# INTERNATIONALISATION OF CHINESE HOTEL COMPANIES
# – A CASE STUDY OF GUANG DONG (INTERNATIONAL) HOTEL MANAGEMENT LIMITED

By

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Submitted in fulfilment of the requirements for the
Degree of Doctor of Philosophy
at the University of Strathclyde

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**December 2000**

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## ACKNOWLEDGEMENT

This study could not have been completed without the essential guidance and support from my research supervisor, Professor Tom Baum. His valuable advice, insightful comments have greatly benefited the completion of this research. His friendliness and a unique sense of humour have made an association with him such a pleasant experience.

I am very thankful to Dr. Juergen Brock for his great support which will be treasured forever. Friends who have brought fun and laughter to my life during this period of study, to all of them I am most grateful.

I would like to express my gratitude to the case study organisation – Guangdong (International) Hotel Management Limited, for their continual interest, kind assistance and information without which this work could not been done. I appreciate all my interviewees for their thoughts and opinions.

Finally a very sincere gratitude goes to my family. I am deeply appreciative of their moral support and great encouragement.

# ABSTRACT

The rapid growth of the Chinese economy is reflected in the global expansion of Chinese enterprises. While a lot of attention has been devoted to the expansion of foreign owned enterprises in China since 1978, the interest of this study has extended to Chinese owned service firms which are venturing abroad, with a particular focus on a Chinese hotel chain-Guangdong (International) Hotel Management Limited. This research undertakes an exploratory study – based on inductive and evaluative approach – to generate new, analytical insights into the social phenomenon of a Chinese hotel chain's internationalisation. In entering in international hotel marketplace, Mainland Chinese companies face a very competitive environment in which most of the major players have already achieved strong market positions. Based on consideration of theories and analysis of the empirical evidence, this study develops a theoretical framework of the internationalisation of Chinese hotel companies which is linked to the specific characteristics of the country in transition from a centrally-planned economy to a market economy.

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# Chapter 1: Introduction

## 1.1 Research Background

Within a changing global environment, internationalisation is viewed as almost inevitable if the expansion goals of corporations are to be achieved (Root, 1994). Following the introduction of the so-called "Open-door policy" by Deng Xiao-ping in 1978, the expansion of foreign owned enterprises within China has been very well documented (Zhang and Bulcke, 1996). However, relatively little is known about Chinese owned firms venturing abroad. Although some researchers have paid attention to Chinese firms' internationalisation, they focus on the manufacturing sector (see for example, Gang, 1992; Huang 1993; Young *et al* 1996; Zhang and Bulcke, 1996). The internationalisation of Chinese service firms, in particular location-bound services, has not been widely studied.

Since the adoption of an open-door economic reform policy, tourism in China has developed rapidly and has become a significant sector within the country's economy. In 1998, international visitor arrivals to China reached 63.4 million, a 35-fold increase from 1.8 million in 1978. International tourism receipts also increased from US$ 263 million in 1978 to US$12.6 billion in 1998 (The Year Book of China Tourism Statistics, 1999). In parallel with the expansion of tourism in China, there has also been a corresponding boom in the hotel industry.

However, it is worth noting that when China first embarked on international tourism development in 1978, it suffered from a shortage of lodging accommodations that could meet Western hospitality standards. In order to cope with increasing international arrivals, to accelerate hotel development and to meet the demands of tourists, a preferential policy toward hotel investment, especially for joint venture hotels, was established which provided opportunities for international hotel chains to enter Chinese markets. Despite the positive effect of the introduction of foreign investment and management know-how, the policy also resulted in some development problems in which the industry was heavily dominated by foreign hotel chains and leakages of tourism revenue emerged (Zhang, 1989; Zhao, 1989; Yu, 1992; Pine *et al* 2000). Concerns about these issues led China to start developing its own hotel companies.

The hotel sector has witnessed a process of growing internationlisation since the late 1940s (Litteljohn and Roper, 1991). In entering the international hotel industry, as late entrants, Chinese hoteliers face a very competitive environment in which most of the major players have already achieved strong market positions and brand recognition. How to develop indigenous Mainland Chinese hotel companies and to compete in international markets is a critical issue for Chinese hoteliers and the government.

This study seeks to address this issue by investigating the internationalisation specifics of a state owned Chinese hotel chain. Based on theories and empirical evidence, this study attempts to develop a framework of internationalisation of Chinese hotel companies.

## 1.2 Statement of Research Problem and Scope

While much of attention has been devoted to the expansion of foreign owned enterprises within China since 1978, the interest of this study extends to Chinese owned service firms venturing abroad, with a particular focus on a Chinese hotel chain – Guangdong (International) Hotel Management Limited (GD Hotel Group).

The rapid growth of the Chinese economy has been reflected in the global expansion of some Chinese enterprises. In this exploratory study, the emphasis lies in attempts to undertake inductive and evaluative research in order to generate new, analytical insights into the social phenomenon of a Chinese hotel chain's internationalisation. The study covers the international evolution of the firm, including its competitive advantage, reasons for and problems associated with internationalisation, as well as the role of the government in relation to its development. A framework of internationalisation of Chinese hotel companies is proposed based on theory and the accumulated empirical evidence. This framework is linked to the specific characteristics of Chinese hotel firms operating in an economic system in transition to a market economy.

This study adopts a single case approach. The major reason for the choice of this case study organisation is due to the fact that it is the only multinational Chinese hotel chain with the experience and expertise of running hotels outside China. There are no comparable companies, because other Chinese hotel chains only operate in the home country. This fact determined that a comparative multi-case approach is impossible. Limited comparison, however, is undertaken with the experience of other international hotel companies particularly these located in South - East Asia.

## 1.3 Research Aim and Objectives

Following the introductory remarks above, the overall research aim of this study is to develop a theoretical framework of the internationalisation of Chinese hotel companies. In addressing this, the following research objectives are to be investigated.

a) To investigate the internationalisation specifics of the GD Hotel Group, including reasons behind GD's internationalisation, its competitive advantage and problems associated with its internationalisation.

b) To assess the role of the government in the internationalisation process.

## 1.4 Research Methodology

This study was carried out in three stages: literature review, fieldwork, and analysis of empirical data.

At the literature review stage, internationalisation theory, internationalisation of the service sector, internationalisation of the hotel industry and the unique features of hotel development in China were reviewed and synthesised. The relevant information was collected from relevant books, journals, government publications, conference papers, reports, and theses and the information published on the Internet. Documentary data about the case study organisation was provided by the firm prior to the empirical work. Further documentation was also collected during the data collection period.

This research adopted a phenomenological approach in investigating the internationalisation specifics of the GD Hotel Group, and the case study was the research instrument used. Justification of the case study approach and the rationale behind the choice of a single case is addressed in Chapter 5.

Fieldwork was carried out in GD Hotel Group's home city of Hong Kong using face-to-face interviews. A key theme in studies on internationlisation is the management's mind-set, attitudes and beliefs (see for example Oviatt and McDougall, 1994). Thus, semi-structured interviews were conducted with 13 key informants from the GD Hotel Group. In order to obtain a more comprehensive and in-depth view, 2 hotel consultants who have worked with Chinese organisations also participated in the study. The interview questions were based on the literature review, company documentation and some informal observation prior to and between interviews. Interview guides were faxed to the respondents before the interviews took place, they are exhibited in Appendix A and B. Data was analysed by using cognitive mapping techniques.

The face-to-face interviews provided the opportunity for the researcher to raise additional questions and to make sure that the desired information was obtained. However, the use of interviews may reflect the researcher's preconceptions of what is interesting and worth pursuing, which a positivist may see as potentially soft science, unscientific, very subjective, personal and liable to bias. Nonetheless it is these very things which give qualitative research its richness and allows for nuances of the phenomenon to be studied. Details of the research methodology are discussed in Chapter 5.

## 1.5 Value of the Study

This research will provide some insights into the nature and extent of a Chinese state owned hotel company's international expansion and shed light on aspects of organisational behaviour in the process of the internationalisation. The key ideas of the internationalisation framework of this study can be adapted and transferred to other Chinese hotel companies through a process which Rose (1993) calls 'Lesson-drawing'. It is believed that this developed framework of internationalisation will benefit Chinese hoteliers.

Secondly, dynamic changes in a country's economic development and the expansion of MNEs there are not unique to China. Similar events are also happening in other emerging markets such as India, South America, South Africa and Eastern Europe. These countries share similarities to China in terms of strong government control, changing government policy, reform of their economies, no deep roots of a market economy and the danger of political instability. Therefore, the internationalisation framework proposed in this study might also be valid in explaining firms' international expansions within these emerging markets where the government is the key body for changing the social and economic structures of the society. It is believed that this framework will extend the boundaries of existing knowledge in international business and the internationlisation of new entrants from the developing world.

Thirdly, the existing literature on international business and internationalisation has paid relatively little attention to the internationlisation of Chinese enterprises. Although some researchers have paid interests to the international development by Chinese multinational firms (see Young *et al* 1996; Young *et al* 1998; Zhang and Bulcke, 1996), they all focus on the manufacturing sector. This research will contribute to knowledge of Chinese service firm's outward investment and provide an increased understanding of the current limited knowledge about China's outbound tourism, Chinese hotel firm's internationalisation and its impact on international markets. Furthermore, it is also anticipated that this empirical research will help to address the academic imbalance in studies relating to China's inward and outward foreign direct investment (FDI) with their focus on foreign firms investing into China rather than the other way round.

Finally, the value for policy makers stems from a better understanding of the possible ways that Chinese hotel chains will be able to compete in the global market. Evidence from this study will make a useful contribution to government decision-makers in formulating macro policies towards China's outward investment and assist corporate decision-makers in formulating their internationlisation strategies.

## 1.6 Limitations of The Study

At the methodological level, this research adopted a case study approach. From a positivistic standpoint this work cannot be regarded as representative and is incapable of generating findings which can be validly generalised to wider instances of the phenomenon in the population at large. There is a recognition of the difficulties of generalising on the basis of a case study approach (see Bryman, 1988; Clark *et al* 1998), because case study lacks scientific weight and general applicability. This lack of statistical validity makes generalisation difficult. Like any other research study using a qualitative approach, the question of generalisability can always be challenged.

Indeed, by adopting a case study approach, the study did not have the strengths of providing wide coverage of the range of situations and of being fast and economic to conduct in comparison to quantitative research. By using a single case, it did not allow for a strategic comparison, thus the evidence and theories drawn from the case are less powerful compared to a multi-case approach. However, each research strategy has its own strengths and weaknesses, the appropriateness of a research approach derives from the nature of the social phenomenon to be explored (Morgan and Smircich, 1980). The nature of this research has determined that the case study approach is the most appropriate (for details see chapter 5).

As mentioned before, the researcher intended to incorporate external primary data relating to views of hotel consultants into the study in order to increase its validity. In relation to the selection of respondents from hotel consulting firms, the researcher contacted the major consulting firms in Hong Kong and explained the nature of the work. Unfortunately, these firms either did not have a hospitality division, or had never done any work that is China related. Only two organisations were able to provide the information that resulted in the sample size being so small. However, their views regarding the internationlisation of Chinese firms have brought some fresh ideas to the researcher and contributed to this research.

## 1.7 The Organisation of The Thesis

The thesis is organised into eight chapters. The initial chapter introduces the research background, research problem and scope, research objectives, research methodology, assesses the value and limitations of the study. The chapter ends with an overview of the structure of the thesis.

Chapter 2 reviews the literature on internationalisation of services. It starts with defining the term internationalisation, reviews the reasons for internationalisation and discusses the internationalisation process model. Services fit into different categories according to their tradability, the classification system for services is therefore reviewed. Entry mode strategies designated for services to deliver their products and services beyond national boundaries are discussed next. Services going international led to the internationalisation of competition and this is discussed in the latter part of chapter 2.

Chapter 3 reviews the internationlisation of the hotel industry. It first reviews the different entry modes strategies pursued by international hotel chains when entering international markets. Dunning's eclectic theory is used as a framework to explain the growth, form and distribution of multinational enterprises in the international hotel industry. The international expansion strategies employed by major American, European and Asian hotel chains are reviewed, compared and analysed in order to identify how they achieved competitive positions in the international hotel industry.

Chapter 4 starts with a review of China's political dimension because as a developing country with a socialist economy, it has a significant effect on changing social and economic structure of the society. In order to address this issue, this chapter examines the impact of economic reform on China's hotel development. The interesting issues of the relationship between government policies and the development problems, manpower and reasons for developing indigenous Chinese hotel companies are reviewed and discussed.

Chapter 5 first discusses research philosophies. Secondly, it assesses the respective strengths and weaknesses of quantitative and qualitative study and demonstrates the rationale for using a case study as the appropriate research method in this research. Thirdly, the chapter justifies the selection of the single case approach, and reports the implication of the case study research. Data analysis method of cognitive mapping is discussed. Finally, the limitations of the study are addressed.

