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# A holistic approach of assessing and improving competitiveness in tourism: the case of Ionian Islands (Greece)


## Abstract

The consistently inferior return to equity capital (ROE) achieved by the hotel sector in Ionian Islands compared to the one for the entire country of Greece during the period 1995-2004 was examined. The SWOT analysis, the five forces model and business matrices were used to analyze the strategy followed by the region in tourism. The scope of this paper was the assessment of competitiveness in tourism, through a holistic approach and data analysis, by using the paradigm of Ionian Islands. Results showed that the product of mass tourism for summer vacation has reached its stage of maturity, while at the same time the Ionian region can not maintain a competitive advantage based on low cost anymore and has followed a stuck in the middle strategy. Product differentiation strategy based on its enrichment with alternative forms of tourism and quality of services is proposed as a means to combat seasonality and high price elasticity of demand, as well as, a means to increase per night tourist spending and boost the linkages of tourism to local economy. It will increase the multipliers of tourism spending, improve profitability and enhance viability of the sector.


**Keywords:** hotels, ROE, SWOT, business matrices, SPACE, MARAKON.
**JEL Classification:** G10, G33.

## Introduction

The Ionian Islands region (Corfu, Zante, Cephalonia, etc.) in Greece has a GDP that it is close to the 75% of the average for the European Union. Its regional development plans aiming to close the gap with the other regions of the Union from 1990's up today, are crafted around tourism which is the most important sector of the local economy. The competitiveness of tourism is vital in promoting regional development.

Competitiveness which is a very complicated and nebulous concept to be precisely defined and measured, in this paper is approached through the measurement of the profitability and return to capital of the hotel sector companies that represent the core of the tourism industry. Return on capital above the average in the long run, presupposes an attractive sector (the mass tourism for summer vacation in our case) and appropriate positioning in it (Porter, 1991, Kay; 1994; Grant, 2002).

In the Ionian region were operating 853 hotels with 42.003 rooms and approximately 80.157 beds in 2004, compare to 8.889 hotels, 351.891 rooms and 668.271 beds respectively for the entire country of Greece. The region was representing the 12% of the hotel bed capacity of Greece and it is considered on of the most popular destination of the country. The bed/nights recorded at the hotels of the region were 4.466.290 in 2004 or 8.66% compare to 51.589.793 total bed/nights for the entire country in that period.

The developments in the tourism sector of Ionian Islands are examined through the analysis of the financial statements of the hotel sector of the region. Hotels represent the basic factor and the main prerequisite for the viable existence of the activity of tourism. Financial soundness of hotels in the long run is the discernible result of competitiveness attained in the market. The scope of this paper is the assessment of competitiveness in tourism, through a holistic approach and data analysis, by using the paradigm of Ionian Islands. The research is mostly micro oriented, combining business strategy matrices and financial analysis, primarily based on field research (Curtis, 2004).

## 1. Profitability and return on capital as measures of economic performance and competitiveness

The rate of revenue change is more volatile among firms and over the years, than profitability and the return to capital. This observation indicates that companies monitor and safeguard profitability change with more care compare to the corresponding of revenues (Geroski, 1994). Return on capital more than the average is the result of value added creation over and above the opportunity cost of capital (Kay 1994; Grant, 2002). The Return on Net Assets (RONA) is equal to:

$$\text{RONA} = \frac{Net\ income}{Revenues} \times \frac{Revenues}{Total\ capital}. \quad (1)$$

The net profit margin (i.e. net income/revenues) is considered as a measure of economic efficiency in the use resources by an economic entity, which indicates that "things are done right". It is further multiplied by a measure of effectiveness in the use of capital employed (revenues/total capital), which is mainly determined by the industry a company operates in. The increase in revenues emanates from the appropriate alignment of products offered to the corresponding demand. It indicates that companies (and the sector) "do the right thing".

The net profit margin improvement reflects the increase in productivity and efficiency attained in the use of resources inside the firm to generate a certain amount of revenues. Positive net profit margin, according to Porter, reflects the presence of competitive advantage in the market. Greater level of net profit margin leads to a greater market share (Trailer et al., 2000). The negative average profit margin in Ionian Islands for the period under consideration means that productivity and efficiency in the majority of hotels are not at a desirable level to guarantee viability for the sector.

