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Operating Environment and Strategy: The Profitable Connection

Abstract

Which operating strategy will work for your hotel? The answer depends on your market situation. Here's how to match your strategy to your market.

Keywords

hotels, marketing, operating strategy, hospitality business organization

Disciplines

Hospitality Administration and Management | Marketing

Comments

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Operating Environment and Strategy: The Profitable Connection

Which operating strategy will work for your hotel? The answer depends on your market situation. Here's how to match your strategy to your market

by **Chekitan S. Dev**

MOST LODGING operators do not need to be told that they have faced a hostile environment for the past several years. The growth in demand was two percent during 1987, while supply expanded by 2.6 percent.¹ In an environment where supply is expanding faster than demand, and inflationary, regulatory, and competitive pressures are mounting, hotel executives must ask whether there is a strategy that will give them a chance to outperform their competition.

Based on the study I will describe here, I believe that there is, in fact, an optimal fit between the operating environment and your hotel's business strategy. A single strategy will not be successful in all environments. Moreover, I have found that lodging firms whose strategy matches the environment are more successful than those that are using an inappropriate strategy.

¹Laventhol & Horwath figures.

What Is Strategy?

The term strategy is bandied about a great deal these days. Simply put, your strategy is the pattern of decisions you make about how you conduct your business, or more specifically how your business competes within its product or market segment.² Several researchers have attempted to classify business strategies, and none of these typologies has gained general acceptance.³ The most useful framework for the purpose of this analysis is one created by R.E. Miles and C.C. Snow that focuses directly on the intensity of a company's product and market development. This typology divides strategies into the following four categories:⁴

²See: H. Mintzberg, "Patterns in Strategy Formation," *Management Science*, 24 (1978), pp. 934-948; R.E. Miles and C.C. Snow, *Organization Strategy, Structure, and Process* (New York: McGraw-Hill, 1978); and C. W. Hofer and D. Schendel, *Strategy Formulation: Analytical Concepts* (New York: West Publishing, 1978).

³Michael E. Porter, *Competitive Strategy* (New York: Free Press, 1980), p. 5.

⁴C.C. Snow and L.G. Hrebiniak, "Strategy, Distinctive Competence and Organizational Performance," *Administrative Science Quarterly*, 25 (1980), pp. 317-366.

- **Defenders:** Companies that emphasize *efficiency*. These firms are best at production, applied engineering, and financial control.
- **Prospectors:** Companies that emphasize *innovation* through product and market effectiveness. These companies are best at product research and development, market research, and basic engineering.
- **Analyzers:** Companies that *adapt* the prospectors' innovations and *imitate* the efficiency of defenders. These firms quickly jump on successful products developed by innovators, adapt them to efficient production using *technology*, and market them heavily. They are best at production, applied engineering, and marketing.
- **Reactors:** Companies that *lack fo-*

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EXHIBIT 1

Description of responding hotels

Affiliation	Frequency	Percent
Best Western	9	5.0
Comfort Inns	3	1.7
Days Inns	5	2.8
Doubletree Hotels	3	1.7
Guest Quarters	2	1.1
Hilton Hotels	8	4.4
Holiday Inns	48	26.7
Independent	34	18.9
Marriott Hotels	7	3.9
Quality International	6	3.3
Radisson	5	2.8
Ramada Hotels	10	5.6
Sheraton Hotels	14	7.8
Self-Serv Inns	2	1.1
Travelodge	2	1.1
Eighteen other chains	18	10.8

Size	Frequency	Percent
Fewer than 160 rooms	37	20.6
160 to 200 rooms	51	28.3
200 to 260 rooms	47	26.1
More than 260 rooms	45	25.0

Location	Frequency	Percent
Airport	20	11.1
Center City	37	20.6
Highway	34	18.9
Resort	35	19.4
Suburban	54	30.0

Operating Arrangement	Frequency	Percent
Chain owned/managed	24	13.3
Chain leased/managed	3	1.7
Chain managed	19	10.6
Franchised	101	56.1
Independently owned/managed	33	18.3

cus on their competition. They have no clearly defined competencies. This "strategy" is unstable and not viable in the long run.