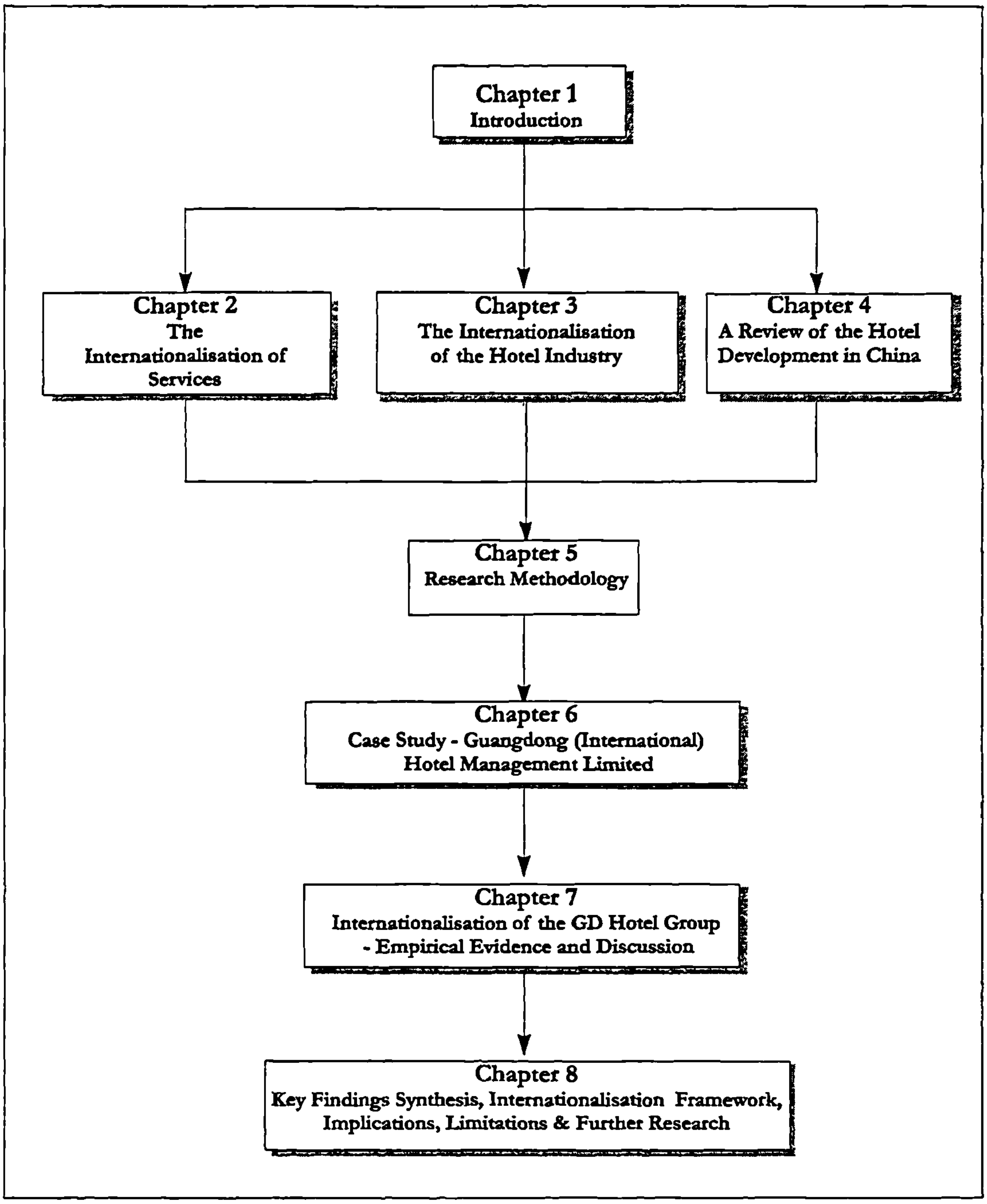
Chapter 6 presents the backgrounds of the case study organisation and its parent company. The unique features of the development of the GD Hotel Group in terms of its development routes, characteristics of its managerial behaviour towards internationlisation, and its operational performance are presented and analysed.

Chapter 7 presents the empirical evidence from the interviews addressing research objectives (a), that is to investigate the reasons for GD's internationalisation, competitive advantage of GD and the problems associated with GD's internationalisation, and research objective (b), that is to assess the role of the government in GD's internationalisation.

Chapter 8 synthesises the key findings and develops a framework of internationalisation of Chinese hotel companies. The implications and limitations of this research are addressed. This chapter also recommends future research directions.

The structure of the thesis is summarised in Figure 1.1.

Figure 1.1: The Structure of the Thesis



# Chapter 2: The Internationalisation of Services

## Introduction

Within a changing global environment, internationalisation is viewed as almost inevitable if corporate expansion goals are to be achieved. Root (1994) highlights that all companies should plan for growth and survival in a world of global competition, the most promising strategy for growth and survival is to become an international player. Rapid globalisation of economic activities in recent years has greatly expanded the opportunities for marketing services abroad (Hassan and Kaynak, 1994). Trade in services represents 20 to 25 percent of all world trade, with an annual growth rate of 20 to 30 percent (Terpstra and Sarathy, 1994). And the contribution of the service sector to international trade is expected to expand further with recognition of international trade in services within the 1993 General Agreement on Tariffs and Trade (GATT) and subsequent agreements.

This chapter focuses on the internationalisation of the service economy and will start with defining the term "internationalisation". Before considering the process of internationalisation, it is essential to understand the reasons for internationalisation. When service firms decide to go abroad for profit or survival, they need to consider and design entry strategies. Services fit into different categories according to their tradability and this will ultimately affect foreign entry mode choice. Strategies designated for services to deliver their products and services beyond national boundaries are reviewed next. Services going international lead to the internationalisation of competition and this is discussed in the latter part of this chapter.

## 2.1 Definitions of Key Term "Internationalisation"

Johanson and Vahlne (1977) have defined the term "internationalisation" as a process in which firms gradually increase their international involvement. This definition provides the seminal theoretical contribution on the internationalisation of firms and it is best understood as an evolutionary process (Young, 1990).

Similarly, following Johanson and Vahlne's (1977) original definition, Luostarinen (1994) regards internationalisation as a step-by-step process of international business development whereby a firm becomes increasingly committed to and involved in international business operations through specific products in selected markets. The overall notion of a developmental process is shared by Buckley and Ghauri (1993), who suggest that internationalisation means a changing state and thus implies dynamic change. Interestingly, they argue that the growth of the firm is the background to internationalisation. However, this view has been challenged by other researchers who do not agree organisational growth as a necessary condition for internationalisation. Market seeking, resource seeking, efficiency seeking, strategic asset seeking (Dunning, 1988), risk avoidance (Robock and Simmonds, 1983) or client following (Erramilli and Rao, 1990) can also determine the internationalisation of firms. Therefore, it becomes clearly that not only the organisational growth forms the background of the internationalisation, motives are also shaping the internationalisation of firms.

Hedlund and Kverneland (1985) in their definition of internationalisation stress foreign market entry as a manifestation of international involvement and commitment, addressing that the internationalisation of the firm has been regarded as a process in which the firm gradually increase its international involvement and chooses more firmly committing entry strategies. In comparison to other definitions, this definition explicitly focuses on changes in the organisational structure of the firm. Such a focus on observable organisational outcomes was also argued to be superior because it increases the robustness of the concept of internationalisation (Anderson, 1997).

Reviewing the concept of internationalisation, Beamish (1990) sees internationalisation as the process by which firms both increase their awareness of the direct and indirect influence of international transactions on their future, and establish and conduct transactions with other countries. This definition does not address an incremental involvement as a core feature of internationalisation. It regards internationalisation as an uni-directional process of increased involvement and commitment and has been criticised (see for example Calof and Beamish 1995).

Calof and Beamish (1995) argue that the internationalisation of a firm does not necessarily only imply increased levels of involvement and commitment. Internationalisation should also be understood to include de-investments, which is a temporary decrease in the level of international involvement of a firm. Thus, they define internationalisation as the process of adapting firms' operations (strategy, structure, resource, etc.) to international environments. This view is shared by Anderson (1997), who defines internationalisation more specifically as the process of adapting exchange transaction modalities to international markets. Clearly, they do not support the view that internationlisation is a constant increase in commitment and involvement, they rather suggest that internationlisation is a dynamic process by which firms adapt their involvement and commitment to international markets as well as to international competition.

Many researchers offer their perspectives on the concept of internationlisation. In summarising the core factors as discussed above, internationalisation can be summarised and defined as a gradual and dynamic process by which organisations increase their awareness of the importance of international activities and become involved in operations across national borders, and a process of adapting exchange transaction modalities to international markets. An interesting question arises here as to why firms seek to deliver their products and services beyond the traditional boundaries of domestic markets? Attention now turns to the reasons for internationalisation.

## 2.2 Reasons for Internationalisation

Companies undertake internationlisation for a variety of reasons. Some firms internationalise due to necessity because their rivals and customers have globalised (Ohmae, 1990). Other companies internationalise their operations because multinationalism is a symbol of success and progress (Perlmutter, 1995). There is also evidence that increased internationalisation results in improved profitability (Go and Pine, 1995). Despite these benefits, internationalisation is also regarded as a complex, costly and risky activity (McKiernan, 1992) due to the fact that international operations inject greater elements of variability and complexity into organisational activities. Environments become more variable because locational differences in terms of economic, social/cultural, demographic and legal factors become greater than they would if the company restricted its activities to a single country. In other words, geographic expansion implies a degree of risk because the organisation may not have previous experience of operating within the new location. (Watson and Litteljohn, 1992).

Given the greater risk and uncertainties which are involved in international expansion, questions are raised as to reasons behind internationalisation. The past two decades have witnessed the rapid growth of a substantial body of literature and research within the field of international business. This literature has made a substantial contribution to understanding the needs and the underlying reasons behind internationalisation activities (see Cavusgil, 1980; Albaum *et al* 1989; Ohmae, 1990; Anderson, 1993; Root, 1994; Perlmutter, 1995;).

Cavusgil (1980) classified the reasons for internationalisation into two broad main categories: macro and micro. The macro level can be described as the broad trends in the world, particularly after World War II, with the beginning of a more liberal environment in international trade and investment. This level also includes such factors as the raising of the world's income level and the decrease in the poverty level of some developing countries over the last decades; reduced barriers to international trade as a consequence of General Agreement of Tariff and Trade; the creation of regional trading blocs and integration, such as European Union and American Free Trade Association; and improvements in technology. Micro factors can be described as the companies' specific reasons that influence the organisations' decision to internationalise.

Albaum *et al* (1989) put forward several reasons which explain firms' internationalisation decisions. As classified by these authors, reasons may spring from factors which are internal to the firm such as managerial urge, growth and profit goals, economics of scale, offer a unique product or extension of services, or from external factors in the business environment such as foreign market opportunities, encouragement through change agents. In addition, motivations have been distinguished on the basis of whether they are proactive or reactive.

This view has been shared by McKiernan (1992), who notes that internationalisation may start when there are internal change agents who actively push companies towards greater internationlisation (proactive explanation). Alternatively, internationlisation may be initiated by external stimuli such as unsolicited orders from overseas customers and incentives from local government (reactive explanation). The reason behind many Chinese State-owned enterprises venturing abroad in the early stage appears to fit into the latter explanation.

The conscious impulse behind a company's initial entry into foreign markets is almost always the prospect of profit on immediate sales (Root, 1994). Companies may go abroad in search of markets for greater sales volume in order to reduce the unit costs of manufacturing overheads and thereby strengthen their competitiveness at home as well as in foreign countries. A further empirical study, conducted by Booz, Allen and Hamilton (1991) on the subject, shows that companies which operate internationally, enjoy higher profit margins and greater return on assets than those that are strictly operating in domestic markets. They also view international markets as a safety net when the domestic economy slumps as their study shows that firms which have already internationalised could minimise their domestic downturn turnover risks. That might be the motive for many European, Japanese and Pacific Rim companies which have tended to push harder and move faster in order to fully understand growth potential and compete globally.

A closer look at the micro factors reveals that demand push factors can be considered as a restriction on growth in the firm's domestic market which act as a powerful incentive to internationalise (Hamel and Prahalad, 1985). This analysis is shared by Alexander and Lockwood (1996), who argue that market saturation or maturity, competition from foreign imports and a high level of industry concentration have forced companies to develop new markets in order to survive and compete. Similarly, Porter (1990) highlights that the result of home market saturation is vigorous efforts by a nation's firms to penetrate foreign markets in order to sustain growth and even to fill capacity. He further argues that home market saturation is particularly beneficial if it is combined with buoyant growth in foreign markets. In hotels and fast food, for example, American firms moved overseas as they neared full coverage of the U.S. market. Consequently, American hotel chains and fast foods corporations have established strong international positions in the service sector.

Another major internationalisation trigger is domestic recession. Based on an empirical study which investigated the behaviour of US exporters during the 1980-1982 recession, Rao *et al* (1992) note that firms which were affected by the recession not only intensified their exports but also expanded their export destinations' portfolio by seeking new overseas markets to avoid risks. This view is shared by Robock and Simmonds (1983) as a motive to internationalise.

Demand pull factors present some enticements to firms as the underlying reasons for internationalisation. Erramilli and Rao (1990) note that a common reason among service companies (e.g. advertising, computer services, hotels and insurance) going abroad is to follow their domestic customers who are going international. A large number of business travellers within the spread-out borders of the United States, for example, helped American hotel chains learn to serve this global market segment. This motivation has been defined as *client following* (Erramilli and Rao 1990). This is an important element within the internationalisation process discussed in this study.

Yip (1989) notes that the rapid rate of technology change and the increasing costs of technology development act as an important stimulant to internationalisation. In industries where research and development require a massive investment, for example in the pharmaceutical industry, the need for large markets is paramount.

However, if the domestic market is not large enough to absorb the research and development costs or the entire output of an industry, entry into foreign markets may be an attractive alternative.

Another factor, which also drives companies to seek other markets, is competitive forces (Anderson, 1993). Root (1994) states that if the global economy is a threat to domestic firms, it is also an opportunity for them to exploit bigger and faster-growing international markets. He further identifies that the best way to defend against foreign competitors at home is to attack those same competitors in international markets. According to Anderson (1993), in some industries, the expansion movement of competitors to other countries or markets could act as a powerful stimulant for companies to internationalise or follow their competitors whether by moving into the same new markets or countries, or moving to other untapped markets. Similarly, Ohmae's (1982) study also shows that fierce and intense competition does not come only from domestic companies, but also comes from foreign companies. Japanese companies, for example, have been able to compete with companies from developed countries not only in Japan, but also in other countries including Europe and the USA.