The effective use of capital (also called assets turnover) depends greatly on the degree a company's production is aligned to the market. The amount of revenues measures the external effectiveness. It is a function of the acceptance of the company's output by the market. Hotels must maintain close relations to the market needs, as a means of securing competitive advantage, since consumers are the final judges of the value added (Reimatz et al., 2000).

Productivity and effectiveness are interrelated, and influence each other. The greater the asset turnover attained, the higher the net profit margin that can be achieved by lowering the average cost (we assume that greater revenues have not been achieved by lowering prices). It can be achieved due to the presence of increasing returns to scale and of high break-even point that characterizes hotels, which are considered by high fixed costs in their operation. Greater profit margin attributed to the efficient use of resources, allow companies to lower prices and obtain more revenues.

Competitiveness is achieved when an economic unit "does the right thing" and also "does it right" or in other words when it combines effectiveness and efficiently respectively. It also means that it achieves profitability above the average and this is the visible result of competitiveness attained in the market. Lasting superior return on capital can't be succeeded and sustained without competitive operation (Grant, 2002).

The Return on Equity (ROE) ratio is what equity capital gets as net profits. It results from RONA through the multiplication by the structure of total capital (in equity and the rest sources of funding). Thus,

$$\text{ROE} = \text{RONA } X \frac{Total\ capital}{Equity\ capital}. \qquad (2)$$

The use of debt magnifies a positive RONA, since the ratio total/equity capital is greater than one. A tourism destination is competitive when the majority of the companies comprising it are competitive (Grant, 2002, Porter, 2002*)*. The return on equity is the most widely used criterion for investment decisions. It is a good measure of "assessment of the management performance" (Flamholtz et al., 2000), the most important criterion and benchmark of company's performance (Teitelbaum, 1996), the most important accounting ratio and "the most important measure of performance" (Copeland, 1994).

## 2. ROE in hotel sector of Ionian Islands

The analysis of financial statements of a sample of 70 hotels representing approximately of 20.550 beds (or the 25.6% of the total available in the region in 2004), indicates that the profitability in Ionian is inferior compare to the average one for the country and at the same time demonstrates greater fluctuations.

Table 1. The average return on equity of the hotel sector to Ionian Islands and Greece compared to the risk free rate

| | Return on equity | | Risk-free rate |
|---|---|---|---|
| | Ionian Islands | Greece | Yield to maturity of the 10 year government bonds (Greece) |
| 2004 | -2,3 | 0,1 | 4,26 |
| 2003 | -1,4 | -0,4 | 4,3 |
| 2002 | 2,5 | 3,1 | 5,12 |
| 2001 | 4,8 | 4.84 | 5,3 |
| 2000 | 1,52 | 1,63 | 6,1 |
| 1999 | -2,75 | 1,20 | 6,3 |
| 1998 | -5,37 | -0,39 | 8,48 |
| 1997 | -12,0 | -2,63 | 9,93 |
| 1996 | -12,5 | -3,12 | 14,46 |
| 1995 | -12,8 | -0,59 | 17,02 |

Source: ICAP SA, Curtis, 2004.

The average return on equity capital for the hotel sector of the region for the period 1995-2004 was – 4.02 % compare to +0.27 % for the entire country. The average risk-free rate, which represents the least opportunity cost for the equity capital invested on the hotel sector, as it is approximated by the yield to maturity of the 10 year government bonds in Greece is equal to + 8.1% for the same period. As a result value was destroyed in the hotel sector in the Ionian region (and for the whole country to a lesser extent).

Value is a positive function of profitability and of the return on capital. The later reflects all the necessary factors of financial health of companies. Even in the most favourable years the return on capital achieved in Ionian Islands is below the risk-free rate. The full cost of equity capital based on CAPM model, is equal to the risk-free rate and the market risk premium multiplied by Beta (Copeland, 1994). The average return to equity capital at regional (and the country) level does not cover even the risk-free rate, not to mention the additional risk premium that an investment in the hotel sector in Greece entails. This reflects the lack of competitiveness of the

Ionian region in the specific sector in and the low attractiveness of the mass tourism itself.