Environment

Your hotel operates in two kinds of environments—the internal environment of the hotel itself and the external environment. In this article, I am dealing only with the effects of the external environment, which may be defined as all the physical and social factors that are taken directly into consideration in your decision-making process.⁵ Your market environment may be relatively stable, which means that you can easily foresee the modest changes that are occurring. Alternatively, the market environment may be rapidly changing and uncertain. I believe most hotel executives can identify whether they are dealing with a stable or uncertain environment, even if they do not think of it in those terms.

Success

Your business strategy should have an effect on how well your company performs. If you have matched your strategy to the characteristics of your environment, your company should outperform those lodging organizations that have failed to make such a match. The two major ways of measuring the success of a business operation are profitability and sales. So, for this study, I compared the business strategy, the level of environmental uncertainty, and financial performance, as measured by profit and revenues.

Go Ahead, Ask...

I mailed questionnaires to 4,000 executives at 2,000 hotels with more than 150 rooms across the U.S. I received responses from 204

hotels (ten percent). The respondents represented many major chain flags, although the largest single group operated Holiday Inns (26.7 percent) and independents formed the next largest group (18.9 percent). Four out of five hotels in the survey had between 150 and 300 rooms. Looking at the responding hotels by type of operation, the suburban hotels constituted the largest single group (30 percent), followed by nearly equal numbers of center city, highway, and resort hotels (around 19 percent each). Just 11 percent of the hotels were located at airports. Over half the hotels were franchised, a statistic that may have had some bearing on the findings. See Exhibit 1 for a complete description of the sample.

Uncertainty. To determine the level of environmental instability, I asked survey respondents to report the level of change in 26 items connected with six inputs to their business over the past year. I asked about suppliers, competitors, customers, financial and capital markets, the labor market, and government regulation.⁶ The items in these six categories included prices charged by competitors, competitors' additions to the room supply, the level of interest rates, and the availability of employees (see Exhibit 2). The higher the score on these 26 items, the greater the level of environmental uncertainty.

Strategic moves. To assess strategy, I gave the respondents descriptions of the four strategic types and asked them to check the one that came closest to describing their hotel. I asked both the general manager and at least one member of the hotel's top-management team to identify the strategy. Asking two members of the top-management team to identify strategy provided a cross check on the self-identification of each hotel's strat-

⁵R.B. Duncan, "Characteristics of Organizational Environment and Perceived Environmental Uncertainty," *Administrative Science Quarterly*, 17 (1972), pp. 313-327.

⁶Miles and Snow, p. 200.

egy. I received two surveys from just 70 hotels, but the agreement on those was remarkably high.

Attempting another method of determining the hotels' strategy, I also gave the respondents a list of 23 strategy characteristics and asked them to rate the extent to which each one fit their hotel. The following were among the items on the list: "building reputation," "selling at lowest rate," "maintaining operational efficiency," and "keeping track of the competition." The idea of this part of the survey was that an outside observer should be able to figure out a hotel's strategy from the characteristics that describe it.⁷ That supposition was not supported by the results, however. There seemed to be no relationship between the reported characteristics and strategies. I will not pursue that finding in this article, except to point it out and suggest that other researchers may wish to examine this matter in greater detail.

Environment and Strategy

Just under one-third of the hotels reported operating in a stable environment, while more than one-quarter reported considerable volatility. The remaining group (43.6 percent) faced a somewhat volatile environment. The hotels most likely to face a volatile environment had highway or suburban locations. Center city, airport, and resort hotels generally perceived themselves as being in relatively stable environments.

Nearly half of the hotels considered themselves prospectors, while about one-fourth were analyzers and another one-fourth said they were defenders. A minuscule three percent identified themselves as reactors. These results make some sense. Many researchers have sug-

⁷See: Jeffrey D. Schaffer, "Competitive Strategy, Organization Structure, and Performance in the Lodging Industry: An Empirical Assessment" (Blacksburg, VA: Virginia Polytechnic Institute, 1986).

gested that the prospector mode is connected with a volatile environment, and we all have seen the environment grow more volatile. The small number of reactors is also a common-sense result, because most researchers consider the reactor mode the death knell of a hotel operation. Even after removing reactors from the statistical analysis, I found no relationship between location and reported strategy.

