful to employ an environmental system’s perspective, depicting broad aspects or features of a company’s strategic behaviour in terms of its embedded and surrounding education and training-, industrial relations-, social value-, and government business relation systems (Weiermair 2001). In the Austrian or German case the system’s perspective could be depicted as follows:

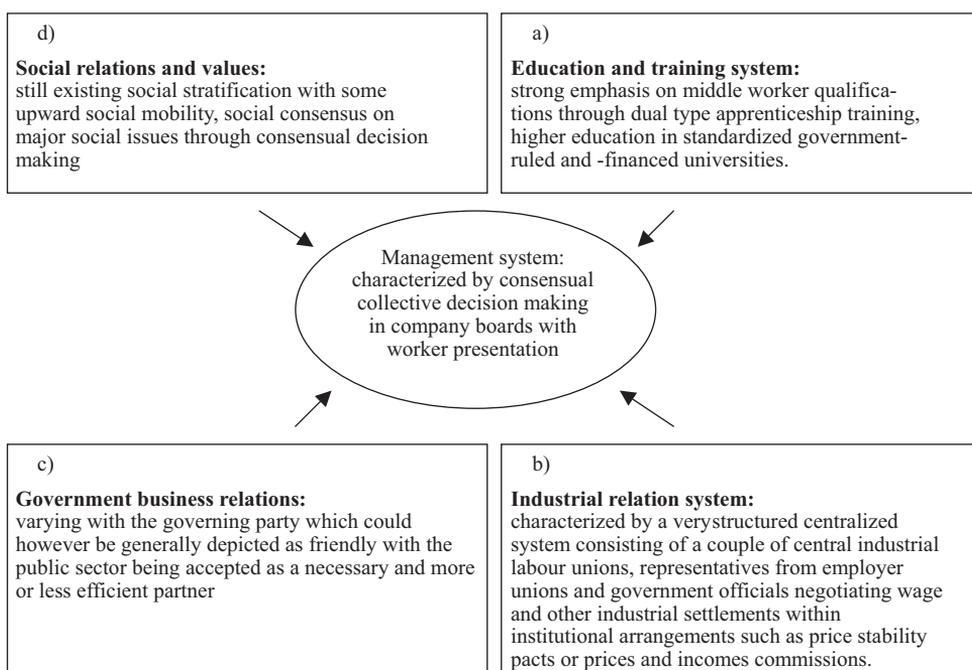


Figure 1. Driving environmental forces for a West German or Austrian System of Management during the period 1950-85

As distinct from many jurisdictions, notably the United States, large corporations in West Germany and Austria are not governed by a CEO but are legally required to be managed by a board of managing directors who in their corporate governance share power and responsibility. The advantage of this form of governance as claimed by its advocates (Siegwart 2002) is its greater representation and hence its better - fairer - sharing of power, a possibly more seasoned and reasoned pro-

cess of decision making. The argumentation that group decisions making process may encourage opportunistic and / or free rider behaviour, may lead to an average rather than optimal decision and might allow individuals in the group decision making process to shirk.

While smaller companies were not required by law to joint decision making in management boards, in practice many small- and medium-sized firms in Austria and Germany similarly had working arrangements where power of attorney and decision making are shared among a handful of top managers.

Corporate governance both its structure and substance were in the postwar period strongly codetermined or driven by the four environmental forces as shown in Figure 1:

ad a) An education and training system which centered on mid level qualifications notably in the form of the dual type apprenticeship system including over 350 apprenticed occupations, which provided middle management skills (first level of supervision) and which for many top managers and entrepreneurs remained the final form of educational preparation. Over 45% to 50% of the labour force (depending on the year in question) in Germany and Austria received this form of educational preparation.

Recruitment of university graduates (in the fields of engineering, law, management and other fields) was in those days strongly stooped in various technical disciplines, whereas the recruits came from public universities only, which in turn were financed, controlled, co-managed and normed (standardized) by provincial or federal governments. Whether they all upheld high or low standards of educational achievement, research and learning is not material to the arguments advanced here. For whatever the quality level of universities in Germany or Austria was, there existed much less of a quality spread between the least known little college or university as compared to the United States, India, or even France.