## 3. Strategy, SWOT analysis and the five forces model

Competitiveness is achieved through a strategy that attains alignment of the internal and external environment of a region that results in profitability above the average (Grant, 2002).

The SWOT model represents a concise way of analysis of the business factors and of the internal environment of the region, which are most likely to influence the development of strategy in a specific way. SWOT analysis is considered a systematic procedure for identifying and presenting the critical success factors for the region in terms cost, quality, responsiveness and innovation. The analysis of the existing situation and its prospects with respect the internal and external environment of tourism in Ionian region, implemented through the SWOT analysis model, give us the following picture.

Table 2. SWOT matrix

| | |
|---|---|
| *Strengths*<br>• existence of satisfactory tourism infrastructure;<br>• valuable cultural and historical resources;<br>• mild weather conditions and clean beaches;<br>• long term presence of Ionian Islands in tourism and good access to channels of distribution;<br>• reasonable level of prices and gate of Greece to Western Europe;<br>• safe destination. | *Opportunities*<br>• development of alternative forms of tourism and differentiation of the product;<br>• improvement of sea and air transportation;<br>• improvement and renewal of the infrastructure and superstructure;<br>• on time sufficient promotion of the product of the island. |
| *Weaknesses*<br>• not very good transportation and general infrastructure;<br>• mass tourism with high price elasticity of demand and low income elasticity;<br>• poor positioning;<br>• low spending per tourist arrival;<br>• great dependence on foreign tourist operators;<br>• small size of the hotels with seasonal operation;<br>• inferior management and insufficient organizational competencies;<br>• great ratio of tourist arrivals per inhabitant;<br>• high transportation cost to the islands;<br>• insufficient vertical integration and absence of business clusters in tourism. | *Threats*<br>• slowness of traditional Mediterranean mass tourism market and prop up of new destinations;<br>• insufficient development of alternative forms of tourism;<br>• changes in the preferences that don't favor mass tourism;<br>• reduction in the duration and increase in the number of journeys;<br>• increase in the bargaining power of clients (and tour operators) and great dependence on the markets of England and Germany;<br>• fierce price competition. |

External sources of change stemming from demand, price and technological fluctuations affect the ability of the region to outperform its competitors, given the internal environment determine the time of response and its effectiveness.

The analysis of the immediate external environment (industry conditions) concerning tourism approached through the popular framework of the *"five forces"* (Porter, 1985), based on the answers to the questionnaire gives us the following results (Curtis, 2004):

- the intensity in competition of the tourism industry in Ionian Islands has been intensified (according to 80% of the responses);
- the impediments to new entrants in the industry have been eased (52%.) due to easier access to distribution channels and new sources of financing;
- substitutes are increasing and so does the price elasticity of demand (86%);
- consumers bargaining power is rising (50 %), and so is the power of tour operators whose opinion is reflected in their contribution to the hotel strategic management process (80%);
- the bargaining power of suppliers has not changed substantially.

The previous results are in line with the findings that: a) substitutes of the mass tourism are increasing, b) new competitive destinations appear and competition in the industry is increasing with the lapse of time; and c) the bargaining power of hotels towards tour operators is decreasing as the monopsony power of the later is strengthened and so the attractiveness of the mass tourism is undermined (Falzon, 2003, Ezzamel and Willmott, 2004).

## 4. Strategy and the regional dimensions of competitiveness

The function of the "five forces" in the regional market determines the attractiveness of the mass tourism sector in Ionian Islands. In addition to those forces, four more factors that constitute the "the diamond of competitiveness", co-determine the framework in which the tourist companies operate and shape the conditions for the competitiveness of tourism in the region (Porter, 1991).

The competitive advantage is affected by the conditions of the region a hotel is located ("the diamond of competitiveness"), that contribute or prevent the alignment of the available resources to external environment. The competitive advantage depends on the region a company is based, as well as on the capabilities a company possesses. The region determines how activities are shaped, which resources and capabilities are combined in a unique way from companies (Porter, 1991). The national and regional environments are dynamic and exert considerable influence through the factors of "the diamond of competitiveness" on the management practices, the forms of organization of companies, the values and the goals set at personal and corporate level. The environment creates the conditions for business success that can be exploited through the appropriate strategy.

