Business in Tourism: SMEs Versus MNCs

Nevenka Čavlek*

Abstract: The tourism business worldwide is dominated by small businesses (SMEs). However, the liberalisation and globalisation of the world economy have led to a growing integration of markets not only for goods and capital, but for services too. This has had an inevitable influence on the development of the tourism industry. The extensive internationalisation of tourism demand has forced companies involved in tourism to create large corporations (MNCs), international strategic alliances and other forms of co-operation. The aim of this paper is to determine and analyse the business environment within which tourism companies operate.

JEL Classification: M21

Keywords: tourism, SMEs, MNCs, development strategies.

Introduction

Tourism has been among the fastest growing sectors of the world economy for more than fifty years. From 1950 to 2000 the number of international tourist arrivals in the world increased from 25 million to 698 million, and international tourism receipts in the same period increased from $2.5 billion to $478 billion (WTO, 2001). In the past 15 years, international tourism receipts have grown 1.5 times faster than world GDP. Indeed, just as the world economy in the past few decades has undergone radical changes, so has the business of tourism. The most significant transformations can be attributed to the increasing globalisation of economic activities, and the change from the manufacturing of goods as the predominant production activity to the production of services. According to the World Bank (2000), around 60% of the world’s GDP

* Nevenka Čavlek is Associate Professor at the Faculty of Economics, University of Zagreb, Croatia.
derives from services. ‘In this context of structural change, tourism services play an important role as a fast growing activity’ (Smeral, 2001:3).

The tremendous growth of air-passenger traffic and the favourable package holidays offered to tourism consumers by tour operators have, without doubt, caused a rapid development in international tourism (Čavlek 2000a:325) and, consequently, in international tourism business, too. Under the influence of global tourism development, the companies involved in tourism began to internationalise. The ‘internationalisation’ of tourism companies not only means the involvement of foreign capital, but today also involves the ‘internationalisation’ of the business of the tourism concerns. This has been accomplished, in part, by the strategic power brought by business on the international capital market (Čavlek 2000a:331). The process of the creation of a single European market, and a new business framework created with the signing of the General Agreement on Trade in Services (GATS), has given plenty of opportunities for companies to penetrate outside their domestic markets. This trend of development has brought into direct confrontation multinational corporations (MNCs) from tourism generating markets and small and medium enterprises (SMEs) based dominantly on receiving markets.

Structural Changes in Tourism

It is clear that tourism has become a big business, which is nowadays increasingly controlled by big business. Although, depending on the sector, it has been estimated that the tourism business worldwide is dominated by small businesses (Gartner, Lime 2000:6), and in EU countries, for example, 99% or almost 18 million companies in the tourism sector can be classified as SMEs (Hitrec 2000:5), the airline industry and, lately, tour operators are exceptions to this rule.

In Europe, a SME is defined in terms of employment as a company with a workforce of less than 250 employees (Wanhill 2000:133). In practice, there are actually three groups of SMEs: very small, with up to 10 employees; small, with 11-49 employees; and medium, from 50-250 employees (Middleton 1998). Although there is no general agreement on the definition of a MNC, in this paper Robock’s and Simmonds’s (1989) perception of a MNC is used which describes multinational and transnational corporations as corporations ‘controlled by one headquarters but with operations spread over many countries’ (p. 6).

As every market-oriented company tries to adapt its business organisation to the conditions and relationships of the market where it operates, tourism companies do the same, although this process is more complex and ‘almost impossible to comprehend if left unstructured’ (Go and Ritchie 1990:287). For tourism-related branches this means ‘on-going structural change’ (Keller 2001) in generating as well
as in receiving tourism countries. One might say that this is nothing else but the process of adaptation ‘of the parts of a system to the system itself’ (Keller, 2000:287). But, since the international tourism environment is vast, companies involved in the tourism business must change and adapt their strategic development plan to respect the movements on the global tourism market more than companies involved in other sectors. Global competition has a very positive effect on tourism consumers, because tourism supply has become transparent worldwide and therefore ‘pressure in the direction of quality, optimal prices and efficient use of time with regard to tourist offer’ (Laesser, Jäger 2001:40) has become a must for the companies in tourism sector. Some companies in these processes of change are successful and some are not. But, as also stressed by Keller (2001), one has to bear in mind that there are actually two different sectors of tourism: one called the ‘travel industry’ with tour operators and airline companies that represent MNCs based on generating markets, and the other which is destination-oriented and based on SMEs. They differ greatly in their development strategies, functions and goals on tourism markets, and also vary in many other elements.