Generally tight university regulations prevented and/or had a levelling effect on motivation and qualification profiles of universities. In an era where craftsmanship and traditional technologies complemented each other producing high quality products and services, the old education system was well suited to the traditional German and Austrian company providing an army of well trained and discipline-skilled workers who could e.g. work to small tolerance levels and in greater collaboration with production and development engineers than could their American counterparts in the same industry (e.g. car industry). The Austrian and German management system already spoiled by an education and training situation which provided ideal entry level skills and hence saved industry, trade and commerce a considerable amount of job- and firm-specific training was furthermore greatly helped by relatively peaceful and smoothly functioning industrial relations.

ad b) For here, too, emphasis has been placed upon consensual decision making aiming at mid-level, average or a common denominator type of solution which have

been greatly facilitated by a highly centralized bargaining process among a small number of players, e.g. the German or Austrian labour federation, the equivalent centralized employers' association and some top government officials from the economics ministry in either country. Called „social partnership“ or at times „parity incomes and prices commission“ this form of Central European collective bargaining / industrial relations system needed solidarity-based institutions and an environment characterized by only small and well distributed wage-, price-, productivity- and technology differences among firms and branches of economic activity thus facilitating easily consensual, collective solutions with respect to e.g. wage settlements and/or price/inflation targets.

As soon as productivity, technological change and innovation conditions begin to vary considerably among companies as they appear to be doing in the „new economy“, companies and trade unions are likely to act more individualistically thus impairing easy collective industry wide bargaining solutions, suggesting the need for different institutional industrial relations arrangements.

ad c) The same argument applies to government business relations which enjoyed a long and golden age of peaceful cooperation throughout the periods of post war industrial reconstruction both in West Germany and Austria, helped by coalition governments and/or coalescent forces between trade unions and socialist governments, yielding industrial policies aimed at often subsidized not so competitive industries and/or provided equal support to all firms in given industries irrespective of the economic and/or financial health of firms. Again measures were levelled at the „average“ firm as opposed to the innovative growing or superior firm. By subsidizing and supporting at times sunset industries such as coal mines, textile mills or agriculture, market forces were considerably threaded creating dynamic inefficiencies.

ad d) In contrast to America's rugged individualisation, we find both in Germany and Austria a social value system characterized at least until well into the 90s where behaviour is much more collective and guided/determined by such social institutions as family structure and social class, the state, the education system and the church yielding much more a „socially sanctioned and protected“ group behaviour where the individual can hide in the mass which also includes taking „individual“ decisions and assumption of responsibility.

With the onslaught of „individualism“ throughout the world and based on evolutionary forces, desolidarisation has become the hall mark of social relations and social values throughout Central Europe. At the moment this swing to individualisation and turning the back on traditional institutions fostering collective behaviour is creating considerable identity and uncertainty problems in the context of industrial leadership, management and decision making.

3. Historically grown competitive disadvantages in dynamically changing markets

Among these driving environmental forces there are also company external and internal developments which influence competitive conditions. These competitive disadvantages can be found in large parts in the small and medium sized segment of most industries, commercial and tourism markets. In today's markets with hard competition, small and medium sized enterprises must overcome these competitive disadvantages which can be developed through external or internal forces. Schematically these can be shown as follows (Peters & Weiermair, 2001):

Historically Grown Competitive Disadvantages	
Due to Firm External Developments	Due to Firm Internal Developments
The rise of individualism	Inefficient and ineffective management
An accelerating rate of technical change and the associated possibilities of flexible manufacturing and flexible servicing	Insufficient adjustment of entrepreneurial capacities and behaviour
The rise in the intensity of competition through the opening of markets and globalization	Problems related to firm succession
↓	Insufficient adjustment towards more effective leadership styles (e.g. employee guidance)
	Problems related quality management
	Missed market opportunities (in terms of new competitive strategies, new positioning)
	Incorrect investment planning
Necessity for business adjustment	↓ Necessity for restructuring and / or reorganization of internal processes

Figure 2. Source of competitive disadvantages for SMEs

As shown in Figure 2, there are basically 3 external forces which influence the competitive disadvantages of small and medium sized enterprises. They are:

- a) The rise of individualism
- b) An accelerating rate of technical change and the associated possibilities of flexible manufacturing and flexible servicing
- c) The rise in the intensity of competition through the opening of new markets and globalization

ad a) The rise of individualism

The best example of demonstrating the dead end of commoditization has been provided by Pine and Gilmore's "Experience Economy" (Pine & Gilmore, 1999) where

they show that both the consumer and the suppliers can only benefit from individual perspectives leading to heavy product differentiation and unique selling points on the supply side and individual consumer experiences on the demand side.