The hotels' operating arrangements seemed to correlate with their location, the volatility of their environment, and their strategy, however. The franchised hotels were most likely to be in highway or suburban locations, they were most likely to report that they were in a volatile environment, and they were most likely to be prospectors (innovatively searching for business). This correlation must be taken with a grain of salt, however, due to the great preponderance of franchised hotels in the respondent group. Moreover, a cross tabulation that included all the respondents found no relationship between the hotels' strategy and their environment.

Performance. The first performance measure I used was a profit measure of income before fixed costs (IBFC) divided by total sales. The IBFC is a consistent measure for most hotels, because all the cost items involved in this calculation are, by definition, operating expenses. This measure is not contaminated by variations in financial structures (e.g., interest expense) or the nature of property ownership or management. I also used a revenue measure—sales per available room (SPAR)—as an alternate method of judging the hotels' success.

The Main Question

The principal purpose of this study was to investigate the relationship between strategy content, environ-

EXHIBIT 2

Environmental characteristics

1. Suppliers of food, beverage, or operating supplies:
 - a. prices charged
 - b. product quality standards
 - c. product/service specifications
 - d. introduction of new products
2. Competitors' actions:
 - a. supply of rooms
 - b. rates charged
 - c. renovation and refurbishment
 - d. new services/facilities offered
3. Customer's demand:
 - a. for your services
 - b. for new facilities/services
4. The financial/capital market:
 - a. interest rates
 - b. availability of credit
5. The labor market:
 - a. wage and salary rates
 - b. availability of employees
6. Government regulatory agencies (changes in laws or policies):
 - a. regarding rates you can charge
 - b. regarding room, food, or beverage quality
 - c. regarding provision of your services
 - d. affecting personnel/labor decisions
 - e. affecting sales and marketing
 - f. affecting accounting/bookkeeping

Respondents rated the degree of change in each item on a scale of 1 (stable) to 6 (volatile). A mean score of 3.2 or above indicated a volatile environment. A mean score of 2.25 or less indicated a stable environment.

The dual nature of hotel operation may require a combined strategy of efficient core operations and innovative service.

mental uncertainty, and financial performance of lodging operations. To begin with, the results showed that matching strategy to the environment does make a difference. If this were not the case, one might expect a single, given strategy would show good financial results across all markets regardless of volatility. The research results did not support this theory. What this means is that one single strategy will not necessarily be successful everywhere and that different strategies can result in equally strong performance, depending on your market situation. The success of a hotel's strategy is, in fact, dependent on the market situation in which it operates.

In this analysis, I noticed a pattern connected with financial measures. The financial measure you use might influence your assessment of how successful your strategy has been. These results were not statistically significant, but the pattern emerging here deserves examination. If you use the profit ratio (IBFC divided by total sales), defenders outperformed analyzers, who, in turn, outperformed prospectors. Specifically, the defenders' profit ratio was 40 percent overall, the analyzers' was 38 percent, and the prospectors' was 30 percent. The efficiency-oriented defenders were able to make more money from their sales, while hotels that used greater levels of innovation, particularly the prospectors, saw a somewhat lower percentage of profit on sales. However, when measured on sales per available room, the prospectors were top performers. Defenders showed the lowest sales levels, and analyzers were once again in the middle ground.

Looking at the aggregate numbers, the prospectors realized sales per room of \$79.57, the analyzers drew \$73.41 per room, and de-

fenders had just \$54.46 in sales per room. To reiterate, the choice of performance measure makes a difference in how various strategies are assessed.

Stable Environments

Hotels using the defender strategy performed best in a stable environment, particularly when the measure being used was profit level. Prospectors placed second, and analyzers were a distant third in profit level in a stable environment. A note of caution, however—the statistical difference between defenders and prospectors was not significant, and the statistical difference between prospectors and analyzers was not significant. Significance was found in the difference between defenders' and analyzers' performance.

Using sales per available room as a measure, analyzers and prospectors had the greatest success, while defenders' sales were substantially lower. However, none of these results is statistically significant. The fact that defenders reported the greatest profit on the least sales may be indicative of the efficiency component of the defender strategy.

