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**THE IMPORTANCE OF VALUE CHAINS, NETWORKS AND CO-  
OPERATION AS DRIVERS FOR SMEs GROWTH, PERFORMANCE  
AND COMPETITIVENESS IN THE TOURISM-RELATED  
INDUSTRIES**

**Creating value to tourism products through tourism networks and clusters:  
uncovering destination value chains**

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**CREATING VALUE TO TOURISM PRODUCTS THROUGH TOURISM NETWORKS AND CLUSTERS: UNCOVERING DESTINATION VALUE CHAINS**

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**ABSTRACT**

It is widely accepted that technological change underpins a global economy and that geographic location and concentration is of foremost importance for tourism development and competitive advantage. This paper discusses the role of tourism networks, clustering and destination value chains for micro and small and medium size tourism enterprises (SMEs) in freely assembled destinations. In discussing destination benefits and barriers surrounding SME clustering, SME positioning and performance are highlighted. It is proposed in this paper that SME clustering and value are not always naturally established. Successful destination clusters may be created by upgrading SME performance, analysing local value chains and matching both tangible and intangible sources of value, such as systems, leadership, relationships and brands with demand-side value segmentation.

**INTRODUCTION**

The growing influence of ICT, networks and relationships as critical factors in shaping the distribution of economic advantage is relevant to tourism, as it directly impacts on interactions between local and global forces (Giddens, 1990). The realities of global competition require an understanding on the local level of global markets and the complexities of interactions with multiple stakeholders along global supply chains (Youngdahl & Loomba, 2000). Today's tourism manager is expected to possess the ability to mobilise information and capture knowledge that contributes to the augmentation of product or value along global value chains. Well resourced large and vertically integrated industry players in the tourism sector have been steadily upgrading and globalising their network systems, building on long-established relationships for competitive advantage. The dynamics are quite different for small and medium size enterprises (SMEs) in freely assembled destinations, where the benefits of network strategies are less well understood. Tourism networks are complex structures, yet there are relatively few studies on tourism networks (Morrison, Lynch, & Johns, 2004), resulting in a limited understanding of tourism networking processes at the destination level.

**BACKGROUND**

Theoretical discussions on generic networks can be found as far back as 1960 (Philips, 1960), although it would take several more decades until Davidow and Malone (1992) called networked organisations 'virtual corporations', referring to the loosening of well-defined hierarchical company structures into a more flexible and shared approach towards the delivery of products and services to match customer desires. Connectivity and the Internet have added new externalities to the concept of networked firms.

Today's networks coordinate much of their business through the virtual marketplace. In principle, such networks are made up of a set of interconnected nodes with fluid decentralised structures and boundaries. A network is able to integrate new nodes based on the node's ability to communicate with or add value to the network (Castells, 2000). Within the texture of interdependence, modifications in a

network can be caused by both exogenous factors, such as a transformation in the economic and technological climate, and endogenous ones, such as network actors initiating changes in the business relationship (Håkansson & Snehota, 1995) The extent and importance of these networks usually relate to firms' and actors' horizontal and vertical relationships, network culture and strategic complementarity. The latter will influence the scope of the network and its global positioning.

## **TOURISM NETWORKS**

The interrelationship between tourism networks and technology is not a recent phenomenon. Its legacy is worth revisiting as it still dominates today's dual industry structure composed of large international players and SMEs. Computerised Reservation Systems (CRS), developed and operated by airline companies in the 1960s to manage their increasing volume of passengers and related logistics, were among the first integrated global information technology networks. In due course proprietary CRS were made accessible to travel agents and subsequently expanded to include hotels and car rental companies (Werthner & Klein, 1999).