Creating individual experiences requires, however, a departure from center or average focused strategies.

ad b) An Accelerating rate of technical change and the associated possibilities of flexible manufacturing and flexible servicing

As long as technologies and worker qualifications were guided by traditional methods found in such fields as e.g. mechanical engineering, average or standardized norms were keys to such motions as efficiency, productivity or industrial success. IT-based technologies have rendered traditional craftsmanship redundant and/or have relegated it to the backwaters of arts (manship). That is e.g. craftstraining and craftsmanship in the woodworking trades have been relegated to (artistic) cabinet or furniture maker while all other aspects of woodworking craftsmanship can be handled with the same or even higher level of quality or “craftsmanship” by computer aided design and flexible manufacturing replacing traditional (middle level) skills by polarized qualification structures. Similarly, it is possible to individualize or personalize services production using IT-based technologies.

Increasing individualisation in the production and marketing of goods and services enable firms to move out of standard or average position without necessarily incurring higher costs.

ad c) The rise in the intensity of competition through the opening of markets and globalization

Probably the strongest argument against policies aimed at supporting middle level industrial standards and/or qualities comes from the market itself which on account of secular deregulation and liberalisation leading in some cases to a complete globalization of certain markets and industries provides today for a much greater variety of specialisation and quality differentiation as predicted by the late Nobel laureate J. Stigler (the degree of specialisation is limited by the size of the market).

Departures from “stuck-in-the-middle” positions in an otherwise benign environment of peaceful industrial and government-business relations and consensual collective decision making are therefore very often initiated by market forces.

4. Strategies for SMEs

To counter the firm’s internal disadvantages in the small and medium sized segment the choice of the right corporate strategy is of extreme importance (Peters & Raich, 2002).

Michael Porter (1992) has argued persuasively that three generic competitive strategies exist: overall cost leadership, differentiation, and focus.

Cost leadership: An overall cost leadership strategy requires efficient-scale facilities, tight cost and overhead control, and often innovative technology as well. Having a low cost position provides a defense against competition because less efficient competitors will suffer first from competitive pressures. Implementing a low cost strategy usually requires high capital investment in state of the art equipment, aggressive pricing, and start-up losses to build market share.

Differentiation: The essence of the differentiation strategy lies in creating a service that is perceived as being unique. Approaches to differentiation can take forms like brand image, technology, customer service, and other dimensions. A differentiation strategy does not focus on costs, but its primary thrust lies in creating customer loyalty. The differentiation strategy allows the service provider to require a higher price because of the services unique on the market.

Focus: The focus strategy is built around the idea of serving a particular target market very well by addressing the customers' specific needs. The market segment could be a particular buyer group, service, or a geographical region. The focus strategy rests on the premise that the firm can serve its narrow target market more effectively and/or efficiently than other firms trying to serve a broad market. As a result, the firm achieves differentiation in its narrow target market by meeting customer needs better and/or by lowering costs.

Every small and medium sized tourism enterprise has to choose one of these generic competitive strategies. For small and medium sized enterprises the cost leadership strategy is hard to realise because of the missing size of production. Bigger enterprises, especially industrial enterprises can supply their goods at relatively low prices because of the high production rate.

Thus, for small and medium sized enterprises in the tourism industry concentration on the differentiation or the focus strategy seems to be more profitable.

Another strategic option for SMEs in tourism is 'Cost-efficient differentiation', e.g. the production or supply of strongly differentiated services at low cost, i.e. the production and the offer of differentiated products/services at low costs.

Figure 3 gives an overview about the possible positioning for SMEs.

Looking at Figure 3 above we assume that the only sustainable market position for SMEs in tourism is the one of heavy product differentiation, yielding USPs in the form of distinct quality services or tourism experience for customers who consequently are willing to reward higher quality with a higher price. Customers' expectations will be met or even exceeded through added services and values for the customer or through new or differentiated products. The latter apply appropriate effects throughout the value chain of the tourism enterprise including sourcing of quality manpower, appropriate marketing, R&D policies, and the production and management of brands. Diseconomies of Scale and Scope, myopic behavior of