There are several reasons that drive companies to internationalise. The major motives behind this activity are survival, growth and profit. When companies no longer believe that they can attain their strategic objectives by remaining at home they become committed to international markets. However, international operations inject greater elements of variability and complexity into organisational activities.

Environments become more variable because locational differences in terms of economic, social/cultural, demographic, and legal factors become greater than they would if the company restricted its activities at home. Thus it is important that the management has to recognise the diversity of the international environment and make strategic decisions which allow the firm's commitment to be as effective as possible. The internationalisation process model has benefited many global managers by seeing internationalisation as an evolutionary and learning process that involves making careful and incremental changes (Lam and White, 1999). These are discussed below.

## 2.3 The Internationalisation Process Model

Internationalisation describes the process by which organisations increase their awareness of the importance of international activities and become involved in operations across national borders (Beamish *et al* 1995) and internationalisation theories explicitly address the timely fashion of the process of internationalisation of a firm. Models of internationalisation usually address two areas. On one hand the internationalisation process and its underlying forces and on the other hand the organisational manifestations of this process.

Recent reviews (see for example Strandskov, 1986; Welch and Luostarinen, 1988; Rao and Naidu, 1992; Andersen, 1993; Leonidou and Katsikeas, 1996; Brock, 2000) have generally distinguished between the Uppsala model of internationalisation and export developmental models or innovation related models according to Andersen's (1993) review. Since the internationalisation of location-bound services, the focus of this thesis, is characterised by the inability to use the export mode, the following section will focus on a critical discussion of the Uppsala internationalisation model.

### 2.3.1 The Uppsala Internationalisation Model

The Uppsala Model of internationalisation is mainly based on the early empirical findings of Johanson and Wiedersheim-Paul (1975) and a theoretical elaboration by Johanson and Vahlne (1977) which has been extended by Johanson and Vahlne (1990). The following sub-sections will review and discuss the assumptions of the model, the suggested process of internationalisation and the organisational manifestations of the process.

#### 2.3.1.1 Assumptions

Mainly based on four case studies (Johanson and Wiedersheim-Paul, 1975) and grounded in early economical contribution by Beckermann (1956) and Linder (1961), this model assumes that a firm first develops in its domestic market and then gradually develops its operations abroad, as a consequence of a process of incremental adjustments to changing conditions of the firm and its environment (Johanson and Vahlne, 1977).

According to Johanson and Vahlne (1990), the model has its theoretical base in Cyert and March's (1963) and Aharoni's (1966) behavioural theory of the firm and in Penrose's (1959) theory of the growth of the firm. It is based on the assumption that the firm strives to increase profits, which is regarded to be the equivalent to growth.

Furthermore, it is assumed that the firm seeks to keep its overall exposure to risk at a low level (Johanson and Vahlne, 1977).

At the core of the internationalisation process is lack of knowledge and subsequently uncertainty about markets abroad, due to lack of market information (Johanson and Vahlne, 1977). The accumulation of experiential knowledge – according to Penrose (1959) a type of knowledge that can only be learnt through personal experience, and is thus unique – about foreign markets is assumed to be the main source and key driver in the internationalisation process (Johanson and Vahlne, 1990), as it reduces uncertainty and the related perceived risk by providing the firm with information about a foreign market.

**2.3.1.2 Manifestations**

The firm's gradual development of operations abroad is postulated to manifest itself in four market entry stages (no regular export activity, export via independent agent, sales subsidiary and production abroad) which the authors have termed the "establishment chain". The postulated stages represent increasing resource commitments to and increasing control over a firm's operations abroad (Johanson and Wiedersheim-Paul, 1975).

Furthermore, the firm's establishment chains in different countries are supposed to correlate with the concept of "psychic distance" (Vahlne and Wiedersheim-Paul, 1973). That is "the firm starts exporting to neighbouring countries or countries that are comparatively well-known and similar" (Johanson and Wiedersheim-Paul, 1975) according to various factors like political systems, culture, language and education. Psychic distance is supposed to correlate with geographic distance, though exceptions like the British Commonwealth and the dynamic nature of the concept (psychic distance changes over time) are acknowledged (Johanson and Wiedersheim-Paul, 1975).

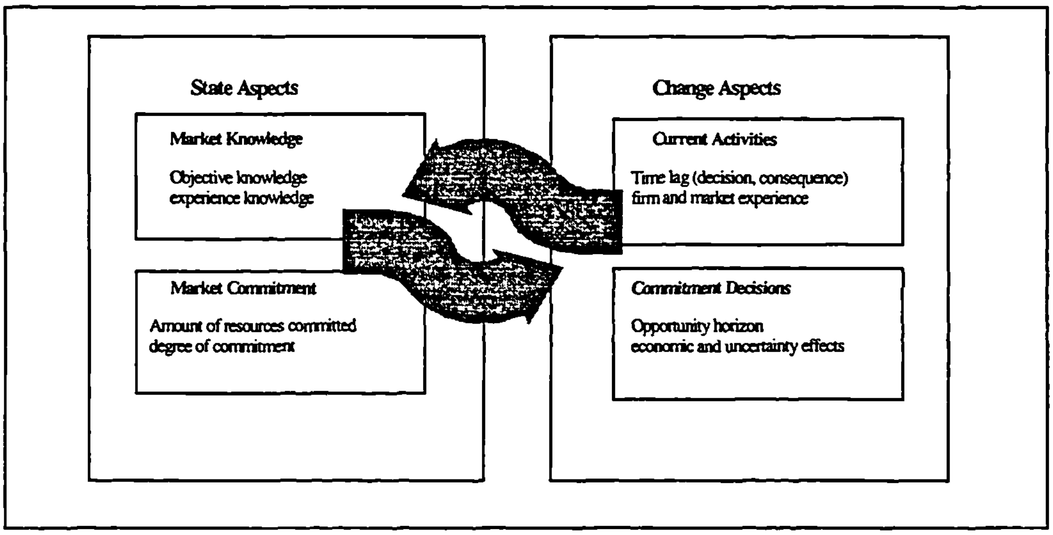
The establishment chain and the psychic distance construct represent the two dimensions, or directions as Johanson and Vahlne (1977) have referred to, along which the organisational internationalisation process of increased commitment of a firm manifests itself over time.

However, its rigid outcome typology can now be considered outdated (Buckley, 1996). Firms do not necessarily internationalise according to the postulated stage manifestations, for example, born global companies (Madsen and Servais, 1997) and for location-bound service firms these modes may not always apply. Cavusgil (1980) also notes that the establishment chain might not be relevant for many services due to the nature of services (intangibility, inseparability, heterogeneity and perishability which will be discussed in the following section). In many cases, being inseparable from the service provider and due to the simultaneity of production and consumption, some services cannot be exported in the traditional sense. In order to internationalise such firms have to locate the production of the service in the host country. However, the postulated direction of stages can apply to location-bound services. For example, Scandic's expansion, a Swedish hotel company with 153 properties, mainly focuses on Sweden, Finland, Norway and Denmark. Currently, they intend to break into Estonia via Finland.

#### 2.3.1.3 The Process

The process of internationalisation can theoretically be separated from its stages (Madsen and Servais, 1997). This underlying process of internationalisation still applies and will be discussed in more detail in this section. The underlying basic mechanism of the internationalisation process, operationalised by the two constructs, establishment chain and psychic distance (Johanson and Vahlne, 1990), distinguishes between a state and a change aspect (see Figure 2.1).

**Figure 2.1: The Uppsala Process Model of Internationalisation**




Source: adapted from Johanson and Vahlne (1977).

The state aspect represents the current knowledge and commitment of the firm and the change aspect represents the factors affecting and potentially altering the current state of the firm. Both aspects of the model interact with each other.

The firm's current state of internationalisation is characterised by the firm's amount and degree of resource commitment to foreign markets, as well as, by its objective and experiential knowledge about foreign markets and operations, both at a general and a market-specific level of knowledge. The current state of the firm interacts in causal cycles with the firm's commitment decisions and its current activities, the change aspects of the model (Johanson and Vahlne, 1977, 1990).

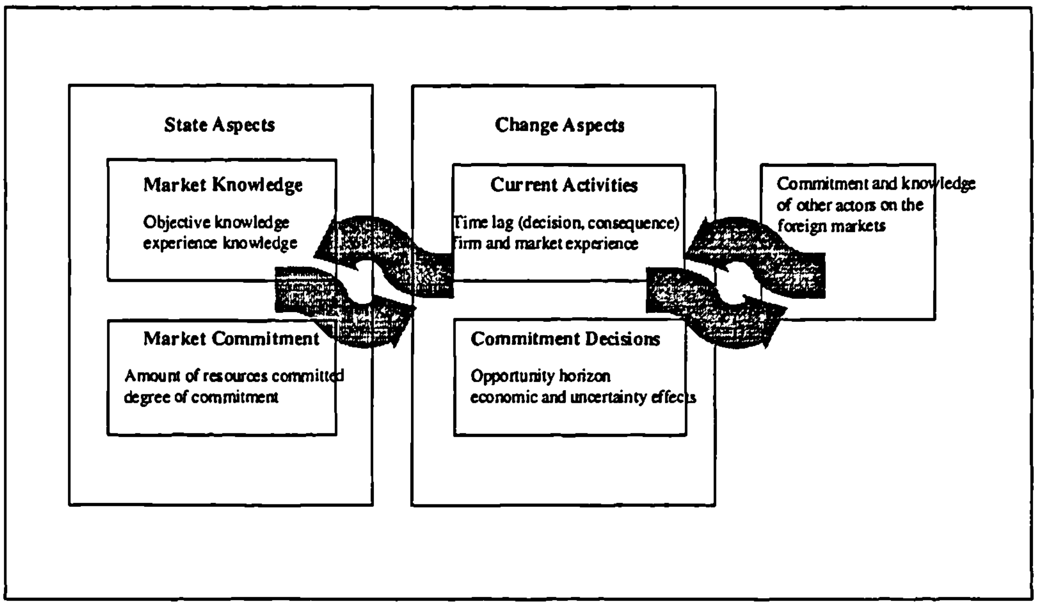
The change aspect includes the current activities of the firm and its commitment decisions concerning foreign markets. The current activities of the firm – its prime source of experience – is characterised by a time lag between decisions made, action implemented and its consequences for the organisation. The model suggests that the higher this time lag is, the higher the commitment of the firm. In order to highlight this, one might think about the following example. Capital investment in a wholly-owned luxury hotel abroad is high and the time lag before reaching the break-even point is probably large. This "lock-in" represents a much bigger commitment, to occur at later stages of a firm internationalisation, compared to a less committing mode, for example, a minority stake in a small hotel abroad.

The second sub-dimension of the change aspect of the model, the commitment decisions, are influenced by the firm's opportunity horizon, as well as, economic and uncertainty effects. The opportunity horizon of a firm represents the "bounded decision space" of a firm. It is assumed that decisions regarding international market opportunities are dependent on and formed by a firm's experience. Hence, means of addressing market opportunities are searched for and will be related to the environment the firm is interacting with, to the degree of its existing market commitment and influenced by economic aspects and uncertainty.

The model implies that this interaction process will lead to an incremental commitment to markets abroad that will subsequently manifest themselves in the organisational forms of market entry, as well as, in incremental changes in the psychic distance of countries served as discussed in the previous section.

Johanson and Vahlne (1990) extended their original process model theoretically (see Figure 2.2). The model indicates the important influence of a firm's network, that is its web of external relationships. In this respect, the emphasis of internationalisation is on a firm's external relationships and its impact on the firm, rather than purely focusing on internal aspects. This approach follows the notion that "no business is an island" (Hakansson and Snehota, 1990) and it views this interaction with other firms as providing a firm with the capabilities to perform its activities. Thus, its external network becomes a crucial resource and a valuable asset in its own right and in addition to its internal resources and assets. Various empirical studies have validated this network extension of the internationalisation model (Johanson and Vahlne, 1992; Coviello and Munro, 1997; McGaughey *et al*, 1997).

**Figure 2.2: The Extended Uppsala Process Model of Internationalisation**




Source: Adapted from Johanson and Vahlne (1990).

In summary, the traditional Uppsala Internationalisation Model proposes that growth-seeking and risk minimising firms gradually increase their international operations as their domestically accumulated internal resource-base expands, their external resource-base (the firm's business network) expands and their information and consequently knowledge about foreign markets increases (Brock, 2000) and its suggested stages can now be considered outdated, as well as considered separate from its suggested internationalisation process.

## 2.4 The Internationalisation of Service Operations

Multinationals increasingly dominate the global economy in all sectors, led by manufacturing but with an increasing role for operations within the service sector. Many international service firms are already household words around the world: American Express, McDonald's, Avis, Citybank, Hilton, Thomas Cook and Arthur

Anderson. This phenomenon clearly illustrates that the whole world is the domain of business service activities today. As producers go global, their service suppliers must follow. Indeed, Vandermerwe and Chadwick (1989) argue that consumers are becoming more homogeneous, the unifying forces of media, travel, technology, information transfer has accelerated the move to take both retail and business service concepts and corporations to every corner of the earth.

In the past three decades, the international service sector has been studied from three different perspectives. (1) Some researchers have sought to put forward a conceptual framework in explaining the *interaction between international growth of services and service multinational enterprises* (Boddewyn *et al* 1986; Dunning, 1989; Li and Guisinger, 1992). (2) Some researchers have focused on *industry specific studies* to investigate the reasons for the internationalisation of service firms. The research has been undertaken in the area of international banking (Jones, 1990; Sagari, 1992); hotels (Dunning and McQueen, 1982; Dunning and Kundu, 1995); advertising (Terpstra and Yu 1988); and shipping (Kindleberger 1985). (3) Some research has been undertaken in relation to the impact of transitional service firms on both developed and developing countries (Blomstrom and Lipsey, 1989; Schott and Mazza, 1986).