In the 1980s CRS started to integrate with other technology networks to form Global Distribution Systems (GDS), examples of which are Amadeus, Galileo, Sabre, Worldspan and the Australian ETAS system (Inkpen, 1998). In another systemic upgrade, interconnected GDS technologies that linked to supplier hotels were advanced into HDS or specialist hotel distribution systems, in effect becoming sector-specific horizontal distribution networks. HDS have been of the greatest importance to those hotels without their own distribution system and formerly reliant on traditional intermediaries. However, most of the accommodation establishments worldwide are family-run small and medium size tourism enterprises belonging to local entrepreneurs (Buhalis & Main, 1998). In Europe alone, 85 percent of micro and small tourism firms are not listed on GDS serving more than 50,000 travel agents worldwide (Werthner & Klein, 1999), restricting both tourism firms and customers access to one another. In Australia, the marketing distribution system known as the Australian Tourism Data Warehouse (ATDW) similarly excludes micro and small tourism firms, which make up over 90% of the Australian tourism industry.

Strongly interdependent SME tourism network structures tend to exist only within a destination based on complementary product, e.g., activities, accommodation, transport and food, whereby clients are referred from one organisation to another to provide a comprehensive tourist experience (Grefe, 1994). SMEs that exclude themselves from these linkages end up disadvantaged as such inter-firm connections often results in market visibility and strategic leverage (Pavlovich, 2001). The structure of the destination network and the manner in which the linkages between SMEs are formed and maintained can therefore be critical.

## **CLUSTERS**

For SMEs, local networks represent a complementary response to insecurity arising from development and use of new technologies. There is increasing evidence that the performance of existing enterprises is significantly improved by clustering (Rosenfeld, 2003, 2001). By networking and sharing knowledge, small firms are able to compete for and access specialised resources and information systems as well as internalise competencies and assets that typically are internalised by large firms with economies of scale (Tayler & McRae-Williams, 2005). Clustering hence provides SMEs benefits that would be unavailable or be available at a greater cost to non-clustering members. Clusters and networks are interdependent, whereby small business network structures underpin the growth and sustainability of clusters.

There are various clustering forms that may ensue to optimise competitive advantage. In horizontal clustering companies within the same industry sector are co-located in a particular geographic area and

might share an industrial or technological base, operate within a common market and use a common purchasing and/or distribution channel. Vertical networks include horizontal cluster participants as well as supply chain members such as suppliers, consumers and related services. Diagonal clustering refers to the concentration of complementary or symbiotic activities, whereby each firm adds value to the other, thus creating a value chain.

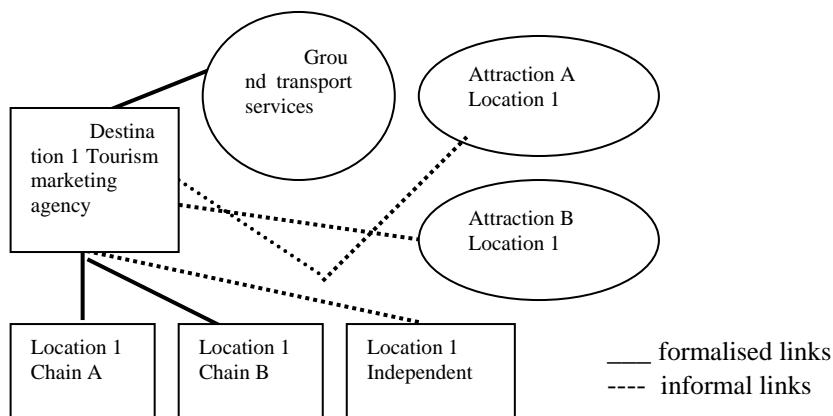
As industry clusters become more accepted, their definition, boundaries and composition become more complex, which has led some cluster researchers (see Rosenfeld, 2003) to focus on clustering activities rather than on clusters as such. The cluster definition adopted for this paper is a co-location of activities that are linked horizontally, vertically or diagonally along the value chain. As the cluster gains an identity, such as a recognised tourism brand, it becomes an attractant to new entrants and creates major external economies for cluster participants. With the exception of virtual clustering, where geographic proximity is not necessarily applicable, much of the cluster literature emphasizes the importance of local networks, social capital and trust for competitive advantage (McRae-Williams, Lowe, & Taylor, 2005, Rosenfeld, 2003). Trust as the basis of collaboration is conducive to information and knowledge flows, which improves cluster efficiency and effectiveness, either formally or through spillovers, and may spur innovation (McKinsey and Co, 2000). Constraints that affect cluster development include lack of leadership, low levels of collaboration, and lack of trust between firms.