The four elements which form the "diamond" are the supply and demand factors, the presence of supportive to tourism services and the institutional framework that affects the operation of the hotels. The importance of the diamond factors is considerable, since they are the elements of the framework in which the "five forces" function, constrained or facilitated.

In the case of Ionian tourism the following factors with respect the consisting parts of the "diamond" have been observed (Curtis, 2004):

Regarding the supply factor, the natural environment, as well as the historical and cultural factors, they are considered to be favorable elements. The transportation infrastructure is mediocre. The human resources and the quality of management in the tourist sector are considered to be below the required level and represent the main restrictive factors of the internal environment of the hotel sector in connection with absence of the appropriate strategy.

The role of the domestic demand in the tourist development of Ionian Islands not only during its early stages, but also today, has not been substantial. The proximity of the island to Central and Western Europe, as well as its natural characteristics have contributed to its attractiveness. Favorable developments in international demand for tourism influenced on the economic growth of Western countries, the increase in leisure time and the aging of population, etc. All these factors contribute to the rise of demand for more vacation trips but of shorter duration. At the same time the demand for alternative forms tourism is increasing at a greater rate.

As concern as the supplementary and supportive to tourism services and the clustering of the sector related companies, the situation is not considered satisfactory.

Finally, the function of the companies and the existing institutional framework of the sector are not so propitious. The undue increase in rooms to let intensify competition and the lack of sufficient support by the public sector aren't considered favorable. Insufficient vertical integration and the absence of cluster of business in tourism, in connection with inferior management and organization of hotels represent additional unfavorable factors (Curtis, 2004).

In addition to the quality of the factors involved, the exact analogy of them in relation to the external environment at large reinforces each other and the efficiency of all these elements that are used given the circumstances. Porter believes that the four factors that constitute the diamond of competitiveness create the milieu in which the industry's companies exist and function, so influencing the way opportunities are contemplated and exploited with the use of appropriate goal setting and strategy respectively. Also these factors of the region create the possibility and the rate of improvement, the pace and the direction of innovation. The five forces model determines the attractiveness of the industry, reflects the soundness of local competition and the long-term productivity growth which is based more on dynamic efficiency and less on allocative and technical ones (Porter, 2002). Strategic positioning and value propositions to clients that exceed operational effectiveness and foster innovation determine the rate of productivity, competitiveness and the standard of living of the region. The decreasing attractiveness of the region is reflected in the reduced average staying period and most importantly in the lower spending per tourist arrival.

A better understanding of a) the competitive advantage, b) the customer needs, c) capabilities and d) the forces of competition, contribute to innovation, flexibility and to better exploitation of opportunities (Grant, 2002). Critical success factors (CSFs) are those product-service characteristics that are particularly valued by a group of customers and, therefore, where the region must excel to outperform competition in tourism. They will differ from one market segment to another since different customer groups' value different service-product characteristics. The stage of the product cycle that mass tourism for summer vacation is going through in Ionian renders prices a critical success factor (CSF). To the extend that the tourism product of the region remains undifferentiated, the high price elasticity of demand and the competitive pressures from new destinations as well as the existing ones are increasing. Appropriate scale utilization, cost control, the efficient use of labor, reduction in transportation cost, idle capacity utilization, reduction in seasonality are critical factors of success. None of these factors is favorable according to opinion of the management of hotels operating in the region.

Even more development of the existing product is not proposed without reservations due to the change in the structure of demand and tastes, the increasing competition, the fall in prices, the increasing of costs, and the unbearable (in same cases) dependence on tourist operators.

The latter take advantage of the situation asking for lower prices, while at the same time exploit the last minute booking tactics to create additional uncertainty and anxiety in the industry, which can not store its excess production capacity that is lost due to the insufficient demand and so exert more pressure on prices.

The scope for differentiation through product enrichment ant high quality services to build customer loyalty, is the appropriate strategy for Ionian Islands, given the advanced stage of the life cycle of its the mass tourism product. Given the previous analysis, the sustainability of the Ionian tourism depends on the enrichment of its product with alternative forms of tourism and differentiation (73%). Finally, according to M. Porter, becomes evident the lack of clear cut strategy, indicating that a stuck in the middle type. The appropriate strategy has a great influence and is consider as a vital determinant of success, profitability and competitive advantage either based on cost leadership or differentiation and focus.