The growth of services reflects a combination of both demand and supply driven factors including the following:

- The growth of per capita output and high income elasticity of demand for some consumer services in industrialised countries;

- The increasing role of producer services in the value-added process;
- The increasing tendency of firms in non-service sectors to externalise less productive service activities;
- The growing importance of marketing, distribution and after-sales maintenance and servicing activities to the value of a physical product;
- The growth of finance, banking, legal, insurance, transport, other support services and more leisure time;
- The emergence of new intermediate markets for services;
- The liberalisation of markets for several services, notably insurance and financial services and technological changes (Dunning and Kundu 1995).

This, in turn, has led to the growing internationalisation of services. Although not much has been written on how to take services worldwide, service internationalisation will undoubtedly be an important managerial focus in the years ahead. In order to understand the behaviour of internationalising service firms, the following sub-sections will highlight the characteristics that distinguish services from goods, review classificatory systems for types of international services and its implications relating to entry mode choice. This is followed by a review of four broad strategies in relation to internationalising service firms.

### 2.4.1 The Characteristics of International Services

In understanding the process of internationlisation in the service sector, it is important to highlight the differences in characteristics of services from goods, and the consequent classificatory systems for types of international activity which are introduced. In contrast to manufactured goods, the products of services such as those provided by international hotels are relatively immobile – they have to follow the customer. Marketing theorists have proposed five distinct features of services (Cowell, 1986):

- intangibility
- inseparability
- heterogeneity
- perishability
- ownership

*Intangibility* refers to the fact that services, unlike goods, do not always consist of physical attributes which can be judged by consumers by sight, taste, smell or touch. Customers are not able to inspect the product before purchase and where knowledge of the product is only obtained after the product is purchased. They are, therefore, "experience goods" rather than "search goods" (Bateson 1977; Berry 1980 Dunning; and McQueen 1982), for example, hotel services.

*Inseparability* of production and consumption refers to the fact that many services are supplied and consumed simultaneously. Thus, whereas goods are produced, sold and consumed, services are often sold and then produced and consumed at the same time (Zeithaml, *et al* 1985, Go and Pine 1995). Personal contact between the producer and consumer is thus an important aspect of many services. Following on from this, Langeard *et al* (1981) note that as the production of a wide array of services is embodied in the firm's personnel there is, potentially, wide variation in the way the service is produced, and the quality of the service. This *heterogeneity* poses problems of quality control, and of providing consistency in the service communicated to customers and in that ultimately delivered. By understanding this distinct feature, many service firms have paid great attention and devoted significant resources to their staff training.

According to Thomas (1978) and Lovelock (1981) some services are also *perishable* and cannot be stored. For example, an empty room in the hotel is a lost sale and can never be recovered. This, in turn, has a major impact on marketing, pricing and sales strategies in the service sector. This illustration also serves to highlight the issue of *ownership*. A consumer buys access to his room in the hotel, but he does not own it. With many services the customer merely buys the right to use, to access or hire the service (Buckley *et al* 1992).

It is important to understand that few services display all these features, although most exhibit more than one. Due to the heterogeneous nature of the service industry, it would be virtually impossible to identify a list of characteristics applicable to all sectors (Buckley, *et al* 1992). Having characterised the distinctive attributes of services it could be concluded that services are different from goods. However, the problem of defining a service is complicated by the fact there are few pure goods or services. The distinction between goods and services cannot be viewed as a simple black and white categorisation (Dunning 1989; Ekoledo and Sivakumar, 1998). It rather depends on the extent to which the service is embodied in physical attributes within the overall package implicitly based on the degree of tangibility / intangibility of good and services, and which will in turn determine the entry mode choice. Therefore, attention now turns to the classification system for services.

### 2.4.2 Classification System for the Internationalisation of Services

Over the years, the literature has provided two general streams of classification systems for services. One stream illustrates the differences among services and consequent marketing and strategic implications (see for example, Maister and Lovelock, 1982; Lovelock, 1983). The other stream looks mainly at trade-related issues and shows how different categories of services are internationally transacted. Boddewyn *et al* (1986) classify types of international services according to their tradability, based on the extent to which services are embodied in physical goods and the degree of inseparability in provision of the service:

- *Foreign-tradable-services*, which are distinct from their production process, are tradable across national boundaries and are thus exportable, such as music and movie videos.
- *A location-bound service,* where production can not be separated from consumption as in the case of legal advice, so that a foreign presence is necessary.

- *Combination service,* where services comprise a mix of distinct commodities and location-bound service elements, where some location substitution is possible.

Similarly, Sampson and Snape (1985) categorise services according to their tradability. They propose 'separated' services, that is those which do not require direct contact between supplier and consumer, as the only services which can be exported as distinct from those which demand movement of factors of production to the consumer (e.g. repair services), or movement of the consumer to factors of production (e.g. tourism).

Based on a combination of these research works, Vandermerwe and Chadwick (1989) developed a classification system for the internationalisation of services based on relative involvement of goods (i.e. pure services / low on goods, services with some goods, or delivered through goods, and services embodied in goods), and, degree of consumer / producer interaction, from lower to higher. The result of this two-way classification is a general six-sector matrix shown in Figure 2.3 and described briefly below.

**Figure 2.3 Six-Sector Service Matrix**

**Degree of Consumer / Producer Interaction**

| Relative Involvement of Goods | **Lower** | **Higher** |
|---|---|---|
| Pure service<br>low on goods | **Sector1**<br>Domestic mail delivery<br>Knife sharpening | **Sector 4**<br>Engineering<br>Consulting<br>Advertising<br>Insurance<br>Education<br>Medicine |
| Services with some goods<br>or<br>Delivered through goods | **Sector 2**<br>Retailing<br>Couriers<br>Fast food<br>Hotels<br>Shipping<br>Air freight | **Sector 5**<br>Banking<br>Personal air travel<br>Maintenance |
| Services<br>embodied in goods | **Sector 3**<br>Music/Compact disks<br>Software/diskettes<br>Movies/video cassettes<br>Training<br>Journals<br>On-line news service | **Sector 6**<br>Teleshopping<br>Electronic mail |

Source: Vandermerwe and Chadwick (1989).

*Sector 1, Low goods / lower interaction*

In Sector 1, goods do not feature to any extent and the degree of interaction is minimal. Basic services like some mail delivery, knife sharpening and so on fit this category. These services are limited in international potential in their present form.

*Sector 2, Medium goods / lower interaction*

In Sector 2, interaction is relatively low, but goods take on a more significant role. Examples of these are hotels, air freight, shipping, retailing and couriers. This sector has high internationalisation potential because goods that facilitate the service are easily taken to foreign markets.

*Sector 3, High goods / lower interaction*

Services in this section are primarily embodied in goods with a low level of interaction, e.g. movies on video-cassettes, software on diskettes. These services are basically exportable and can be globalised easily and quickly. They are embodied in goods and thus can be carried from the country of origin through goods.

*Sector 4, Low goods / higher interaction*

Services in this sector are called traditional services characterised by high interaction between producer and consumer during delivery and low use of goods as inputs to production. The role and interface of customers and staff being so vital, internationalisation principally involves people.

*Sector 5, Medium goods / higher interaction*

In this sector, interaction is high and goods feature to a larger extent. Banking, personal travel and maintenance are examples. In each case, services providers and consumers interact personally and the use of goods is reasonably high. Internationalisation involves both people and goods in balance between the two.

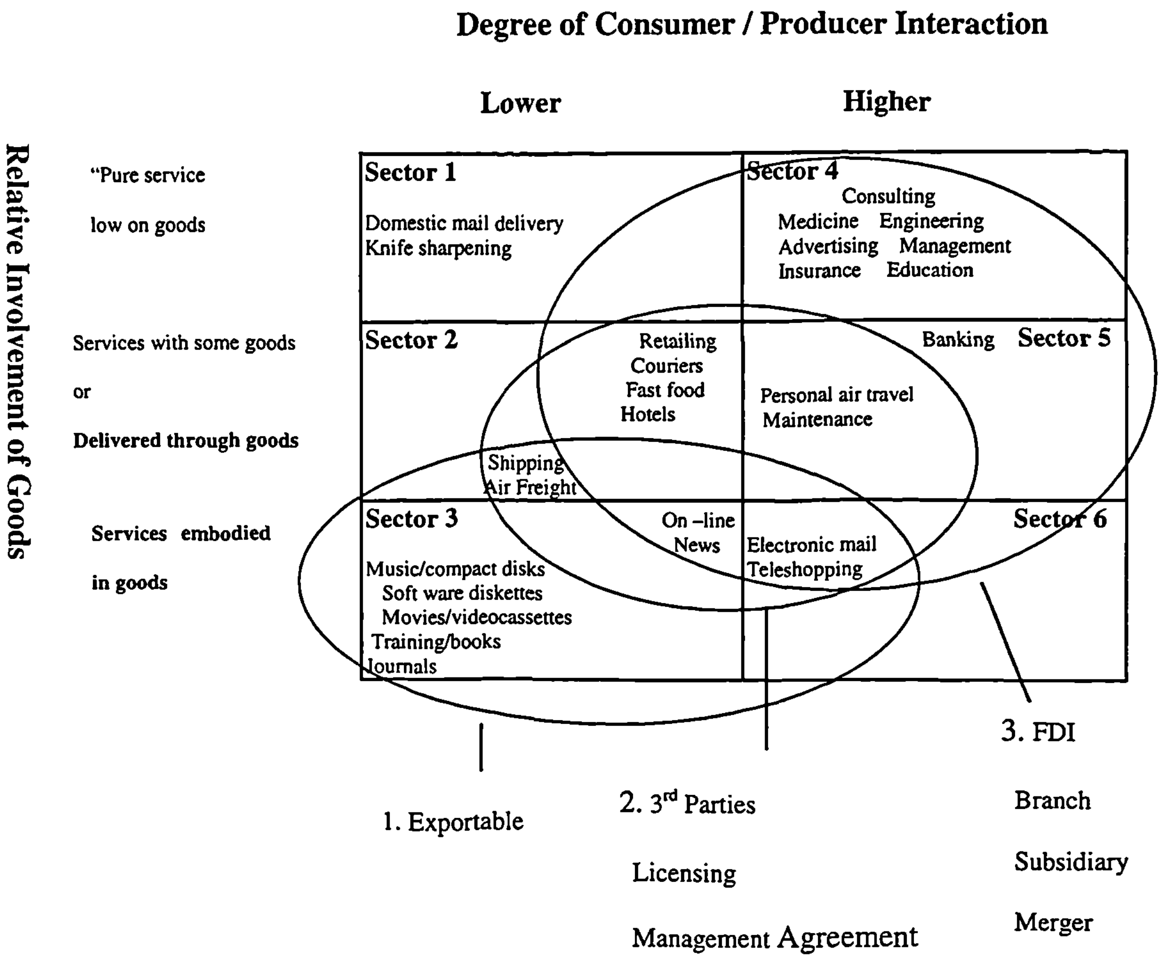
*Sector 6, High goods / higher interaction*

Both the use of goods and interaction are high in this sector. Interaction is two-way but takes place through machines rather than people, for example, teleshopping. With the continued development of new technologies to house and customise services, this sector is likely to become more globally significant in the future.

The matrix is a useful conceptual tool because services tend to cluster within it and each cluster tends to have a different set of internationalisation modes (see Figure 2.4). The three emergent clusters can be classified as follows:

***1:Exporting:*** which involves minimum presence and control. Where a firm can export the service through some physical embodiment included in service package, exporting is the most appropriate way. This can involve the firm employing the services of overseas intermediaries to distribute and sell the product in the foreign market.

**Figure 2.4: Clustering of Services and Internationalisation Modes**




Source: Vandermerwe and Chadwick (1989).

***2: Licensing, joint venture and management contract***: where some degree of investment in terms of either financial or management is needed in order that the company be represented abroad.

***3:Foreign direct investment***: the most appropriate where the service is people-embodied and where there is a high degree of producer / consumer interaction. In high quality and information-intensive sectors, in order to protect such assets and avoid leakage of firm-specific knowledge, there is greater likelihood to pursue foreign direct investment.

Looking at Figure 2.4, we can see the overlaps. For instance, shipping and air freight export their services in mode 1, but also get involved with third parties like ports and air terminals, a characteristic of mode 2. Figure 2.4 shows that there are categories of nonexportable or location-bound services such as fast foods and hotels. Since these services are non-exportable in the traditional sense, they can only move to the more advanced types of entry modes, such as contractual or investment options. Such modes require a high commitment to foreign markets (Cicic *et al*, 1999). In expanding internationally, a firm (e.g. hotels) may replicate its organisation in a foreign country by using its own equity investment. Alternatively, for other locations, it may contract with local investors. This reflects Edvinsson' s (1981) view that firms lacking legitimacy and identity in the foreign market, require some kind of 'platform' and local support environment to operate successfully.

As is becoming apparent, service internationalisation is influenced by a combination of the nature of the service – the degree of interaction between service provider and consumer – and the way in which it is delivered – the degree to which services are embodied in or delivered through goods. In reality very few services fit neatly into one mode, services tend to cluster around three levels of internationalisation. However, although this classificatory matrix highlights the importance of the impact of the degree of service intangibility and inseparability on the foreign-market servicing decision of internationalising firms, it is somewhat simplistic and flawed in terms of its ability to explain the behaviour of all firms within the disparate industries (many of which operate across several categories of service) (Buckley, 1992).

Researchers appear to have failed to take strategic alliances as an internationlisation mode into consideration. Strategic alliances are an important strategy to cope with today's intensified competitive international business setting, and this can be seen by the growing number of firms pursuing this strategy. According to Cyrus and Freidheim (1999), in 1970s, the number of strategic alliances formed each year was in the hundreds. The annual rate in the U.S. hit 2,000 in 1990, and the number grew to 10,000 in 1995 and will reach 20,000 by the end of 2000.