Regional conditions have great bearing on the clustering process. Porter discusses a cluster's competitive advantage as being created and sustained through a highly localized process that cannot be duplicated by global partnering (Porter, 1998). Critical to Porter's analysis of clusters are the dynamic effects created by the interaction of industry and place (Porter, 2003).

## TOURISM CLUSTERING

The diagonal or local destination network (Figure 1) proposed by Tremblay in 1998 as a possible framework for SME collaboration forms a useful basis to envision the make-up of a tourism cluster, as it builds on the coordination of complementary assets at the destination end of the service chain. Tourism operators at the destination share public infrastructures and attractions; cooperatively manage their resources; and innovate while reducing the threat of negative externalities. Cooperative marketing transaction strategies and upstream linkages (in partnership with the local destination marketing organisation, on which SMEs have traditionally relied for market exposure) play a pivotal role in such local destination networks. Diagonal integration and value adding is made possible through ICT-based marketing and destination portals. Portals tend to rely on technologies that broker access to remote web sites on the user's behalf, so users do not need to leave the portal interface (Clark, 2002). As a business entry point, e-marketplaces can perform a number of functionalities, ranging from procurement to customer relations and knowledge management, to supply chain and value chain management.

Figure 1. Local Destination Network: Adapted from Tremblay 1998



Tourism SMEs can participate in one or more overlapping networks, depending on perceived value, such as the lowering of transaction costs and exploitation of economies of scale. In this scenario a variety of value-based SME networks may be established within a destination or tourism cluster. Present day cluster theory poses that based on (customer and industry) communication, knowledge exchange and community building, these internal destination networks have the potential to drive the growth and specialisation of the SME tourism cluster (Porter 2000).

Natural resources have long provided small tourism firms with a clustering incentive around geographic icons such as a natural health spa or a national park. Cluster research indicates that industry players tend to concentrate on certain locations, demonstrating that the tourism industry has the potential to achieve positive economic outcomes through clustering (Roberts, 2000). This is in keeping with mainstream literature on destination competitiveness, which has traditionally found that certain attributes such as scenery, climate and accommodation attract visitors (Crouch & Ritchie, 1999). Positive tourism clustering reports come, for example, from Far North Queensland, home of The Great Barrier Reef, which has driven SMEs to concentrate in various locations along this popular icon. Another successful Australian cluster example hails from the natural spa region in the state of Victoria, where SME collaboration has spurred a virtual gateway as an additional destination sales channel and supply chain booking service (Multimedia Victoria, 2002). This is not to say that these cluster formations necessarily occurred organically or that they do not require ongoing support.

## BARRIERS TO CLUSTERING

Interesting models and success stories notwithstanding, there is still a significant gap between the rhetoric and reality of tourism clustering. Many regions lack the critical mass of firms as well as the critical elements of strategic infrastructure (hard, financial and human infrastructure) needed for cluster development and growth.

It has been suggested that small tourism enterprises form a natural amalgam, because the fortunes of the local destination and the firms are closely intertwined (Buhalis & Cooper, 1998). Although research indicates that tourism SMEs tend to cooperate rather than compete by formulating value-added networks of product and service delivery that enhance the tourist satisfaction, e.g., by referring customers to each other (Greffe, 1994), SME participation in networks and clustering is far from guaranteed.