## 5. Strategy formulation and business matrices

The increase in revenues that is necessary to surpass the break even point of operation the corresponding hotels and the sector as a whole and secure profitability, may come, according to Ansoff, from the increase in revenues of existing product in the present markets of incoming tourists (England, Germany, Italy, France, etc.) or through the acquisition of new markets, as well as through the development of new type of products offered to the existing or to new markets. As the region explores new markets and develop new products the risk in implementing the strategy is increasing of course.

The considerable size of the market share of mass tourism for summer vacation and its slow rate of development corresponds to the so called "cow" segment of BCG Matrix (Grant, 2002). The size of the market is big enough to create surplus in cash flows and its needs for additional investment in this type of market are limited, given its mature stage of the product cycle.

The development of new products and markets (Ansoff, 1979) must take in to consideration the risk and the profitability of all options that emanate from the attractiveness of each segment in connection with the particular advantages that Ionian Islands posse. The development of alternative forms of tourism for the region is necessary. It will create a more balanced and viable portfolio of products with more favorable prospects. So, only selective investments on the existing product are advised that have to be accompanies by placing the surpluses of cash flows to finance the alternative forms of tourism (conventions, cruises, yachting, agro tourism etc.) that represent the so called "question marks". Conventions (60%) and yachting tourism (53%) are considered that possess the necessary market share that is required to attract investment capital in the region. The aim of this strategy is to transform these new forms of tourism in to "stars", with respect the market size and growth rate that will boost tourism in the region. According to GE matrix that combines the attractiveness of each segment and the competitive advantage of the region in each of them, reveals that selective investment strategy is the most advisable one (Ghemawat, 2002), given the results of the research.

The financial conditions with respect to profitability, cash flows, liquidity, solvency, etc. as it is reflected in the financial statement analysis of the hotels in Ionian, it is not acceptable. This situation does not safeguard the flexibility, the effectiveness and the success in a fast changing external environment for the tourism product of the region, as it is contemplated by the management of the hotels and come out through their answers in our research. The change is expedited at an accelerating pace due also to the presence of new type of tourists (Kotler et al., 1999). The fickleness of the external environment is triggered by changes in demand, prices, and the conditions in the industry, the competitive pressures, the great fixed cost and the difficulty for the hotels to leave the industry. The 65.5% of the management executives consider the changes in the competition as the greatest threat for the region and 29.1% the change in the tastes of tourists.

The analysis based on the SPACE matrix, combines the internal, as well as, the external environment of tourism viewed from a specific angle. Environmental instability on one hand which is defined in the tourism industry by demand variability, low barriers to entry, competitive pressures, high price elasticity of demand, increase the risk involved and it is combined with weak financial position places hotels. This situation, on the other hand, is accompanied by the lack of any comparative advantage of hotels in Ionian Islands with respect to mass tourism, which combined with the low attractiveness of this sector. The later indicate that Ionian Islands cannot compete on low prices any more and that is why financial health of hotels is deteriorating. Fixed costs are surging more than prices and hotels are embroiled in a struggle over market share to secure operation above the breakeven point. The dependence on tour-operators, the inadequacy of appropriate human capital erodes competitive advantage and offset the low attractiveness of the sector.

Given the fore mentioned situation externally and internally, the proposed strategy is the defensive one (SPACE matrix). It reflects that the hotel sector lacks competitive product and sound financial structure. It recommends improvements of the weakness inside and reduction or avoidness of threats coming from the external environment. This strategy is achieved through reduction in investments regarding mass tourism, liquidation flee from the sector and product differentiation (Rudder and Louw, 1998).

The abatement of weaknesses and the avoidance of threats command product enrichment, quality improvements and diversification as a means to correspond more fully to the change in tastes of the new type of tourists, who is trying to satisfy superior needs in Maslow's pyramid of needs. The proposed strategy is in an agreement with the previous SWOT analysis.