Strategic alliances involve co-operation between two or more firms (Lorang and Roos, 1992) that agree to cooperate but still retain their separate identities (Dev and Klein, 1993). The aim of the strategic alliance between two or more companies is to offer eachother an advantage that one company would be unable to obtain by itself (Go and Pine, 1995). Thus the difference between a strategic alliance and a joint venture is that the latter requires the formation of a new legal entity, whereas the former enables partners to benefit from the alliance without the creation of a subsidiary.

Why are strategic alliances used so extensively by firms in the implementation of their strategies? By the identification and the analysis of four characteristics of international business today, Lorange and Roos (1992) attempt to explain the increasing number of strategic alliances:

* Increasingly internationalisation with tightened competitive pressure, stemming from global scale and / or scope advantages. Hence, a need to team up with partners to ameliorate resource shortages to gain time.
* Despite internationalisation, firms need to remain strong in national markets and adapt to local needs and demands. Hence, the need to have a local partner.
* Rapid technology developments leading to shorter product life cycles calling for considerable response and demand. Hence, the need to have joint R&D, to have a sufficient resource base and to put together scarce eclectic competencies.
* The emergence of many new competitors in otherwise more traditional businesses, combined with the often strong need to reposition oneself pro-actively. Hence, the need to build strong alliance networks, not only as a way to rapidly be in the right position to generate business but also as a defence.

The main reason for companies to enter into strategic alliances have been to gain access to new markets and technology, to minimise capital investment, to share the costs and risks, to accelerate the pace of entry into new markets, to surmount barriers to markets, to create operational advantage, and to manage innovation more effectively (Dev and Klein, 1993; Thomson, 1993; Varadarajan *et al* 1995, Strate and Rappole, 1995). But rather than seeing them as tools of convenience, Ohmae (1989) views strategic alliances as critical instruments to better serve customers in a global environment. Similarly, empirical studies show that strategic alliances can provide customers with greater value (see for example, Strate and Rappole, 1995).

All of these factors have contributed to the increasing use of co-operative strategies. Indeed, strategic alliances have become an important means for firms of all sizes to come up with a practical approach to increasing possibilities for being able to implement their international strategies (Lorange and Roos, 1992; Varadarajan *et al* 1995). There are several kinds of alliances. Each form of alliance is distinct in terms of the amount of commitment it represents, and the degree of control it grants each partner. According to Lewis (1990) and Dev and Klein (1993), there are three main kinds of alliances:

* Informal coorporation: firms work together without a binding agreement. Each party receives some satisfaction through a clearly defined set of expectations, mutual commitments are modest. For example, hotels have engaged in limited promotions with other businesses including cross-advertising and joint coupons.
* Strategic networks: are composed of any or all of the other kinds of alliances and thus provide varying amounts of commitment and control. For example, hotels participate in such alliances with airlines in their frequent-flyer programmes. Like consortia, networks may involve many firms and so have vast potential for affecting entire industries. For example, sixteen of the largest hotel chains in the U.S. are cooperating in THISCO, The Hotel Industry Switch Company. THISCO involves a computer product aimed at

giving travel agents more-direct access to member companies' databases of more than four million rooms worldwide.

* Equity Alliances: such relationships are characterised by high degree of sharing control and the parties in these arrangements expect continuity and mutual commitment. These relationships offer considerable opportunities for synergy. Competing computer giants IBM and Apple, for example, have formed an equity alliance to respond to the pressures of global competition.

The three types of alliances represent a hierarchy, in the sense that relationships can progress from a simple level to a more-involved arrangement. In theory, alliances allow firms to focus on their core strengths and offer a stronger product line with better market coverage (Dev and Klein, 1993). In practice, alliances are characterised by high rates of failure (see for example Hergert and Morris, 1988; Bleeke and Ernst, 1991; Lorange and Roos; 1992; Vyas *et al* 1995).

Managing strategic alliances is difficult, particularly when the business partners come from different cultures. Thus, choosing the right partner is a critical part of making an alliance work. Bleeke and Ernst (1991) argue that alliance between strong and weak partners rarely work; they fail to provide the missing attributes necessary for growth; and they lead to mediocre performance. Indeed, ascertaining the partners offer complementary strengths is the key matter, but care must also be taken to find companies with compatible objectives and styles.

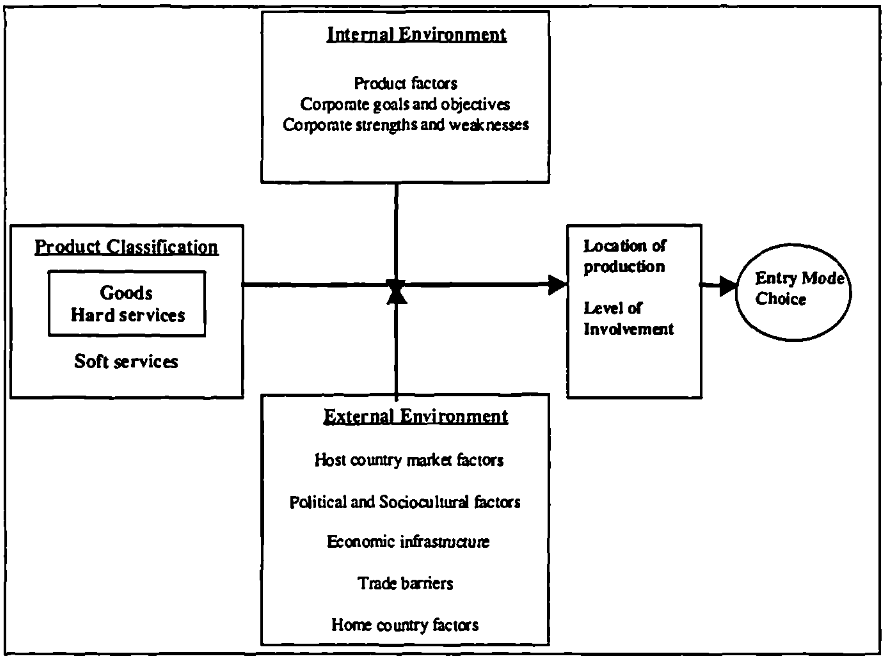
Interestingly, Madhok (1995) argues that even in a situation where the economic structure of a relationship may seem paramount, without the social glue of trust and commitment, alliances will not deliver their potential strategic or economic payoff. Similarly, Cullen *et al* (2000) note that trust and commitment are central for successful international strategic alliances. Their study shows that without investing in relationship capital (trust and commitment), the alliance would fail to reach its strategic potential. Therefore, it is important for managers to consider building and sustaining commitment and trust in international strategic alliances.

### 2.4.3 Choice of Foreign Market Entry Modes by Service Firms

The choice of a foreign market entry mode is "one of the most critical decisions in international marketing" (Terpstra, 1987,p.333), since it determines how firms market their products abroad, and how firms contribute to the country's balance of payments. The eclectic theory is an attempt to incorporate several theories of entry mode choice into a unified framework (Goodnow, 1985). Dunning's (1979) eclectic model identifies ownership advantages, location advantages and internalisation advantages as relevant factors for entry mode decision. Hwang, Hill and Kim's (1990) version of the eclectic framework identifies strategic variables, environmental variables, and transaction variables as the broad groups of variables that influence entry mode choice. According to them, strategic variables influence entry mode choice mainly through control needs of the firm, environmental variables influence entry mode choice primarily through their impact on resource commitment, and transaction variables influence entry mode choice through their impact on risk exposure.

Ekeledo and Sivakumar (1998) extend previous eclectic models by incorporating product classification as a key determinant of entry mode choice. (see Figure 2.5).

**Figure 2.5: A Model of Foreign Market Entry Modes Strategies for Service Forms**




Source: Ekeledo and Sivakumar (1998).

The tremendous heterogeneity, which characterises the service sector, leads to widely differing international trade and investment patterns in the service sector (Shelp, 1981). To address this problem, researchers have developed classification schemes for international services. Erramilli (1990) divided international service firms into two groups: hard-service firms (e.g. life insurance, architectural design) and soft-service firms (e.g. food service, hotels.)

Usually, selection of entry mode involves two steps: (1) determining the location of production facilities, and (2) deciding the firm's level of involvement in, or control of the operations of the foreign subsidiary. In step one, a manufacturing business or a hard service business chooses between exporting and production in the target foreign market. Soft service businesses do not have the export option (Sampson and Snape, 1985). Thus, soft service businesses must focus on step two – choosing between full-control or high-involvement modes and shared – control or low-involvement modes. Inability to use the export option has a significant impact on how soft services enter foreign markets because each entry mode is associated with a certain level of risk-return trade-off. Table 2.1 characteristics of foreign market entry mode of service businesses in terms of involvement/control, investment costs, dissemination risk, and returns on investment.

**Table 2.1: Characteristics of Foreign Entry Options of the Service Sector**

| **Entry Mode** | **Involvement** | **Cost** | **Dissemination Risk** | **Returns** |
|---|---|---|---|---|
| Licensing/ franchising | 1 (lowest) | Low | High | Low |
| Exporting (indirect, agent/distributor) | 2 | Low | Low | Low |
| Management contract | 3 | Low | Moderate | Low |
| Joint venture | 4 | Moderate | Moderate | Moderate |
| Sole ownership | 5 (highest) | High | Low | High |

Source: Based partly on Erramilli and Rao (1990); Douglas and Craig (1995); Lovelock (1983, 1996); and Hill, Hwang and Kim (1990).

The fundamental difference between a service (whether hard or soft) and a manufactured good is *intangibility* (Zeithaml *et al*, 1985). A soft service becomes a hard service once the production and consumption of the soft service can be decoupled. Table 2.2 outlines the major characteristics of manufactured goods, hard services and soft services. It provides examples of each group and lists typical entry mode options available to each product group and provides examples of each group.

**Table 2.2: Characteristics of Manufactured Goods, Hard Services and Soft Services**

| Product | Examples | Characteristics | Entry Mode Options |
|---|---|---|---|
| **Manufactured goods** | Toys, shoes, and automobiles | Tangibility, storability Separability, homogeneity | Exporting, licensing foreign manufacturing agreement, joint venture, sole ownership |
| **Hard services** | Advertising, consultants Equipment leasing | Intangibility, storability separability, homogeneity depends on a physical object for storage and export | Licensing, exporting management contract joint venture, and sole ownership |
| **Soft services** | Hotels, restaurants, hospital | Intangibility, perishability inseparability, heterogeneity | Franchising, management contract, joint venture sole ownership |

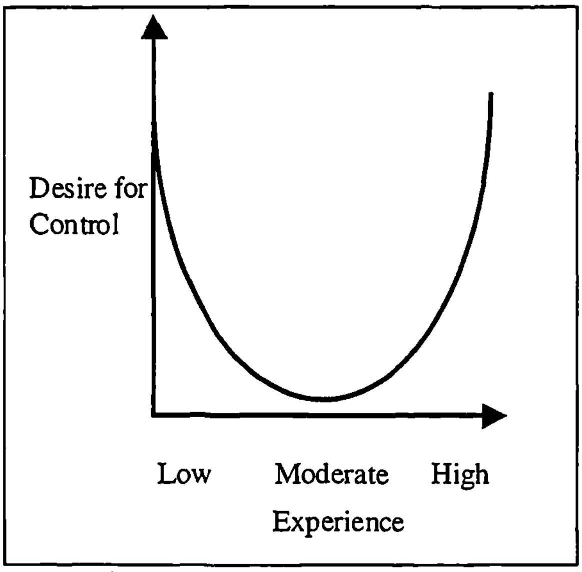
Source: Ekeledo and Sivakumar (1998).

Inseparability of production and consumption is at the centre of differences in entry behaviour between soft services and hard services (Erramilli and Rao, 1993). Inseparability often necessitates production of services at the consumption sites, or close buyer – seller interaction (Gronroos 1983). As a location-bound service, the provider and consumer of a soft service must be in physical proximity during its consumption. For example, the delivery of soft services by hotels, restaurants, and health care facilities requires physical proximity between provider and consumer (Erramilli and Rao, 1990; Sampson and Snape 1985). Therefore, the specific feature of soft services determine that it must depend on non-export modes, such as sole ownership, joint venture, franchising, or management contracts for foreign market entry to entry foreign markets. As a result, soft service providers face special risks in foreign markets in that they must meet consumers on foreign soil from the first day without the benefit of experience from gradual internationalisation that exporting provides (Carman and Langeard, 1980).

In contrast, location-free services, such as computer software, music compact disks are well separable and transportable over national borders (Boddewyn *et al,* 1986), and can be decoupled. As such, they are susceptible to the gradual, incremental process of internationlisation that is standard for manufacturers. Thus, two general patterns of service firm's internationlisation can be established: for firms with a high level of inseparability, the process of internationalisation is swift, decisive and assumes immediate presence of the firm in foreign markets; for firms with separable services, the process is generally gradual and more in tune with the pattern for manufacturing firms (Cicic *et al,* 1999).

Several studies on the entry behaviour of service firms have identified certain characteristics that are unique to soft services. Erramilli (1991) identifies a U-shaped relationship between experience and desired control in the choice of entry mode by service firms. The U-shaped pattern of service firms suggests that they prefer sole ownership during the early years of their foreign market experience; favour shared-control operating modes, such as joint venture, as they gain some international experience; and revert to sole ownership once their international experience becomes extensive (see Figure 2.6). Erramilli's explanation for the U-shaped pattern was lack of experience (Ekeledo and Sivakumar, 1998).

