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How to define business models for SMEs. The case of Hotels

Research paper

Session 2: The behavior and performance of enterprises in the tourism sector

1. Introduction

The Italian Hotel Sector is composed by over 33.500 units which represent the 26% of the total means of accommodation and 47% of the total bed places. In the last years the following main trends characterized the sector:

- the progressive decrease of the low category units (1-2 stars), from 49% in 2001 to 39% in 2006
- the increased number of the medium-to-high category units (3-4stars), from 50% in 2001 to 61% in 2006
- the rise in the average dimension per unit, from 56 bed places in 2001 to 61 in 2006
- the improvement of the services offered (e.g. fitness centres, sauna, sport facilities).

In spite of these positive changes, the structure of the sector remains characterized by a big number of units of small dimension with a family-based management, an average number of 8 employees per firm and an average gross revenue of 500.000€ per year. Only 0.8% of the firms produce a gross revenue exceeding 5 million € while 40% is grouped within the range from 250.000 to 1.000.000.

Furthermore, their location (typology of destination and position within the destination) is greatly responsible for their performance from both the product and market perspective and explains the observed strong differentiation in competition policies adopted, not specifically depending on the firms dimension.

Within this context, the analysis of the competitive conditions and factors of the Hotel sector is crucial to understand which practices become successful or determine the decline and what are the critical variables.

The paper focuses on these issues and summarizes the results of the study carried out for the Italian Ministry of Finance aimed at identifying competition/Business Models (BM) within the Italian Hotel sector, to orientate the industrial policy towards the SMEs.

The objectives of the study are:

- To pinpoint strength and competitiveness factors that lead the Hotel sector of SMEs to success
- To identify the conditions of success (competition factors and organizational structure) that allow the Hotel enterprises to maintain efficient and profitable

performances even among the increasing difficulties (both structural and short-term) that characterize the Italian tourism market.

- To produce guidelines in order to elaborate an industrial policy to support competitiveness in the SMEs

The economic data for the hotels (a sample of over 19.000 enterprises) which have been used for the analysis, have been collected through the “Sector Studies Survey” carried out by SOSE¹ on all the companies of the Italian industrial system, with a turnover limit of 5,16 millions of euro.

Next paragraph focuses on the concept of Business Model (BM) and on the theoretical background; paragraph 3 describes the research plan and the methodology used to identify the Business Models within the Italian Hotel Sector; paragraph 4 presents the Business Models obtained through the application of the cluster analysis, while paragraph 5 discusses the BM positioning and performances. Finally, the drivers for growth and success of the Italian Hotel Sector are identified.

2. Firms’ Business models: the theoretical background

Real markets show that, despite competing on the same market, firms having various and different organisational forms and/or sizes co-exist, moreover, SME’s pursue different strategic responses, finally, SMEs persist in their small and medium sizes dimensions without growing besides large firms. All these facts seem to contradict the most established *market theory* which generally explains the competition among firms as an equilibrium drawn from the specific market structure, where it exists a *typical firm* representing all the other firms playing in that market.

This approach shows a limited explanatory power also because it is not able to fully explain some real situations, particularly evident in the accommodation sector, where a firm could enter the industry with a smaller but efficient size and could maintain itself on that market: this is, for instance, the typical situation in which the entry strategy is based on a niche-positioning or on matching a local/specific segment of demand (Belussi e Pozzana, 1995). These firms can show an optimal combination of resource skills, technology and organisational factors so that in the medium-long terms this strategy could allow them to achieve larger market shares and drive them along growth paths.

Such an empirical evidence is more consistent with the *evolutionary approach* that doesn’t consider the existence of a unique, optimal dimension as the discriminating condition for firms to act competition on market. On the contrary, it underlines the importance of the relationship between each firm and the specific environment it faces as it means an opportunity to enforce its knowledge of the competition rules and better adapt its strategy to them (Gibrat, 1931; Penrose, 1971; Nelson and Winter 1978 and 1982; Lippman and Rummelt 1982; Jovanovic 1982). As the resource-based view explains “...the ability to a firms to use the resources depends on the increasing in knowledge and improvements of techniques...a firm achieves competitive advantage not because it has better resources but rather because of its ability to make better use of its

¹ Società per gli Studi di Settore (SOSE) is a company established by the Italian Finance and Economics Ministry with the Bank of Italy, which is in charge of managing and updating the Sector studies’ database (SdS-DB).

resources” (Barca, 2003). On the same theoretical ground, unused resources can be simultaneously considered a challenge and an opportunity for a firm to innovate and exploit a competitive advantage (Hamel and Prahalad, 1994).