The main development strategy of MNCs is one of growth, which, nowadays, is mainly achieved through consolidation processes. The dwindling opportunities for growth within their national markets have pushed large tourism concerns to expand to markets abroad, and they usually do this through acquisitions rather than by founding new sister companies on these markets. The logic of such a business approach is easy to understand. The investment necessary to buy an already well-established company is much lower than that needed to introduce a new company name on the market. SMEs on the other hand cannot implement a strategy of growth since most of them lack capital, management expertise and innovative business models (Keller 2001). In this way, consolidation processes are very favourable for MNCs which result in economies of scale and an enlarged scope of operations, thus allowing them to offer tourism consumers products at competitive prices. But, consolidation processes within the tourism sector are not only the result of global economic development, but also derive from the development of a business environment which has become increasingly uncertain. The tourism industry is greatly influenced by economic movements on respective markets, by safety and security risks of any kind and at the same time it is a very low net profit business. Therefore, for tourism companies to survive in the very competitive market, it has become essential for them to merge with, or to take over, companies that deliver different components of the whole product (Čavlek 2000: 325). Another reason for the internationalisation of companies in tourism is the nature of tourism services which have to be delivered locally to the consumer in tourism destinations. This means that the service company has a special motive to go multinational ‘to follow its customers’ (Caves 1996:12), and, at the same time, it is one of the ways for tourism concerns to be able to have quality control
over the services provided. Consequently, these companies operate according to global strategies, and make use of local competitive advantages in a worldwide market (Keller 200:292). Since tourism is a semi-functional phenomenon, multinational corporations are not only interested in being involved in the transportation and accommodation sectors, but also in entertainment, insurance, financial services, food production, souvenirs, information technology, etc.

**MNCs and SMEs: Threats and Challenges**

The movement of capital in tourism is hardly different from the movement of capital in other sectors. The main agents of these movements in the world are giant multinational corporations. This can also be confirmed by the example of the use of capital and the growing influence of the leading European travel and tourism concerns on non-domestic markets. The prominent concentration of the travel and tourism business in the hands of a few large corporations on the market, and their constant expansion to foreign markets, can be illustrated through the consolidation processes of the 4 major travel and tourism companies in Europe: the TUI Group, with its mother company ‘Preussag’, Thomas Cook, whose owners are ‘Lufthansa’ and the department store and mail order group ‘Karstadt/Quelle’, Airtours (re-named My Travel Group in February 2002) which is quoted on the London Stock Exchange, and Rewe, a large German utility chain. All 4 concerns consist of tour-operating companies both on domestic markets and abroad; they own charter airlines, accommodation facilities in many tourism destinations, travel agency distribution chains, and travel agencies in receiving markets. As these concerns provide very complex customer care, it has become very important for them to form integrated tourism concerns that work right across the travel value chain, providing distribution, tour operations, flights, accommodation, insurance, entertainment, etc., from a single source.

‘Preussag’, whose basic activity lies in the field of energy and technology, which owns TUI (the biggest tour operator on the European market) and Thomson Travel Group, through which it is the number one operator in the UK, and is also the market leader in The Netherlands, Austria, Finland, Ireland and Poland, claims to cover over 70% of the total European package holiday market. In its portfolio, ‘Preussag’ has 63 tour operator brands worldwide, and controls over 3,200 retail travel agencies, as well as 21 agencies at destinations. The six airlines in the Preussag Group provide more than 20,000 seats and fly to countries all over the world from more than 40 airports throughout Europe. There are a total of 90 aircraft ranging from small jets to Boeing 747s and 300s with enough space for 580 passengers. The Preussag Group carries more than 10 million tourists by plane to their destinations every year, and
another 10 million by all other means of transportation. The Group owns over 270 properties abroad with over 100,000 beds in Europe, North Africa and the Caribbean. They currently employ over 46,000 people (Preussag 2001).

Following the merger at the end of 2000 of the second largest German travel group 'C&N' (Condor and Neckermann) with 'Thomas Cook', the new company which retained the British name of Thomas Cook became the second largest European travel concern with accumulated turnover of €7.6 billion and an annual client total of 15 million, and thus pushed the British tour operator 'Airtours' (My Travel Group) into third place among the largest travel concerns in Europe (FVW 2001). Thomas Cook has the same vertically integrated structure as the TUI Group. In Thomas Cook's portfolio there are 73,000 hotel beds in tourism destinations, it owns 30 tour operator brands on different markets in Germany, Great Britain, Ireland, France, Belgium, The Netherlands, Austria, Hungary, Poland, Slovakia, Slovenia, Egypt, India, and Canada. It has a fleet of 85 aircraft, which serve more than 60 international destinations, and controls 3,600 travel agencies, which sell Thomas Cook’s products worldwide. The concern employs 28,000 people.