**Figure 2.6: Effect of Experience on a Firm's Desire for Control**




Source: Erramilli, (1991)

In his study of foreign investment decisions in U.S. multinational corporations, Davidson (1982) empirically demonstrates how market uncertainty, caused by deficient market knowledge, can influence choice of entry modes by firms. In markets highly similar to the United States such as Canada, UK and Australia, firms resorted to licensing and joint venture to very little extent, preferring wholly owned subsidiaries instead. In countries that were less similar to the U.S. the usage rate of licensing and joint ventures rose dramatically. Similarly, in their study of the foreign investment practices of American MNEs, Kogut and Singh (1988) have found that cultural distance (between the U.S and the host country) increased the probability of choosing a joint venture or licensing over an acquisition or a greenfield wholly owned subsidiary. This behaviour could be explained by the intervening variables of uncertainty and perceived risk of foreign markets, lack of market knowledge led the firm to choose this less risky (compared to FDI) involvement. Clearly, these empirical studies support the Uppsala Internationalisation Process model which was developed by Johanson and Vahlne (1977).

Client following and market seeking are found to be among the major factors underlying the entry mode choice of service firms in foreign markets (Erramilli and Rao, 1990). Client following was found to be the main motivation of advertising agencies and banks that went abroad (Terpstra and Yu 1988; Nigh, Cho, and Krishnan, 1986). Also, Erramili and Rao (1990) have found that a greater proportion of market-seeking soft service firms adopted entry modes involving collaboration with external entities.

**Summary**

The firm's choice of a particular foreign market entry mode is a function of a large number of diverse factors. It varies with product characteristics such as degree of differentiation, importance, age, and technological content (Stopford and Wells, 1972; Davidson, 1982; and Goodnow, 1985). It may depend upon certain firm characteristics such as corporate goals and objectives, size and resources, degree of diversification (Stopford and Wells, 1972; Davidson, 1982; Goodnow, 1985; and Root, 1987). Finally, entry mode choice by firms may also be determined by external environment factors. They include (1) host country market factors, (2) political and social cultural factors, (3) economic infrastructure, (4) trade barriers and (5) home country factors (Goodnow, 1985; Douglas and Craig, 1995). These product, firm, and environmental variables could be collectively referred to as "*non-behavioural*" determinants

In recent years, an emerging stream of literature (Johanson and Vahlne, 1977; Reid, 1980; Cavusgil, 1980, 1982) has highlighted the role that behavioural factors play in a wide range of international marketing decisions, such as initial involvement in foreign markets, choice of country markets, and choice of foreign market entry modes. Johanson and Vahlne (1977) postulate a direct relationship between market knowledge and resource commitment, and identify two types of knowledge – objective (which could be taught), and experiential (which could be acquired only through actual operational experience in foreign markets). The focus of this literature is on a generally positive relationship between the decision-maker's knowledge of foreign markets and the level and pace of the firm's resource commitments to these markets.

In addition to influencing the pattern of resource commitment, lack of market knowledge could lead to other kinds of behaviour on the part of firms. Knowledge-deficient firms may try to acquire experiential knowledge by teaming up with individuals and organisations outside the firm that possess such knowledge. This means they will show a greater tendency to employ entry modes such as licensing, franchising, management contracts and joint ventures (Erramilli and Rao, 1990). However, lack of trust in intermediaries and foreign partners also lead firms pursuing foreign direct investment with the aim to overcome buyer uncertainty and protect the firm-specific assets which Dunning (1979) called internalisation.

### 2.4.4 Strategies for Internationalising Service Firms

The success of any firm will depend upon its ability to choose and implement an appropriate strategy in the context of a competitive and changing environment (Tse and West, 1992). According to McLaughlin and Fitzsimmons (1996), the biggest factor in a service firm's internationalisation decision should be whether it fits with the firm's global strategy. Roach (1991) makes this point strongly when he argues that the challenge facing services is primarily managerial. The service company that responds to heightened competition will look very different from its predecessors. Strategically focused, it will have an efficient delivery system, a high-quality product, and a flexible cost structure.

McLaughlin and Fitzsimmons (1996) identify five basic internationalisation strategies namely: multi-country expansion, importing customers, following your customers, service unbundling, and beating the clock which are now discussed.

***Multi-country expansion***

Many multinationals have maintained continuous growth and long-term viability by expanding beyond their home countries into markets with opportunities. Apart from the increased profit for the firm itself, multinationals also play a pivotal role in the economic development of the host countries. In a discussion of growth and expansion strategies for service firms, Fizsimmons and Fizsimmons (1994) identify multi-site expansion and multi-service development at a single site as the logical growth vectors for a successful service firm. Multi-site expansion has commonly been accomplished using franchising to attract investors and a 'cookie cutter' approach to clone the service rapidly in multiple locations, for example, the success of McDonalds and Holiday Inn. This expansion strategy is necessary when the service market is defined by the need for customers to travel physically to the service facility.

Collier (1985) highlights some important factors that the firm must take into consideration when pursuing this strategy. These factors are called " international transportability" and include legal restrictions, advertisability, adequate channels of distribution, standard or customised service package, technical capabilities, cultural and social norms, buyer behaviour, distance, language, political stability, and national synergism. This view has been supported by McLaughlin (1992), who adds five key operational issues:

1) level of cultural adaptation
2) impact of telecommunications
3) potential for unbundling service components
4) approaches to teamwork; and
1) re-engineering opportunities

It is important to note that many strategic issues are involved in moving a service operation out and around the world. However, the current literature does not yet provide much guidance on the role that the operations management functions should play in this process. In their study, McLaughlin and Fitzsimmons (1996) point out that duplicating a service worldwide is best accomplished when routine services are involved. The best approach to this would appear to be to hire and train locals to handle that part of the process in consultation with those who know successful approaches that have worked in other countries. Since cultural adaptation is a major service issue, customer contact or front room operations must be sensitive to the local culture in order to make a success. Douglas and Craig (1989) highlight the importance of adapting to local market conditions in pursuit of efficiency, market share and profit.

Service firms enter foreign markets with the aim to increase profit and brand recognition. However, lack of knowledge and information about foreign markets creates uncertainty and heightens the risk. In his study, deGeus (1997) confirms that a firm's success and longevity are increasingly defined by its ability to learn from and adapt to the changing environment in a timely manner. In order to successfully implement a multi-country expansion strategy, a firm has to closely monitor its environment for opportunities and threats, and make critical decisions about the direction of expansion.

The degree of geographical growth will also impact on the extent to which mobility of managers and working practices in different cultures will require to be addressed. Attention will need to be given to all these key variables when deciding on the strategic approach to human resources management (Watson and Litteljohn, 1992). They further argue that the extent to which an organisation can take a proactive rather than a reactive approach to internationalisation will depend not only on the financial resources available, but also on the skills and ability of top management, particularly in the area of environmental scanning and business trend analysis. In other words, people influence the extent to which an organisation can expand and its human resource management has to be integrated into corporate growth strategy within the service firm.

**Importing customers**

Today, an industry or firm is considered to be global if there is some competitive advantage to be gained by integrating activities on a worldwide basis (Porter, 1986a), or if the firm's competitive position in one national market is significantly affected by its competitive position in other national markets (Hout, et al 1982). Multi-service development represents an alternative growth vector for a successful service firm. For the multi-service single-site strategy to be successful internationally, customers must be willing to travel a long distance and stay for an extended time or telecommunications must be substituted for physical travel. Many services such as prestigious colleges and universities and tourist attractions (e.g. Disney World) meet these stipulations.

Customers are demanding a greater variety of services as well as services of increasingly quality and sophistication. Because of unique tourist attractions at a particular location, a service evolves that is focused on that attraction such as catering to skiers in the winter and mountain biker in the summer. Club Med has combined both multi-site and multi-service strategies by creating a network of varied vacation sites around the world. Rather than exporting the service as in a multi-site strategy, the multi-service strategy imports the customers (McLaughlin and Fitzsimmons, 1996).

**Follow your customers**

Porter (1990) notes that a nation benefits if its home demand is for service varieties or approaches that are demanded in other countries. In the international hotel industry, following American travellers by offering them a standardised ideal of American service and home-away-from- home accommodation was a key element in American hotel companies successful expansion (Pine and Go, 1995). When China first opened its door to the outside world, most foreign service companies entering China were not there to serve the local Chinese markets so much as to follow their corporate clients overseas and continue to serve them, although this is no longer the case.

However, this strategy ignores the vast markets represented by the rapidly growing local middle classes in countries such as China. Companies serving these populations are free to grow without competition until they reach sufficient quality and scale to become a threat internationally. Holiday Inn, for example, applied strict operating standards, which was described as an "obsession" by Go and Pine (1995), and was not sensitive to the issue of thinking globally and acting locally which led to a number of development problems. For a hotel firm to be successful, it must be competitively able to penetrate markets by appealing to domestic markets and targeting various customer groups.

As noted by McLaughlin and Fitzsimmons (1996) the sales volume available from visitors or expatriates in a foreign country is small. To survive in an increasingly competitive international market, management should consider the business not only aiming to serve the expatriates and visitors but also cater to local customers. Attracting local business requires adaptation of operations to the local environment, and to bring in experienced and flexible managers to make the transplantation work in the face of local infrastructure and social system complexities.

**Service unbundling**

Chase (1978) discusses the advantages of viewing service operations as a dichotomy between the front room where customer contact is observed and the back room where additional processing is accomplished. He suggests that back room operations do not need to be located on site. Dry-cleaners and photo processors create processing plants far from their retail sites. These processing plants are usually in an industrial location that involves minimal real estate investment. Moving off-shore to seek savings in labour costs is a natural extension of this opportunity to divorce the front and back rooms. In the hotel sector, the opportunity to locate central reservations offices off-shore is one example of service unbundling. Service unbundling is similar to the factory focus strategy and plant-within-a-plant notions found in manufacturing

(Yang *et al,* 1992). The benefits from focused operations may be, in part, the reason why many of the unbundling experiments in services have been successful.

**Beating the clock**

Time-based competition is a widely accepted strategy in manufacturing. In the real time world of services there is every reason to expect new innovations to use the speed of light to beat the clock around the world and gain a competitive advantage. There is no doubt that being able to give 24-hour service despite local work norms or government regulations on market closings has helped lead to the true internationalisation of securities markets (McLaughlin and Fitzsimmons, 1996). However, the greater reliability and co-ordination among locations and time zones require substantial additional investments in training, methods of operation, and telecommunication. Telecommunications will certainly be necessary to make the location shift transparent to the customer and to realise the full value from the time advantage.

Five basic strategies relating to service firms internationalisation are discussed. What is more important is to understand that there are some strategic issues which are unique to international competition requiring companies desiring to compete internationally to change their strategic orientation. For a company entering the global arena, there is a need for management to revise their perceptual maps of competitors and markets. Global competition requires that a section of the organisation takes the widest possible view of the firm's environmental threats and opportunities (Leontiades, 1986)

In studies of international business strategies, many researchers have examined the macro-level indicators of various countries, including their economic, social/cultural, political, technological and legal environment for the purpose of target market selection and market segmentation. This environmental scanning is regarded as an early warning system of the environmental forces and effective base to ensure a company's international expansion and continued growth (see Terpstry, 1982; Jain, 1990; Ohmae, 1990; and Taggart and McDermott, 1993).

Recently, a number of researchers consider the international expansion of firms as an evolutionary process in which firms seeking opportunities overseas gradually acquire the requisite knowledge, secure the necessary resources and adapt to the local market condition in pursuit of efficiency, market share and profit (Douglas and Criag, 1989). In 1996, Craig and Douglas updated their evolutionary process, and argued that successful expansion is based on learning, reaction and adaptation to the external environment by timely deployment of effective strategies. Their later work recognised the influential role of environmental contingencies on firms operations, and raised the important issue of pursuing time-based strategies.

Clearly, their new view is based on the belief that not only products and services have finite lives, strategies also have life cycles. Strategies which deliver value and competitive advantages will bring benefits to the organisation in terms of success, growth and profits. However, if consumers' preferences change, or strategies of competitors vary, and the factors creating the advantage are no longer perceived as valuable, the advantage is lost. A change of competitive strategies is required due to the environmental changes. Researchers here addressed the importance of timing.

Indeed, many researchers support this view and studies of multinationals in various industries and country markets have suggested that strategies which fit environmental contingencies, have a great impact on the internationalisation and expansion of firms (Lambkin and Day, 1989; Dunning and Kundu, 1995; and Sun, 1996). As the world's markets become increasingly interdependent, and the environment is becoming increasingly competitive, it is clear that the key determinant of successful expansion is the extent to which a firm optimally matches its resources with environmental contingencies (Lambkin and Day, 1989)

There are several reasons and strategies associated with internationalisation of services, which, as a result, have led to international competition in service industries. Companies have been competing internationally in tourism, banking, insurance, and other service industries. The extent and significance of international competition in services continues to grow and the following section will emphasise this issue.

## 2.5 The Internationalisation of Competition in Services

Many service firms go international and compete at a global level in the hope of gaining a greater market share and increased profits, resulting in growing international competition in services and more sophisticated service offerings. As many service firms are faced with increasingly demanding customers, quickly changing technology, and an increasingly competitive environment, there is growing interest in the concept of strategy to anticipate changes and adapt to the challenges. In other words, strategy as a competitive method becomes the management tool to survive and compete in international markets (Tse and Olsen, 1999). As mentioned before, the success of any firm depends on its ability to choose and implement an appropriate strategy in the context of a competitive and changing environment. Attention now turns to the issue of defining strategy.

### 2.5.1 Defining Strategy

Ansoff (1965) defines strategy as a rule for making decisions determined by product/market scope, growth vector, competitive advantage and synergy. By taking the environment as an issue into the consideration, Mintzberg (1979 p.25) notes that "strategy is the mediating force between the organisation and its environment: consistent patterns in streams or organisational decisions to deal with the environment". Similarly, Porter (1980) argues that strategy is coping with competition. Porter believes that there are five forces that affect the strategy a company develops: the threat of new entrants, the bargaining power of customers, the barging power of suppliers, the threat of substitute products or services, and industry competitors. Strategy is a process of understanding and shaping these forces.