Volatile Environments

Based on previous research, I expected prospectors to report the greatest profits in a volatile environment. The results of my study did not bear this out. Prospectors did, indeed, have the greatest sales levels. But once again, there was no significant difference among the strategies on the SPAR measure. Profit levels were a different story. Analyzers, with their combination of innovation, efficiency, and marketing, easily outperformed prospectors and defenders on the profit measure. The analyzers were apparently able to keep more of their sales per available room, despite

the fact that prospectors and defenders both outsold them.

Size

The size of the hotels in this sample seemed to affect the levels of profit and revenue. Larger hotels (those over 260 rooms) earned significantly smaller profits than the smaller hotels, particularly those with 150 to 160 rooms. On the other hand, larger hotels commanded greater sales per available room than the small hotels.

The Price of Innovation

Obviously, it is not possible to give a strategy unequivocal credit for high or low performance. The choice of a performance measure is often based on tradeoffs that may be biased in favor of one type of test. Profit is the defender's strong suit, for instance, but prospectors look better when success is measured by revenues. Regardless of the measure used, analyzers' performance depended more on the environment. This finding is consistent with the hybrid nature of the analyzer strategy. Finally, reactors, the organizations that essentially ignore their environment, evidently paid a price in terms of inefficiency and fared worst of all.

The findings indicate the trade-off business organizations must often make between innovative growth and financial return, market share and return on investment, and profit and revenue. If a hotelier follows a prospector strategy, the firm will need to invest substantial resources in research and development as a necessary prerequisite to innovation. The hotel will eventually be tapping new markets with its innovative products, but the short-term result will be lower profits. Conversely, the hotel management that seeks an improved bottom line will take the necessary efficiency steps that en-

sure more profits—namely, cost control and cutting fat. This is the defender mode of operation.

In this discussion, I am looking at the extremes, and I do not mean to imply that prospector-type operations cannot be profitable or that defenders cannot increase revenues. In the short term, however, the organization's executives must determine a plan of action that is based firmly in the outcome (performance measure) that they are aiming toward. The optimal solution for hotels may be the analyzer strategy—to wit, a balance of efficiency and innovation. It also may be that another measure of performance should be used to discriminate among these strategies.

Analyzer service. Taking a closer look at the unexpected success of analyzer-type hotels in volatile environments, there is a strong possibility that this finding may result from the dual nature of hotel operation. Your hotel is a combination of two types of business activities. It seems likely that hotels can be efficient in operating their core technologies while being innovative in the input and output stages of their service-delivery system. Your back-of-the-house operations are generally amenable to systems and controls. But your guest-contact areas are best suited to innovative and personal service.

In a volatile environment, such as that experienced by many hotels today, the analyzers were able to make maximum profit from a minimum of revenue. Prospectors were able to bring in maximum revenue in both volatile and stable environments, but the cost of innovations apparently brought their profit levels down. A volatile environment was costly to defenders, who made the smallest profit levels in this situation.

In a stable environment, prospectors again brought in the great-

est revenue, but defenders were able to make the greatest profit from relatively small sales levels. Analyzers had the greatest difficulty making large profits in a stable environment.

Limitations. The relatively large number of franchised highway hotels may have skewed these results. I also believe we need to validate the self-report method for determining what strategy a hotel is following. It is particularly important to note that a strategy can change as management sees fit. Researchers should also experiment with other measures of success, since this study could not resolve the apparent contradiction between revenue and profit measures. Finally, I make no claim of causality from these findings, because I did not investigate causes. The best conclusion that can be drawn from these data are that a certain strategy is associated with certain types of results in a certain environment.

Nevertheless, that finding is important, because it validates a theory that has long been held by many researchers. There seems to be an interaction between environment and the success of different strategies. No single strategy is guaranteed to succeed in all situations. This finding supports what is known as the contingency school of thought, which holds that a number of factors interact with strategy, making different strategic choices more effective in different situations. In this view, strategy is an adaptive mechanism to be used for achieving optimal performance. Moreover, the strategy that will produce the best results is dependent on existing environmental circumstances. Once that strategic choice is made, management must make internal adjustments so that the organization can conform to the strategic imperatives and improve its performance. □