The tourism industry in Ionian Islands demonstrates rates of revenue development and profitability that according to Marakon matrix indicate and explain the problem reflected in financial statements (Hax and Majuf, 1996). The Ionian tourism is developed at a rate below the average of the industry for Greece and at the same time the cost of equity is not covered by the return on it (Curtis, 2004). Inferior revenue development and low return on equity in Ionian region indicate that the strategy followed is not sustainable and acceptable in the long run. Therefore the present strategy of tourism in the region reduces its share in the global tourism and destroys the wealth, since the opportunity cost of capital employed is greater than its return. The tools of SWOT analysis, the "five forces", the product life cycle (PLC), BCG, SPACE and MARAKON matrices, as well as the return on equity invested on hotels in Ionian region reflect the need for product enrichment and differentiation as a means for the reduction in seasonality and increase in the tourist spending so that the viability of the tourism sector is secured. It is also in line with the priorities and policies of the European Commission (2004).

Improvement in value added can be achieved through the increase of revenues or/and efficiency. The increase in revenues can come about through the increase of the global tourism or/and amplification of the region's share to it. This can be attained through a strategy of low cost or differentiation. The first type of strategy is vulnerable according to Porter since it is based on small profit margins that reduce flexibility, and increase the probability of retaliation on behalf of the competitors. In the long run any asymmetrical relation between price and value added can last only in case it benefits consumers in accordance with Bowman's clock of strategy (Johnson and Scholes, 1999). Branding Ionian destination through a) segmentation of the market into distinctive parts, b) creation promotional material to appeal to them, c) getting all stakeholders together to achieve understanding and produce consensus on cultural, social and economic objectives on tourism development of Ionian islands, d) delivering the brand using a consistent message to both supplier and tourists, and e) establishing specific processes and procedures to performance measurement towards that aim, seems to serve region since its carrying capacity is limited, its cost advantage has been wearing out and differentiation coupled with quality service is the only way out to meagre financial performance of the hotels involved.

## Conclusions

The strategy formulation process indicate that tourism enterprises in the region can't reduce the harmful effects of the intense competition that erodes their competitive position and should try to attain competitive advantage through the provision of a unique value proposition to their clients by differentiating the product. This type of strategy will provide Ionian Islands with a more balanced basket of tourism products (with different market share and growth), compare to the one that it is based almost exclusively on the mass tourism for summer vacations, which has reached the maturity stage of its product cycle and the five forces operating in the industry hamper profitability in tourism and the hotel sector in particular. New segments (conventions, yachting and other forms of tourism) may posses a small market share that represent a question mark (BCG matrix) for the region for the time being, but may be proved of having great prospects. So, Ionian should invest on them using cash-flows earned from the exploitation existing product of mass tourism and hope that they will become stars in the future.

The undermined financial health of the sector is not adequate to fund new investments and exploit any competitive advantage in a industry with prospects and instability in its external environment. The defensive position according to SPACE matrix commands a strategy of overcoming weaknesses and avoiding threats. Operational effectiveness and appropriate positioning is a prerequisite.

The resource allocation and control indicate that Ionian's market share shall develop with a rate above the average one of the market. It is necessary to cover the gap in revenues for hotels and achieve return on capital that is greater than its cost, according MARAKON matrix. Thus, they will keep share holders happy and please the rest of stakeholders in order to secure sustainability of the sector. The existing "stuck in the middle", cloudy and vague strategy in Ionian Islands, is responsible for the unsatisfactory performance in terms of profitability, since it reflects the lack of specific strategy and it is dangerous, since does not encourage the necessary focusing on the specific market segments (Valuebased-management.net).

Furthermore, the cost of goods sold to sales will be reduced due to a combination of higher selling prices and economies of scale, achieved by spreading high fixed costs over a larger sales base that will come about through the development of alternatives to mass tourism. It will reduce the dependence from tour operators and will abate seasonality which exert pressures on the infrastructures of the islands, degrade environment and reduce quality of service. The occupancy rate of hotels will increase throughout the year, assets turnover and utilization will be boosted, enhancing return to equity and competitiveness further.

The holistic approach used, allow us not only to evaluate the present strategy applied in the tourism sector in the region, but also to suggest appropriate means of improving it.

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