Oslen and DeNoble (1981) describe strategy as the means through which organisational resources are employed to meet organisational objectives and the accomplishment of an organisation's purpose. This definition explicitly addresses the relationship between strategy and organisational objectives.

This is shared by Miner *et al* (1985 p372). These researchers argue that "strategy should be defined as the creation of missions, the setting of organisational objectives with full consideration of external and internal forces, the formulation of specific policies to achieve objectives, and the assurance of implementation – all with a view of making certain the purposes and objectives of the organisation are accomplished". It is clear that Miner *et al* support the previous authors' views, but they add an important element to the concept, that is formulation of policies to achieve objectives as a part of strategy.

With the belief that strategy is about positioning and gaining competitive advantage, Porter (1996) argues that strategy is the creation of a unique and valuable position involving a different set of activities. The essence of strategy is choosing to perform activities differently than rivals do. Similarly, by recognising their beliefs, strategy is both a process of understanding and shaping competitive forces and a process of open-ended discovery and purposeful incrementalism (Hamel and Prahalad, 1994) Hamel (1996) views strategy as revolution, everything else is tactics.

Researchers have presented different perspectives in their definitions of the concept. From the definitions given above, the differences are found in three primary areas: the breadth of the concept of strategy; the components of strategy; and the inclusiveness of the strategy formulation process. However, all these researchers recognise that strategy is an environmental or situational analysis used to determine a firm's posture in its field and that the firm's resources are utilised in an appropriate manner to gain what Thompson (1993) notes as competitive advantage.

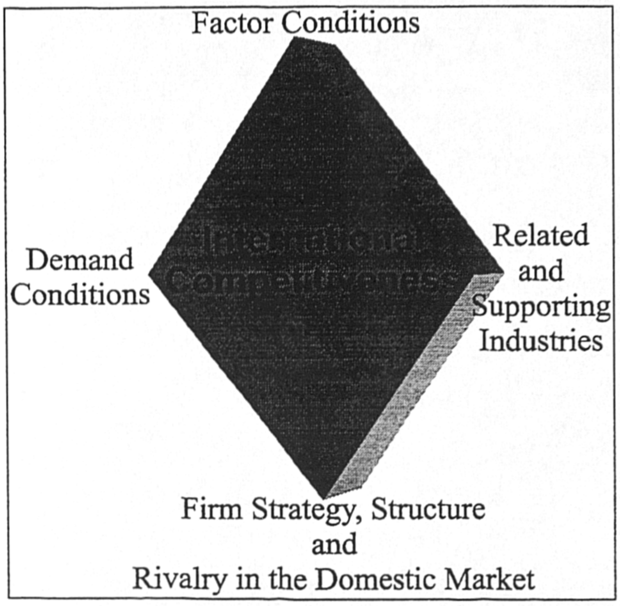
Porter (1985) has developed his work on industry analysis to examine how a company might compete in industry in order to create and sustain competitive advantage. He argues that there are three generic strategies: cost leadership, differentiation and focus in which firms can achieve sustainable competitive advantage. Cost leadership is where the company achieves lower costs than its rivals and competes across a broad range of segments. Differentiation occurs when the company has a range of clearly differentiated products which appeal to different segments of the market. Focus strategy is where a company chooses to concentrate on only one segment or a limited range of segments. With this approach it can again seek either lower costs or differentiation. Although, there are some critiques of Porter's generic strategies (see White, 1986; Hill, 1988; and Mathur, 1988), the importance and relevance of generic strategies has become an important influence on the development of organisations' strategies (Johnson and Scholes, 1993).

Porter's generic competitive strategies describe the ways of coping with the five competitive forces and outperforming one's industry rivals. However, it can not explicitly explain why American firms are leaders in hotel management, fast foods, accounting, consulting and a wide variety of other service industries, or why Swiss firms hold important positions in insurance, logistical services and banking. Companies gain international competitive advantage, succeeding against the best rivals, because they respond positively to pressure and challenge. They benefit from having strong domestic rivals, aggressive home-based suppliers and demanding local customers. The creation of this competitive advantage by certain firms in certain industries does not happen by chance. According to Porter (1990), there are four key attributes which together constitute the 'diamond of national advantage'. The term diamond is used to emphasise the interrelationships and interdependencies between factors (Thomson, 1993).

### 2.5.2 National Competitive Advantage in Services

Porter (1990) addresses the role of location in competition. He believes both companies and countries depend on the nature of the local environment in which competition takes place. The four constituent parts of the diamond are factor conditions, demand conditions, related and supporting industries and firm strategy, structure and rivalry in the domestic market (see Figure 2.7). These determinants create the national environment in which companies are born and learn how to compete. Those national characteristics have particular salience for services (Porter, 1990), and will be discussed below.

**Figure 2.7 Determinants of National Competitive Advantage**




Source: Porter (1990)

***Factor conditions***

Factor conditions relate to a nation's position in factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry. Porter believes a nation's stock of specialised, skilled professional and technical personnel is vital in international service competition. In the United States, there is a large pool of graduating MBAs, large numbers of computer programmers and specialised hotel schools which lead to the nation's strength in international accounting, management consulting, advertising and hotels. The growing complexity and specialisation of these services means that advanced factor creation mechanisms are becoming vital to service competition.

According to Porter (1990), language skills and ability to interact easily with many different cultures are also significant factors in many service industries. Indeed, many services demand extensive communication with customers. English as a native language is a significant benefit to service firms as English is spoken in many parts of the world. Swiss fluency in languages is one of the important reasons Porter believes to explain why Switzerland ranks with the United States and Britain as an important international services competitor. Americans and Swiss are familiar with multiple cultures which help nations yield advantages in client relations.

Technology also plays an important role in helping service companies compete internationally. Many American firms have benefited from the introduction of new technology to cope with labour issues and high operating costs. Thomson (1993) argues that the most valuable factor advantages tend to be specialised and require sustained investment. In fact, quite often they must be specialised in order to be sustainable – generally, a well-educated workforce is not a source of long-term advantage, but particular specialised skills may well be. Frequently the creation of suitable factor conditions is a function of the other three forces which facilitate international competition.

***Demand conditions***

The demand conditions are perhaps the single most powerful determinant of national competitive advantage in services. A nation benefits if its home demand is for service varieties or approaches that are demanded in other countries. A large number of business travellers moving from the domestic market to travel abroad helped American hotel chains learn to serve this global market segment and they become leaders worldwide. This illustrates that if a nation's service firms have a base of loyal home customers in foreign countries, the odds of developing a viable competitive position abroad are greatly enhanced. Porter (1990) argues strongly that global competitiveness actually increases the significance of the home market. A demanding clientele at home often forces firms to innovate if they are to compete successfully, and this is what provides the basis for sustainable international advantage. If the nation's values and culture are also being exported as has been the case with particular aspects of America to the world, such as credit cards and fast foods, the advantage is reinforced.

***Related and supporting industries***

Porter (1990) states that when a nation has internationally competitive manufacturing and services industries, it frequently enjoys the most sophisticated demand for associated business services. In other words, national advantage in complementary manufactured goods or other services pull through demand in some services. It could help the service firms competing and gaining competitive advantage at the global level because the presence of international competitive industries in a nation provide sophisticated buyers at home, creates a base of demand abroad and pulls through linked services.

*Firm strategy, structure and rivalry*

There is no one single universal management strategy which guarantees competitive success. The American hotel chains played a commanding role in the international hotel industry until the end of the 1970s. They did this mainly through the provision of a narrow product line of up-market products under one single brand to appeal to high-spending international travellers, in particular American business travellers (Litteljohn and Roper, 1991), by providing consistency of experience and efficiency all over the world. In contrast, the French company Accor pursued multi-tier branding strategies offering a wider range of products from luxury to budget which led to the company becoming a global organisation.

Porter (1990) argues that rivalry amongst domestic producers acts as a powerful competitive stimulus. Indeed, domestic rivalry can create pressure on companies to innovate and improve. Local rivals push each other to lower costs, improve quality and service and create new products and process. It is also vigorous domestic competition that ultimately pressures domestic companies to look at global markets and toughens them to succeed in them. And having been tested by fierce domestic competition, the stronger companies are well equipped to win abroad. The role of domestic rivalry illustrates how the diamond operates as a self-reinforcing system. It is clear that international success in services requires a local environment that exposes firms to international competition.

Companies gain advantage against the world's best competitors because of pressure and challenge. They benefit from having strong domestic rivals, aggressive home – based suppliers and demanding local customers. In a world of increasingly global competition, nations have become more important. Nations succeed in particular industries because their home environment is the most dynamic and challenging.

Apart from four broad attributes which discussed above, government also plays a prominent role in international competition (Porter, 1990). Porter argues that the government's proper role should be as a pusher and challenger. He argues that many strong international competitors are from nations where governments' policies aim to create an environment in which firms can gain and upgrade competitive advantage by promoting domestic rivalry and stimulating innovation; encourage or even push firms to raise their aspirations and move to a higher level of competitive prowess by entering new industries and overseas markets. This is a preferred option to direct government involvement. Therefore, Porter concludes those nations with the greatest government involvement in providing services, such as Italy, and Germany are among the weakest nations in terms of international service positions.

The 'diamond', which has been discussed, is a mutually reinforcing system. The effect of one determinant is contingent on the state of others. Favourable demand conditions, for example, will not lead to competitive advantage unless the state of rivalry is sufficient to cause firms to respond to them. Advantages in one determinant can also create or upgrade advantages in others (Porter, 1990).

The determinants, individually and as a system, create the context in which a nation's service firms are born and compete. It can be concluded that those firms gain competitive advantage in international markets, where their home base allows and supports the most rapid accumulation of specialised assets and skills, sometimes due solely to greater commitment. When home base affords better ongoing information and insight into product and process needs and the goals of owners, managers and employees support intense commitment and sustained investment, firms can gain competitive advantage. Ultimately, nations succeed in particular industries because as Porter (1990) believes, their home environment is the most dynamic and the most challenging, and stimulates and prods firms to upgrade and widen their advantages over time

## Conclusion

This chapter reviews a number of issues associated with the internationalisation of services. Indeed, in the past twenty years, advances in transportation and communication technologies have significantly enhanced the ability of service firms to deliver their products and services beyond the traditional boundaries of domestic markets. As a consequence, services have become more important in the global economy. Porter (1990) believes that the growth in services is driven by the increasing sophistication, internationalisation and complexity of management.

As service firms become more international, so corporate strategies have to reflect the fact that the business operates in a more diverse set of conditions than was the case when they operated only at home. In order to deal with this issue, Porter (1986b) provides three sets of tools for developing and retaining firms competitive advantage. The firm can exploit differences in the input and output markets among the many countries in which it operates. The firm can also benefit from scale economies in its various activities. Or it can exploit synergies and economies of scope which may be available due to the diversity of its activities and organisation.

What is important is that the primary strategic task facing global firms is to use all three of the sources of competitive advantage appropriately to optimise efficiency and learning while simultaneously minimising risk in a worldwide business (Tse and West, 1992). As international competition in services grows and services become more sophisticated, national competitive advantages in services is assuming growing importance to firms and nations alike. By recognising this point, the chapter also reviewed the four key attributes to which together constitute the "diamond of national advantage".

As an important service sector, the international hotel industry has witnessed a process of growing internationalisation since the late 1940s. Due to its national competitive advantage, the hotel industry was highly dominated by American hotel chains until the late 1970s. Thus, Nickson (1998) notes that the early internationalisation of the hotel industry was Americanisation. In the next chapter, the internationalisation of hotel industry will be reviewed and analysed.

# Chapter 3: The Internationalisation of the Hotel Industry

## Introduction

In recent years the trend toward multinational operations has extended beyond manufacturing industries to many service industries. The hotel industry is one of the service industries which has become involved in exporting products and services abroad since late 1940s (Miller, 1989). As the industry approaches the maturity stage of its life cycle, many firms are discovering that their future survival and growth depend upon successfully competing in the international arena (Tse and West, 1992).

This chapter will first address the different entry mode strategies pursued by international hotel chains when entering international markets. Dunning's eclectic theory (1979) – ownership, internalisation, and location advantages – is used as a framework to explain the growth, distribution and form of involvement of multinational enterprises (MNEs) in the international hotel industry (Dunning and McQueen, 1982). The international expansion strategies employed by major American, European and Asian hotel chains will be reviewed, compared and analysed in order to identify how they achieved competitive positions in the international hotel industry. These will also be considered in relation to the more generic Uppsala model of internationalisation considered in chapter 2.

## 3.1 Entry Strategies of International Hotel Companies

Much of the research which has been reported on the nature of the international hotel industry has utilised the unit portfolios of hotel companies as its data set (Litteljohn and Beattie, 1992; Slattery and Johnson, 1993; Gannon and Johnson, 1995). Like its domestic counterpart, the international hotel industry competes via the placement of its properties in significant and appropriate locations. Furthermore, there are many proponents who now identify the industry as competing on global terms (Crawford-Welch, 1991; Olsen, 1992; Schlentrich, 1992). Tse and West (1992, p.120) provide persuasive reasoning when they indicate that a firm competes on global terms where its "competitive position in one country is significantly influenced by its position in other countries"

One of the means by which hotel companies satisfy these competitive demands is referred to as the internationalisation methods of market entry. These methods will be affected by exposure to risk and resource demands on internationalising companies. Competitive pressures also force them to expand their portfolios as swiftly as possible to seize market share at particular market levels and in particular geographical areas (Gannon and Johnson, 1997).

There are several forms of concentrated strategy practised in the hotel industry which reflect the nature of the industry's almost pure competitive status (Olsen, *et al* 1991). These forms are strategic alliances, franchising, management contracts, joint ventures and foreign direct investment. In many cases, hotel companies do not operate in "pure form", but rather pursue a variety of strategic modes within their portfolio of hotels, dependent on locations, political and economic pressures as well as cultural features. These entry modes will now be discussed in turn. Exporting is not usually a viable option for hotel companies as their products and services must be located at the site of consumption.