Airtours (My Travel Group) is the only public company among the mentioned four largest vertically integrated travel giants. The company is represented in the sales markets of the UK, Scandinavia, Germany and North America with a total of 100 principal brands and serving some 15 million customers. The concern owns 2 charter airlines with a fleet of 49 aircraft: Airtours International in the UK and Premiair in Scandinavia. It also owns 4 cruise ships, one of which is operated by Royal Olympic Cruises on a summer only basis, 2,129 retail travel agencies, and controls over 65,000 beds in its 131 resort properties. The concern has over 27,900 employees (My Travel Group 2002).

Fourth place remains in the hands of another German travel group - 'Rewe Touristic' which consists of 7 tour operators on the German market, and some business units abroad. Nevertheless, this Group’s retail side occupies second place among German travel groups after TUI with some 2,000 retail travel outlets (FVW 2001). Although ‘Rewe Touristic’ does not own a charter airline, it has a very strong links with the third largest charter airline in Germany – LTU – owning 40% of its shares.

These data prove that companies that represent the travel industry on tourism generating markets have grown into giant MNCs that have swallowed up an increasing number of small and medium sized companies, and are now in the move for acquisitions of even larger companies. In this way they have taken control of the market of organised travel in Europe. This situation has created unfavourable conditions for the majority of SMEs on generating markets because they are becoming limited in their access to distribution channels and to the leasing of charter seats. Furthermore, MNCs use their financial power to gain control not only of
generating markets, but to exert strong influence over tourism destinations, too. They are forcing their partners in receiving markets ‘to lower prices or suffer the loss of business to other destination areas which are more willing to accept lower returns in exchange for bookings’ (Gartner, Lime 2000:7). SMEs at the same time have a ‘less favourable negotiating position when contracting accommodation capacities at tourism destinations’ (Čavlek 2000:333). As MNCs which represent the travel industry of tourism generating markets look for accommodation facilities on the global market which faces overcapacity, the consequence of such a situation is increasing price competition in tourism receiving markets, too. So, the competition of MNCs is also spreading to tourism receiving markets where the giants are now involved in a battle for the best accommodation facilities for their clients. However, one of the main problems of tourism receiving countries is ‘the predominance of SMEs which suffer from low productivity and from what is sometimes called ‘cost sickness’ (Keller 2000:292). The negotiating and purchasing power of MNCs today is so great that they mainly dictate their business terms to their business partners in receiving destinations and not vice versa. The prices that SMEs can offer only reflect the general price levels of their economy, and therefore they are usually too high for the quality they offer. Although SMEs hire almost 90% of the workforce (Scheel 1995:476), and in this way can be regarded ‘as the engine of free enterprise economy’ (Crouch and Ritchie 1995:45), they generate only about 10% of the GDP (Scheel 1995:476) of respective developing countries.

So, the question arises: how can SMEs survive the ongoing pressure of MNCs entering their domestic markets?

Consolidation Processes and SME’s

The global economy has allowed MNCs to make direct investments on foreign markets, and this situation is changing the economic, social and political climate where SMEs operate. It can therefore be said that SMEs have been caught up in the globalisation processes. Consequently, the structure of SMEs is changing dramatically. As also stressed by Varaldo and Pagano (1998:2), SMEs are facing two main challenges:

a) the market entry of ‘global players’ in terms of flows and products, services and direct investment in their country or region;

b) the strategic response by other local competitors which are reacting to the increasing competition.