Within this perspective, studying the Italian case and its widespread diffusion of SMEs, Rullani (1993) emphasizes the source of the strategic advantage in the working out of a specific **Business Model** which results, in turn, from combining all together business idea, supply chain relationship, size, and financial and organizational structure.

Summing up, it is the specific system of firms’ economic relationships which provides a strategic advantage to them; following this analytical approach it could be established that:

- heterogeneity of firms can be considered as the structural condition of markets;
- the whole systems of economics exchanges and relationships within the economic environment becomes the source of increasing the knowledge of competition rules and by this way, introducing organisational and/or production innovations.

The brief literature review points out the need for empirical research based on an innovative approach, able to explain such a complexity. The concept of Business Model as “a “framework to compete in a given industry , i.e. the set of activities which a firm performs and how it performs them, so as to offer its customers benefits they want and to earn a profit in a responsible and sustainable way (Afuah, 2003)” or as “a representation of a firm's underlying core logic and strategic choices for creating and capturing value within a value network (Schafer, Smith and Linder, 2005; Chesbrough, 2006 and 2007; Malone and others, 2006)”, seems to go into the right direction. In this view, it becomes crucial to measure some economic performance as a proxy of the success or the decline of the specific firm’s business model on that market, providing a forecast of the possible evolution of market structure.

3. How to identify Business models for the Italian Hotel Sector

The research plan has been organized into the following steps:

1. Setting of the general array of key competition factors by which the BMs could be represented and modelled
2. Selection of variables and indicators aimed to capture all the most significant characteristics of the key competition factors
3. Empirically building and testing of any BM through the application of correspondence analysis and cluster analysis
4. Classification of the specific competition strategy for each BM detected.

The research was performed by applying the correspondence and cluster analysis to the sample of over 19,000 Italian hotels collected through the sector studies survey. The sector studies’ database (SdS-DB) contains information about all the Italian companies – operating in every industry - with a turnover limit of 5,164 millions of euro, and offers three levels of information:

1. quantitative data about markets, organization of production, products, and distributive channels;
2. quantitative data about balance sheets and performance indicators;

3. qualitative data concerning periodical analyses on the structure and strategy evolution of the industry.

The latter is particularly interesting for our research because it provides an evaluation of all the most significant factors affecting SME's competitiveness, both nationally and internationally. Moreover the research outlines a detailed perspective on medium term evolution patterns of firms' BMs.

Although the economic information is referred only to those firms whose turnover is not greater than 5,164 million euros, the DB is representative of the whole Italian industrial system, since such firms represent almost 98% of our country economy.

The SdS-DB is updated annually, since companies are required to fill out the questionnaire of "Studi di Settore" with the income tax return. In this study we used data and information provided by over 19,000 hotels with reference to year 2005. The variation rates were determined through the data from 2001 to 2005.

3.1 The key competition factors: variables and indicators

Each hotel adopts a specific BM, which can be viewed as a strategic approach to competition in its market and is closely related to a range of performance that can be measured within that market. In particular, the different competitive choices can be explained in terms of a set of key competitive factors, whose different combinations give origin to a multiple set of BMs, which synthetically explains the different ways to compete in a given industry.