SMEs do not proactively engage in networking. Micro and small tourism operators tend to be lifestyle entrepreneurs, who often do not even consider themselves part of the industry (Braun & Hollick, 2005a). Other barriers to entering industry networks have been put down to cultural factors on the one hand and lack of resources (time, staff, opportunity) on the other (Evans, 1999). Small and micro firms tend to limit their external contacts to compulsory contacts, e.g., local government and tax agencies and direct support actors and agencies, e.g., customers, accountants and banks. As illustrated in Figure 2, voluntary membership of trade organisations and networks is a low priority for tourism SMEs.

**Figure 2. Continuum of SME Network Relationships**

| Continuum of SME Network Relationships |                       |   |                              |                                |                                       |                                       |
|--|-----------------------|---|------------------------------|--------------------------------|---------------------------------------|---------------------------------------|
| Compulsory-----                        |                       |   | ----- Voluntary              |                                |                                       |                                       |
| Sales to customers                     | Purchase of resources | Government: Central (tax) Local (rates, planning) | Banks Accountants Solicitors | Marketing/ Research Strategies | Advice Consultants Agencies Education | Membership of Trade Orgs and Networks |

An Australian government funded portal initiative undertaken in a product region with geographically dispersed tourism operators indicated that SMEs were averse to clustering across sub-regional destinations based on single icon branding, illustrating that place, network cohesion and branding are important determinants for clustering. The portal project also showed that embracing ICT and technology is still a complex and phase-based process for SMEs. The top-down and technology-driven initiative undertaken on behalf of this tourism network left local operators with no sense of belonging and no perceived sense of value in (virtual) clustering (Braun, 2004, 2002).

A recently completed cluster complementarity study on co-located regional wine and tourism clusters similarly found that wine makers were more inclined towards networking and knowledge sharing than tourism operators, indicating that complementary networks do not routinely create added value; that cluster overlap does not necessarily influence the capacity of clusters, or turn them from passive into active clusters (McRae-Williams et al., 2005). The latter study confirms that place and industry are important factors in tourism clustering.

In considering aforementioned cluster study findings and the dynamic effects created by interaction of industry and place (Porter, 2003), the make-up of the tourism industry merits further examination. The tourism industry remains a largely unregulated industry with low entry barriers, resulting in entrepreneurs entering the industry with a low skill base (Hollick, 2003). Apart from the high level of business failure of small and micro tourism firms, low entry barriers impact on the destination value chain as a whole, since the tourism product is created between SMEs rather than by a single firm. Provided that market demand and product quality can be matched to create seamless visitor experiences, value is created within the destination, which in turn contributes towards positive tourism clustering development and increases cluster opportunity for inclusion in global value chains. Conversely, since there is a cumulative impact on how consumers experience the wider destination, it is argued that one poor experience can negatively impact the entire chain of experiences. Applying Akerlof's (1970) theory of 'adverse selection' to the tourism industry, the presence in the marketplace of operators who are willing to offer inferior product affects not just the local market, but impacts on the industry as a whole.

Large industry players with economies of scale are clearly in a position to dominate global value chains. The literature points to the role of powerful lead firms (such as airlines) in influencing supply-demand, inter-firm relationships, upgrading opportunities for local players (e.g., destination clusters), and flows along the global value chain (Humphrey & Schmitz, 2002). In other words, value chain governance and power relationships may inhibit upgrading of and access by destination clusters to existing networks and global value chains. From the lead firms' point of view, when it becomes more difficult to monitor the value of the product or the performance of the supplier, transaction costs increase, making the establishment of new network nodes less desirable.

Adopting Porter's (1998) view of competitive advantage, the vitality and competitiveness of destinations is essentially linked to the competitiveness of individual firms. The management of a complex of market segments for destination value creation requires a high level of skill (Hollick, 2003). Aforementioned cluster studies indicate that individual tourism SMEs often lack the required skill base and do not have a strategic grasp of whole-of-destination value creation (Braun, 2004; McRae-Williams et al., 2005).