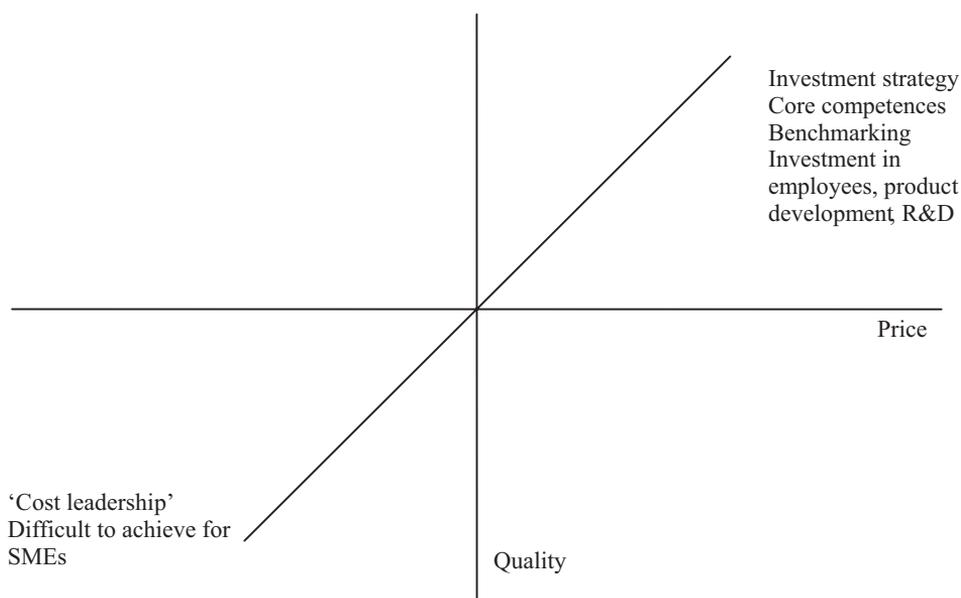


Figure 3. Positioning – Correlation between Price and Quality (following Pompl, Lieb, 1997, p. 172)

SMEs and financial constraints often construct insurmountable barriers for SMEs to move into such market positions.

5. New entrepreneurial challenges for SMEs

These changes in competition signalled the end for many “life-style” entrepreneurs, part-time owner-managers and all those who were unable to reorient themselves strategically towards these new market conditions. Thus, new entrepreneurial skills are necessary to obtain a competitive market position:

Creative Destruction: Entrepreneurship is a process of creative destruction. Schumpeter (1934) referred to the simultaneously destructive and constructive consequences of innovation. Both the creation and the destruction are essential to driving economy forward. Entrepreneurs are central to the process of creative destruction: they identify opportunities and bring the new technologies and new concepts into active commercial use (Volery, 2000)

Integration of market based and resource based view: entrepreneurs are often on the one hand focused on the analysis of the market (to find and explore market niches) or, on the other hand, on the analysis of enterprises’ resources. Thus, their

actions are reactions to the perceived transaction cost of entrepreneurial tasks. Today, more than ever both views are necessary: the integration of market and resource-based management means both market and trend orientation and use or development of necessary resources within the enterprises (Hamel & Prahalad, 1994).

New information and communication technologies (ICT): are particularly relevant for small and medium sized enterprises. While some basic computer applications, such as accounting and logistic processes only represent simple automation processes which can reduce employment sizes, others can support whole business processes, e.g. e-Commerce.

Business Plan & Financing: A number of small and medium sized enterprises fail due to insufficient form of financing. Often, as a result of too high debt-capital, the equity-ratio is too low and necessary investments cannot be done.

New Forms of Leadership: The rise of a new type of entrepreneur who is less operation- and more strategy-oriented, is also relevant in the small and medium sized segment. Entrepreneurs are not only managers: on the one hand they should assume calculated risks, be better trained / experienced, more orientated towards problem-solving. On the other hand, entrepreneurs should possess interpersonal skills or entrepreneurial influence skills, such as creation of a vision, being a coach for the managers and employees, encouraging teamwork, creativity and innovation.

Entrepreneurial networks: Building up networks between tourism companies and / or destinations represents a new form of entrepreneurial cooperation. An important feature of tourism networks is to find a balance between cooperation and competition in the limited local area. The success of locally organized small and medium sized networks seems to be heavily dependent on the learning aspect. Such networks can comprise few company operations like marketing or R&D and can also extend to destination-wide cooperations (Bieger, 2002).

Networking allows small and medium sized companies to combine the advantages of smaller scale and greater flexibility with economies of scale and scope in larger markets – regional, national and global. Compared to larger firms, small and medium sized enterprises can often respond better to changing market conditions, evolving customer preferences and shorter product life cycles by customizing and differentiating products / services.

6. Conclusion

Competition in the field of small and medium sized tourism enterprises has changed fundamentally in the last decade. New market forces, especially the success of information and communications technologies, past and future political changes worldwide and within Europe, the upcoming EU east expansion, represent coeval

change and threat for the small and medium sized segment. Only enterprises can attain a long-term value enhancement that will be able to find a competitive position different from their competitors'. The production of high quality products and / or services and the consequent persecution of a differentiation or focus strategy will strengthen the market position of SMEs in tourism.

Fostering networks in the area of small and medium sized tourism enterprises may be the most expeditious path to this dynamic sector. SMEs can often be more flexible and responsive to customer needs than larger firms. In networks SMEs can pool resources and share costs of research and marketing. These local networks can help SMEs meet the challenges of globalization.

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