The following categories of key competitive factors have been identified, based upon the economic and statistical literature on BMs as well as on existing research:

- a. Structural distinctive characteristics of the BMs**
- b. Types of economies:** each BM, in its production process, is characterized by specific economies: economies of scale, economies of scope, or economies of specialization
- c. Competitive advantage.** It can be of three types:
 - cost advantage:* the firm is able to deliver the same benefits as competitors, but at a lower cost. This advantage is related to economies of scale and to the flexibility of the cost structure;
 - differentiation advantage:* the firm is able to deliver benefits that exceed those of competing products. This advantage can be obtained by means of brand strategies, level of the service added to the core product, technology used
 - location advantage.* It is linked to the particular geographical position of the firm (participation in a district, proximity to relevant resources or to customers)
- d. Business network,** mainly linked to the distribution channels used by the firm
- e. Coordination.** It can be distinguished in: horizontal (agreements among enterprises which hold the same position along the production chain; examples can be the consortiums and the associations which can somehow constrain the strategic choices of the participants), and vertical (upstream or downstream agreements along the production chain)

Starting from these typologies and on the basis of our knowledge of the hospitality industry, we constructed a grid of variables which, for our research purposes, includes the most relevant dimensions of business models of the hotel sector.

The variables concern the positions that a hotel attains and maintains within the sector and the markets in which it competes, the activities it performs to attain and maintain these positions, the resources and capabilities that enable it to perform these activities, and the relationships among these elements.

Each variable was then associated to a measure (an indicator), drawn from the SdS-DB and corresponding to an item of the industry survey questionnaire.

As already said, the testing of the existing BMs has been done by applying the Multiple Correspondence Analysis (MCA) and the cluster analysis to the hotel sector SdS database.

The distinctive MCA feature with respect to other classical factorial analysis methods lies in a particular normalization applied to the data table before the transformation. Before carrying out the analysis, in fact, it is necessary to transform the archive's information in a complete disjunctive table.

In our case, all the variables are quantitative and the construction of the complete disjunctive table was done by following this algorithm:

1. the values of the variables are divided into classes of value: low, medium or high;
2. for each class of every variable, a boolean artificial variable is used, equal to 1 or 0 depending on whether the value of the original variable is within the class of value or not.

The identification of classes was done through observation of the statistical distributions of the values of the indicators. Table 1 shows the variables and the indicators selected and the cuts done to variables used in the analysis.

Table 1. Hotel Sector. BMs variables and cuts

	Variable/indicator	Cuts/range
STRUCTURAL DISTINCTIVE CHARACTERISTICS	Population (kind of destination: urban/non urban)	<80.000 >80.000
	Nights/population (degree of tourist vocation)	</=10 From 11 to 100 >101
	N. of open days (seasonality)	<174 From 174 to 289 >289
	Restaurant (yes/no)	0 1
TYPES OF ECONOMIES	N. of bed places	</=60 >60
	sqm restaurant	</=100 >100
	Internal/external guests Restaurant	0 1

	Spa services (yes/no)	0 1
	% of revenue from individual guests	</=60 From 61 to 75 >75
COMPETITIVE ADVANTAGE	Variable costs/fixed costs	<0,26 From 0,26 to 0,43 >0,43
	Specialisation index of administrative personnel	</=0,02 >0,02
	other services offered (sauna, tennis, swimming pool, etc)	0 From 1 to 30
BUSINESS NETWORK	% of commission to intermediaries over fixed costs	0 >0
POSITIONING INDICATORS	Added value / employees	<26.775€ From 26.775 to 53.734 >53.734
	Stock increase (average rate 2001-2005)	</=0,5 From 0,6 to 6,81 >6,81