Value creation in the new economy impacts both companies and consumers. As consumers become more knowledgeable, they have increasing expectations in terms of convenience, value and customisation (Wynne, Berthon, Pitt, Ewing, & Napoli, 2001). To brand and produce services of commensurate value, the "consumption of the destination in general, and the focal SME services in particular", need to fit into

“visitors’ travel lifestyle and needs” (Gnoth, 2004, 4). SMEs have a less than perfect understanding of how tourists perceive destinations and compose their value path while passing through a destination. In the majority of cases, the ‘path’ which the (independent) traveller follows as s/he moves through a freely assembled destination (or along its value chain) is outside the control of a single SME (Gnoth, 2002) and channel knowledge is therefore not captured. This raises concerns vis-à-vis the flow of knowledge and value chain quality, issues which affect clustering processes and the competitive strength of the destination.

## **FUTURE DIRECTIONS**

This paper has discussed the role of networks, clusters and value chains for tourism SMEs, and explored some of the factor conditions that determine successful SME cluster formation and growth. The paper has suggested that successful tourism clustering requires a high level of cohesion, professionalism and industry knowledge, which is underpinned by SME networking and knowledge sharing. The paper has also suggested that understanding both tourism supply and demand value chains and aligning the destination assets with customer value segmentation has the potential to enhance the competitive advantage of destinations.

What are the implications for policy in the tourism industry? Clusters will grow if a critical mass of firms, strategic infrastructure, inclusive networks, leadership, a pool of skills, entrepreneurship and knowledge flows are in place to create unique sets of core competencies, product and branding. However, as research has indicated, networks and value are not always naturally established and may hence need to be fostered. Since clusters are critical for SMEs in terms of value creation and competitive advantage, tourism policies directed towards SMEs should always include clustering aspects. While such policies cannot compel SMEs to network, they can help augment destination capital, provide infrastructure needs, promote leadership, and benefit overall clustering processes. Cluster processes require cluster members to have specific skills sets with each contributing unique competencies. Consideration should hence be given to augmenting SME competency levels through capacity building programs (see Braun & Hollick, 2005b).

This paper has shown that little is known about SME networks, local value chains and related destination assets. Cluster intervention initiatives that are coupled with competitive research and innovation grant programs can assist in the identification of local value chains, new product uses and markets {Rosenfeld, 2005 #627}. Mapping assets at the destination end of the service chain will provide knowledge on local and regionally embedded networks, while a strategic analysis of the local/regional value chain will help destinations to match local attributes with established and emerging visitor profiles. Cluster challenges faced in this environment include appropriate asset integration and asset management, e.g., how to identify and leverage all sources of value, not just the assets that are tangible, but also intangible assets such as systems, leadership, relationships and intellectual property such as brands (Boulton, Libert, & Samek, 2000). Normann & Ramirez (1993) propose that strategic analysis of the value chain effectively is primarily about aligning the right segments, the right value-adding activities. This type of alignment builds its competitive advantage based on networking with the tourist and sustains the idea that the tourism value chain is a combination of supply-side and demand-side value integration. The relationship with the tourist serves as a source of capturing knowledge, whereby a destination marketing system or local portal might become the place for shared information and networking among different value-creating activities (Ryhänen, 2003).

New technologies have influenced the supply chain inasmuch as the web is considered an important new distribution channel, but due to prevailing GDS make-up and the slow uptake of ICT, many small tourism operators have continued to rely on traditional supply chains for market exposure. Considering that SME isolation from GDS effectively deters their access to broader travel markets, it is vital that more effective and comprehensive linkages are considered between SMEs and global distribution systems.

Reassessing the role of SME clusters vis-à-vis global distribution will advance the adoption of ICT by individual tourism firms and contribute to new destination management partnerships.

As Gretzel et al. (2000) have pointed out destination success in the knowledge economy is more about change in approach than about technology itself. In order to avoid marginalisation of tourism SMEs in the knowledge economy, tourism communities, industry players and policy makers seeking to advance the role of tourism SMEs in the global economy would do well to address core industry standards and performance practices.



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