Since MNCs in the tourism sector are increasing their presence and power on the domestic markets of SMEs predominantly through acquisitions, it seems that SMEs do not have much choice once faced with the global competition of MNCs. But,
business practice shows that there are many examples where both big businesses and small businesses work successfully together, ‘enabling each business to specialize’ (Crouch and Ritchie 1995:45), and what is also very important ‘competition among business provides the stimulus for change and improvement’ (Crouch and Ritchie 1995:45). Something else cannot be overlooked and that is the nature of tourism demand which is changing faster than ever. Giant companies like the mentioned MNCs cannot respond as quickly to these changes as SMEs can. The advantage of SMEs lies in the fact that they have a high degree of flexibility and can respond to changes in demand much more quickly than MNCs; they can offer services tailored to the specific needs of a very narrow segment of demand on the market; and they can be more innovative. Go (1995:32) and Wanhill (1999:134) stress that product innovation is concerned with the development of new products, services and concepts that are critical to a corporation’s growth and financial performance. Therefore, SMEs could take the opportunity to decrease the risks of developing a global approach by relying on the financial and technological support of MNCs, in addition to drawing on information, at low cost to themselves, of foreign markets, which could be provided by the partner. As MNCs seek innovation, they can efficiently use SMEs in this respect and also as a means to provide necessary logistics support on the local markets. Such a business approach should become a ‘gold mine’ for SMEs and provide a solution for their survival on the growing competitive market where the rules are dictated by MNCs. Through co-operation (rather than unrealistic competition with MNCs) SMEs could foster high-quality management and innovative activity. On the other hand, MNCs will see their own interest in co-operating with successful SMEs to penetrate foreign markets (Varaldo and Pagano 1995).

This leads to the conclusion that SMEs on tourism receiving markets as well as on tourism generating markets are an integral and fundamental part of tourism development today and will be so in the future. In competition with MNCs, two main options and opportunities for survival are at the disposal of SMEs (Go and Ritchie 1990:228):

1) SMEs can affiliate themselves in one of a variety of ways with MNCs in some kind of symbolic relationship, or
2) engage in niche marketing.

The first solution enables SMEs access to new markets, which they would not be able to have access to without MNCs. This is the way in which SMEs can foster prospects of survival and/or growth in the specific niche where they are involved (Varaldo and Pagano:3). The second solution requires SMEs on generating markets to adapt to a maximum extent to the wishes and requirements of much narrower segments of market demand, ensuring stricter quality control of provided services. SMEs can never represent a threat to MNCs, but they can survive the competitive
pressure of MNCs by offering with a high degree of professionalism products of high quality standards to clients who have specific requirements. Without a recognisable and superior quality product, SMEs will not be able to compete with the giants which are very well organised, use high-technology and posses the capital for optimal development. SMEs on the receiving markets, beside the already mentioned requirements for companies on generating markets, need to develop specific products and services that are unique for the particular destinations on which these SMEs operate, and products which take into account indigenous development.

But, we have to bear in mind the fact stressed by Wanhill that ‘while it is possible in developed countries to give a higher political priority to local investment, for many (but not all) developing countries the option between local and externally driven development my not be available’ (1999:134).

Conclusion

This short analysis of the companies that are doing business in tourism leads to the conclusion that the consolidation processes are changing the picture of the European leisure travel market significantly. The winners in this processes are the newly created powerful vertically integrated travel and tourism concerns that are creating a leisure travel value chain that can provide customers with distribution, tour operation, flights, accommodation, insurance, entertainment, etc., from a single source. The losers are many small and medium sized, independent companies that have been swallowed up by these large organisations, which have consequently become bigger and more powerful. But, this does not simply mean that MNCs and SMEs cannot successfully work together on the same market. The solution lies in SMEs using their small size as an advantage, and not as a disadvantage. The advantage of their size lies in a high degree of flexibility to respond to changes of demand, and to increased innovation. Instead of competing with MNCs, they should affiliate themselves in a variety of ways, or engage in niche marketing.

The analyses of the development of tourism businesses suggest that the tourism market is consistently heading towards further consolidation. The main targets will always be SME specialists on domestic markets and abroad, but as proven with the examples of TUI and Thomson, even bigger mergers and acquisitions cannot be excluded. The more integrated the travel and tourism concerns, the more complex and riskier their business operation. Therefore the future development of MNCs will seek to achieve the following goals:

- To increase their strength not only on the European market, but more so on the global tourism market. This will involve efforts to increase their market share
by using more and more newly specialised products which they will be able to deliver in close connection with SMEs specialised in niche marketing. This should also help to achieve another strategic goal of MNCs: to increase the market value of the corporation.

- To intensify consolidation processes
- Develop measures that will put customer satisfaction as the priority of their business.

The future development of SMEs will aim towards:

- affiliation with MNCs in one of a variety of ways to form some kind of symbolic relationship; become increasingly involved with the innovative processes and logistics processes of the large corporations;
- engage in niche marketing and tailor their products to the specific needs of a narrow segment of demand; develop unique products and services which will take into account the indigenous development of their domestic destination.

Whatever the strategy of MNCs or SMEs, SMEs can never represent a threat to MNCs. In the same way, MNCs cannot completely expel SMEs from the market. There is a space for both, provided that SMEs offer superior quality products.

REFERENCES


World Bank (2000), World Development Indicators.