4. The Business Models of the Italian Hotel Sector

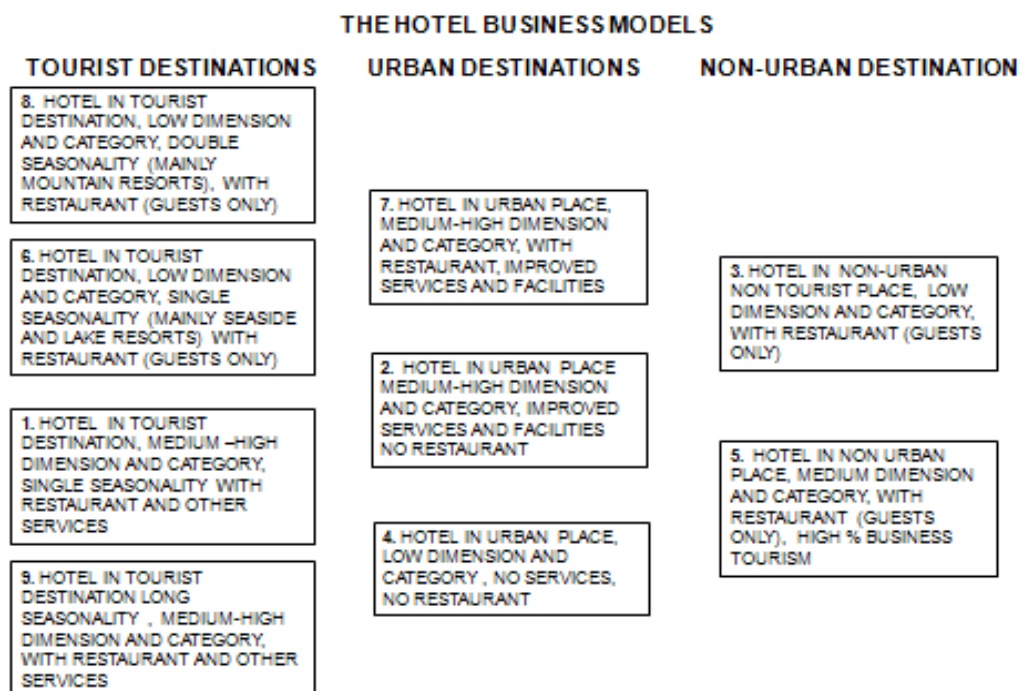
The dimensions selected with MCA have been considered as inputs for the cluster analysis.

The Cluster Analysis (Anderberg, 1973) is an explanatory tool which aims at sorting different objects (hotels in our case) into groups in a way that the degree of association between two objects is maximal if they belong to the same group and minimal otherwise. Cluster analysis can be used to discover structures in data without providing an explanation/interpretation. In other words, cluster analysis simply discovers structures in data without explaining why they exist.

In this study the cluster analysis has been applied using the *k-Means Method* (Hartigan, 1975).

Through this approach 9 clusters, which represent the number of BMs for the Italian Hotel Sector, have been identified:

- Four clusters (n. 8, 6, 1 and 9) refer to hotels in tourist destinations (less than 80.000 inhabitants and Nights/population>101.). Each of them is characterized by the category and dimension (low vs. medium-high) the seasonality (double, single or long, identifying mountain, seaside/lake resorts) and the presence of the restaurant as well as of other services
- Three clusters refer to hotels in urban destinations (more than 80.000 inhabitants). Each of them is characterized by the dimension and category (low vs. medium-high) and the services offered
- Finally, two clusters refer to hotels in non urban and non tourist destinations (less than 80.000 inhabitants and nights/population < 10).



5. Hotel Business models positioning and performance

After identifying and validating the BMs, they have been mapped onto performance. The positioning map has been created on the basis of two variables: value added per employee (average 2001-2005) and the average growth rate of investment in fixed assets (2001-2005). The two variables have been chosen because they allow a better understanding of the competitiveness of BMs and represent more robust and reliable performance measures than financial ones. We used also standard financial performance measures, which however did not produce significant results for our analysis.

The main considerations about the two variables, deriving from the data analysis and helpful for the understanding and interpretation of the positioning, are first discussed. In this context, should be remembered that the period 2001-2005 saw a fair turbulence from the demand point of view, and a consequent reaction (at times very quick and sometimes slower) on the supply side, through structural renewals, innovation in commercial channels, etc.:

- the added value is set on average around 42.000 Euros. Strictly surrounding this area are clusters 1, 5 and 8. These clusters represent 45% of analyzed firms. Two clusters are set well below average (6 and 3, with halved values) whilst clusters 2, 7 and 9 (higher category and high number of services) are above the average.
- the yearly average increase rate of stocks is an indicator that needs to be interpreted according to the dynamism of the sector, the start-up characteristics of the companies (state of structures and equipment, age of the building and its facilities) or the external factors or “push” provided by the context, (e.g. need to comply to new laws or technologies) and, of course, market and customers’ conditions. Moreover, the level of investments may vary at different times and respond to market issues (requiring specific actions) or to the availability of funds. As far as the analyzed hotels are concerned, the average increase rate is of 9,4% with 4 clusters well above it (clusters 1, 2, 6 and 9), whilst clusters 3, 4 and 5 are well below average (with values below 8%).

Graph 1 describes the positioning and performance map.

Models 3, 4 and 5, accounting for the 34,6% of the firms considered are set in the area defined “**declining area**” – that will be called more appropriately “**in risk of decline**” – the added value and stock growth rate of these companies are below average.

In this area concentrate therefore companies characterised by:

- location in areas of limited tourist development
- lower category and small dimensions
- restricted offer of services
- small product portfolio and few commercial channels (individual customers prevailing clearly on other types of customers)
- high variable costs in two clusters (incidence above the average, due to the presence of a restaurant in clusters 3 and 5)
- low specialisation in management (limited incidence of accounting personnel as the role is generally covered by the entrepreneur)
- low propensity/possibilities to invest (probably due to low competition and scarcely dynamic markets)

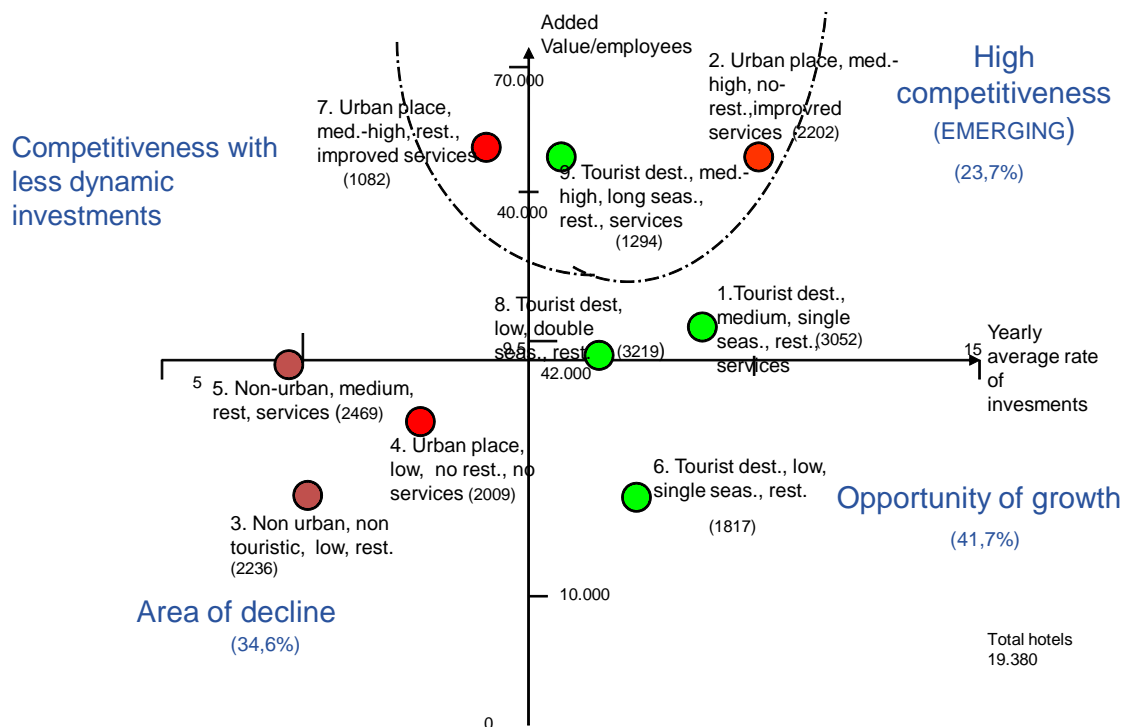
More in detail

- in BM 4 are found small hotels, of lower categories and small dimensions set in urban centres and relying on “business” customers (who might also be long staying) or lower expenditure tourists. They are set at the margins of the overall competitive advantage attributed by the location, even though they can rely on a high percentage of fidelity tourists. Furthermore, this group of

companies is nowadays in many cases competing against alternative forms of hospitality (e.g. bed & breakfasts) that are more dynamic on the market;

- BM 3 includes a similar typology of hotels as far as size and category are concerned (both of lower level), but characterised by a location in centres of medium to low tourist development level and non urban contexts, and influenced in their management by the presence of a restaurant as a “typical” and defining feature. These are “peripheral” forms of hospitality, developed aside a restaurant, often important, which rarely benefited from structural interventions and stand out for the high incidence of variable costs. The presence of distribution channels alternative to direct channels, is irrelevant, as well as the administrative specialisation. These hotels may also be influenced by the growth (during the last decade) of alternative forms of catering and hospitality such as agrotourism and country houses. For both these clusters the number of employees is well below the average.
- BM 5 also aggregates hotels with restaurant and other services, set in non urban contexts and with limited tourist development. This group has a value added near the average but a stock increase below the average; then it couldn’t be defined as in risk of decline since firms might have previously made substantial investments.

HOTEL BUSINESS MODELS AND PERFORMANCE



The area of **"high competitiveness" business models**, featuring high value added per employee and stock increase rate above the average, is populated by firms (23,7%) characterised by:

- location in urban centres or in tourist destinations (therefore stressing the relevance of this distinctive feature)
- high dimension and category
- spread seasonality
- good offer of services
- limited incidence of variable costs
- large product portfolio and high differentiation in distribution channels (high expenditure on intermediation, percentage of individual customers below average)
- incidence of administrative employees above the average, showing a managerial specialisation (and, if necessary, the externalisation of other costs)

This area includes all the businesses that have a high value added, even though cluster 7 has a low stock increase value: seen the overall characteristics, it can be explained because this value is representative of time taken into account, while probably the investments were made earlier.

In detail:

- BM 9 is typical of companies located in tourist resorts, characterised by a wide range of services, of high dimensions and category and a significant share of non individual clients
- BM 2, includes companies located in urban centres, without restaurant, open throughout the year, of medium to high dimensions and category
- BM 7 as well includes companies located in urban centres, of high dimensions and category, yearly opening but with improved services and facilities.

The area **"Opportunities of growth"** includes the firms that mostly characterise the Italian hotel scene (41.7%), and which can be defined on the basis of their flexibility and ability to respond to the demand variability with relatively low costs for adjustment. In fact, in the last five years, during which tourists' expenditure capacity fell down, companies as those in clusters 1, 6 and 8 managed to respond to customers' needs, so proving their adaptation aptitude.

The stock increase rate is above the average as the companies during this time probably had to comply to new rules and laws or renovate or be active from the communication/promotion point of view. As far as added value per employee is concerned, clusters 1 and 8 are positioned above the average, while cluster 6 below it. The organisation level is simple but there are opportunities to grow due to the investment capacity shown. Clusters 8 and 1 represent respectively hotels of seaside resorts (single seasonality) and of mountain destinations (double seasonality) belonging to medium categories and characterised by medium to small dimensions.

6. Conclusions

The research focused on the competitive conditions and performances of the Italian Hotel Sector with the aim to define, on one side, the highly competitive Business Models and their representativeness in terms of number of enterprises (23.7% of analyzed sample), on the other, the declining BMs which do not seem to be able to face the competition in the market anymore and which include 34.6% of the sample. Furthermore, the analysis identified the drivers for growth and success which seem essentially connected to the capacity of relating to the market, to qualitative development and to organization and coordination.

These drivers, particularly crucial for the enterprises set in the area “Opportunities of growth” (41.7%), may be pinpointed as follows:

- the improvement on products and services quality
- the differentiation of customers and the enlargement of market portfolio by means of a positive relationship with distribution channels and intermediation, as a proof of an increased attention and improved forecasting skills on customers trends.
- the push towards aggregation and local coordination, which is bound to strengthen location factors, as well as commercial or “theme” aggregation (e.g. bikers hotels)
- managerial organisation and organisation of work, both relying on a higher specialisation and implying the overcoming of a strictly family management
- the improvement of services offered, which in the case of hotels (more than for other typologies of companies) may be interpreted as an enrichment of activities obtained with no need for high investments (that could not easily be made by these firms), as it is for customised services.

In the end, the main conditions Hotel BMs should take advantage of for competitive growth in the Italian context can be highlighted as follows:

- interaction with the destination and district
- development of services so that to introduce also a distinctive trade mark
- enlargement of the customers’ portfolio
- organisation of the distribution network
- development of managerial skills
- maintenance of a good propensity to investment.

The results obtained represent the starting point in order to develop adequate strategies to support competitiveness in the SMEs of the Italian Hotel Sector.

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