### 3.1.1 Strategic Alliances

The impact of global competition has created the need to innovate constantly and create value amongst hotel corporations. Lately, strategic alliances have become an increasingly important means of conducting business in the hotel industry with one or more partners to create value and innovate (Go and Pine, 1995). Strategic alliances are intended to maximise market coverage, while also achieving economies of scale and scope and minimising capital investment (Dev and Klein, 1993). In the international hotel industry, strategic alliances are categorised into two types. According to Olsen *et al* (1991) and Dev and Klein (1993) the first type of alliances occurs at the strategic level of organisations and is exemplified by the growth of consortia-type organisations such as Best Western and Consort. Firms, generally independent operators, are tied together by a common reservation and marketing system. A more complex type of alliances, not only brings hotel firms together, but also brings in other hospitality-related firms, such as travel agencies, as a form of vertical integration. For example, Radisson Hotel Company has affiliated with Movenpick Hotel (Swiss), SAS international Hotels (Scandinavian), Park Lane (Hong Kong), Commonwealth Hospitality of Canada, and Pacific Rim Leisure (Australia) in order to better promote its product worldwide.

The strength of using strategic alliances as a vehicle of growth is that this approach can quickly take advantage of the brand recognition of several multinational organisations. Marketing costs can be spread over a larger base, making the effort more efficient and effective through gains in economies of scale. Many of the problems of labour and management expertise are minimised by this growth strategy, as are the problems associated with multicultural differences so often encountered when firms seek to expand into new areas of the world (Oslen, *et al* 1991; Tse and West, 1992).

In order to cope with an increasingly fierce, saturated and competitive operating environment, hotel organisations are having to join forces to ensure they harness the necessary resources, both financial and non-financial, to penetrate the marketplace. As Olsen *et al* (1991) note, the case of Radisson indicates that alliances are no longer confined to companies operating in the same industry, and there will an increase in strategic alliances between synergistically related firms such as airlines, car rental, life insurance companies and lodging corporations. This view is also shared by Go and Pine (1995). However, in comparison to the airline industry, the use of strategic alliances in the hotel industry are probably under-developed (see for example, Dev and Klein, 1993).

### 3.1.2 Franchising

Franchising is one of the most popular methods of growth for international hotel organisations. The franchise method implemented can be as simple as one firm with one unit being licensed from a franchisor (Young et al 1989; Root 1994), or as complex as a master regional franchise where one firm has the right to expand a particular brand throughout a region of the world (e.g. Whitbread master franchisee for Marriott in the U.K.). Another example is that of Quality International which has used the master regional franchise extensively in order to expand internationally, while Days Inns in India have used the concept in conjunction with the establishment of partnerships, thus necessitating little or no equity investment on their part (Oslen, *et al* 1991).

The growth in franchising as a form of international expansion is directly related to the brand proliferation evident in the international hotel industry. Many organisations believe that brand awareness, recognition and loyalty is the key to maintaining and increasing market share in this industry. By franchising, firms are able effectively to implant their brand into any given location with few, if any, changes to the general concept. Accordingly, franchising has been a favourite portfolio development strategy of North American hotel companies expanding across that continent (Tse and West, 1992; Go and Pine, 1995; Nickson, 1998). Development through franchising is a popular arrangement and continues to be one of the preferred growth vehicles for international expansion of budget and mid-market products(e.g. the strategy to expand Accor's mass products)

### 3.1.3 Management Contracts

One of the quickest forms of strategic expansion has been through the use of management contracts. If the objective is to accelerate growth and minimise risk, given the fact that the hotel company is relatively unfamiliar with the culture and politics of the countries in which it desires to develop it properties, management contracts are attractive vehicles of expansion (Young *et al* 1989; Root 1994). Rather than hotel equity ownership, the chain provides technical advice, pre-opening assistance, marketing support, management services and, above all, brand equity in return for a fee (Oslen *et al* 1991; Tse and West, 1992; Barge, 1993). In this type of strategy, a firm with an established reputation for being an excellent manager is essential.

Hilton International, Hyatt international and Marriott are perhaps the best-known examples of management contract companies. The greatest advantage of the management contract is that it allows rapid expansion and easy market penetration with little or no initial equity investment. An established reputation in the marketplace, a proven operations track record and consistently sound financial earnings are prerequisites for successful international contractors (Tse and West, 1992;Go and Pine, 1995). Non-equity forms of participation were favoured by many international hotel companies (e.g. American hotel chains) as they see their role primarily as suppliers of technology, management and marketing expertise to foreign hotels. In contrast, to Asian hotel companies and European chain, seem to prefer at least some ownership participation that will be discussed in the later part of this chapter.

### 3.1.4 Joint Venture

Joint venture entry takes place when an international company shares in the ownership of an enterprise in a target country with local private or public interests.

While joint venture can provide substantial rewards to partners, they are also associated with high risk exposure. Therefore, Root (1994) notes that once a company has decided on a joint venture method for a target market, its managers must initiate a search / evaluation process which is very much like that of acquiring a foreign company. The process involves drawing up a joint venture profile that specifies the desired features of a candidate; identifying / screening candidates and negotiating the joint venture agreement. Decision makers also need to know the objectives and strategy of the prospective local partner.

In the hotel industry, according to Olsen *et al* (1991), Tse and West (1992) and Go and Pine (1995), the joint venture strategy is usually employed by a large real-estate developer / holder and a hospitality / travel-related firm. These investors are global in orientation with a long-term strategy of holding assets for long-term appreciation. However, the case in China is different. Many hotel companies entered the Chinese market by signing joint venture arrangements with the Chinese government because the Chinese government encouraged overseas investment in the hotel industry by providing foreign investment and joint venture incentives but did not permit 100% equity entry. It is illustrative of how host country policies affect the firm's entry mode choice.

### 3.1.5 Foreign Direct Investment

Wholly-owned market entry methods are associated with corporate strategies and subsidiary units which require tight control in order to maintain firm specific advantages, and it is conventionally achieved through a combination of unit acquisition and organic growth (Young, *et al* 1989). With a sole venture, full control enables a company to carry out its own strategy in the target country to gain all the profits as well as the risks (Root, 1987). Recent years have seen a tremendous growth in the number of acquisitions in the international hotel industry. Despite the large amounts of capital to acquire the assets, many companies use this often "opportunistic" method (Johnson, 1997). The organic growth option again requires significant capital but may also suffer from being a very sluggish method of portfolio expansion (Watson and Littlejohn, 1992).

The development strategies discussed above reflect the growth posture desired by most international hotel firms. This growth is concentrated on the development of a brand or group of brands worldwide in an attempt to obtain a competitive edge in the fight for market share by taking advantage of scale and scope economies (Tse and West, 1992). Some hotel companies prefer pursuing non-equity entry modes because they perceive large capital investment is risky (e.g. Hilton, Holiday Inn). However, if hotel companies want to break into highly competitive and / or depressed markets, they might have to pursue such strategy which equity is involved (Young, *et al* 1989). Conversely, some hotel companies prefer to have equity in all of its hotels (e.g. Mandarin-Oriental) in order to gain power and control. As noted in chapter 2, the firm's choice of a particular foreign market entry mode is a function of a large number of diverse factors. It can be concluded from these strategies that the internationalisation of the hotel industry is no longer a trend but a fact of competitive life (Tse and West, 1992).

## 3.2 Dunning's Eclectic Theory - An Explanation of Foreign Involvement in the Hotel Sector

Dunning's eclectic theory of the multinational enterprise provides a useful framework in explaining the growth, distribution and form of involvement of MNEs in the international hotel industry (Dunning and McQueen, 1982). The three classifying principles of the eclectic framework are (1) ownership-specific, (2) internalisation-specific and (3) location-specific advantages. Ownership advantages refer to firm-specific assets and skills, such as firm size, multinational experience, or ability to develop and market a differentiated product. Internalisation advantages refer to the benefits of retaining assets and skills within the firm when the market fails or there is potential for opportunistic behaviour by a partner. Location advantages refer to the attractiveness of a foreign market (Agarwal and Ramaswami, 1992; Dunning, 1989).

According to the theory, an enterprise with headquarters in one country will have some form of involvement with firms outside their national boundaries whenever they have a competitive or ownership advantage over other firms (whether domestic or foreign) and can combine their advantage with resources located in foreign countries and which are attractive to the MNEs (Dunning, 1979). Rugman (1981) views a firm-specific advantage in "knowledge" as the key characteristic of the MNE. This advantage, which leads to foreign direct investment when there are imperfect good or factor markets, replaces or complements the country-specific advantages that support trade; and it prompts the creation of an internal market to retain control over firm-specific advantages. Multinational enterprise creates an internal market to overcome imperfect world good and factor markets, so does the multinational bank use internalisation to overcome imperfections in international financial markets (Rugman, 1981). Similarly, Yannopoulos (1983) has reasoned that Dunning's eclectic theory of international production can successfully explain the growth of transnational banking. As noted before, some researchers also have reached fairly similar conclusions (see for example Jones, 1990; Sagari, 1992).

However, studies of other service industries particularly of the international hotel industry (location-bound service) suggest some qualifications and elaborations regarding the nature of ownership, internalisation and location advantages, which will be given more attention and reviewed below.

### 3.2.1 Ownership Advantages

Dunning and McQueen's (1982), and Dunning and Kundu's (1995) studies about the hotel industry have identified three factors in relation to ownership advantages. They are (1) knowledge and experience in serving the market, primarily international business travellers; (2) product differentiation and brand image marketing of the hotel experience good; (3) investment in training.

As noted in chapter 2, Langeard *et al* (1981) highlight that heterogeneity is an important aspect of many people-supplied services and quality variation is common. Consequently, service branding can be an important tool in creating and sustaining a strong brand image and goodwill amongst customers. Coupled with this, the brand image can provide important signals to customers about the nature of the service and performance expectations, which help to minimise consumer uncertainty stemming from the intangibility of the service.

In the international hotel industry, the product that is provided is service, which can not be inspected before purchase, and where knowledge of the product is only obtained after the product is purchased, therefore they are called "experience goods". Under this condition, a trademark of guaranteed quality provides a powerful competitive advantage on a firm, particularly where customers are purchasing the service in an unfamiliar environment. Casson (1982) interprets Dunning and McQueen's hotel study as demonstrating that international hotel chains address quality-conscious markets, serve mostly international travellers rather than local people, utilise brand names, by using international reservation systems, integrated producer and consumer markets. Casson observes that *brand identity* allows such MNEs to distinguish themselves from their host country competitors.

A critical factor in the production of many services is information, differential access which gives rise to competitive advantage. This partly depends on the spatial location of the firm – those firms with geographically dispersed subsidiaries gaining access to a wider pool of information. In the case of the hotel industry, MNEs have the managerial and organisational expertise. According to the degree of multinationality, their sourcing of management and professional staff, marketing information, food and beverage, furnishings, fitments, linen, China and suppliers, etc., are likely to be wider, can be supplied at lower marginal costs (Dunning and McQueen, 1982). Thus, it would result in more potential for future expansion at lower costs. The capability to gather, store, monitor, interpret and analyse information at the least possible cost can be the key intangible asset providing firm-specific advantages (Dunning, 1989).

Go and Pine (1995) support this view, and further argue that multinational hotel firms can obtain supplies more cheaply than small firms because of available discounts. As a result of their bargaining power when implementing international advertising campaigns, they may be able to negotiate lower marketing costs. Their size affords them the opportunity to profit from differential factor costs.

Coupled with information is knowledge, which can be derived from investment in information, or which accrues as a result of the experience gained by the firm's personnel. Dunning (1989) argues that when the knowledge is invested in the personnel of the firm, the knowledge can be produced and sustained over time, the firm capitalising on its innate firm-specific knowledge. In the case of the hotel industry, the knowledge of the requirements and tastes, particularly of business visitors from the tourist generating countries is an important factor to make a successful operation. The knowledge of customers' expectations is obtained through training. Undoubtedly, investment in training enables the hotel chains to maintain the quality of its distinctive brand image, and hence market share of this experience goods. The competitive advantage of the hotel chain is also enhanced by internalising training, because it can more accurately assess employees' abilities and prospects, while maintaining a ready pool of skilled and mobile labour for expansion (Dunning and McQueen, 1982, Dunning and Kundu, 1995).

To conclude consideration of the ownership advantages of international hotel chains, it is clear that MNEs have the managerial and organisational expertise. They have the ability to invest substantial sums in training hotel staff, plus their detailed instruction manuals, often enable them to have superior expertise in the overall planning and design of hotel complexes. Furthermore, MNEs have the advantage of employing technically superior methods of production in the day-to-day operation, control and maintenance of hotels, and to recruit and retain better staff by offering good promotional prospects over other firms (Dunning and McQueen, 1982). These intangible assets and logistical skills enable international hotel chains entering new markets faster and easier.

### 3.2.2 Internalisation Advantages

In the process of producing goods and services, firms carry out many other activities, including marketing, training labour, design and development of products, all of which are interdependent and linked through flows of intermediate products, which mostly take the form of knowledge and expertise. Because intermediate-product markets are difficult to organise due to various imperfections, there is an incentive to bypass them and to bring the activities of producing and marketing within the organisation's ownership and control, that is, to "internalise" them (Buckley and Casson, 1985). Lack of trust in intermediaries and foreign partners are a major motivating factor behind internalisation.

In information-intensive sectors, where information is tacit and costly to produce, but where it can be replicated with ease, there are advantages of internalising such competitive assets and protecting leakage of firm-specific knowledge derived from these assets. In such instances, there is greater likelihood of firms pursuing foreign direct investment strategies as opposed to licensing contracts (Dunning, 1989; Enderwick, 1989). Equity-based FDI is also common in the case of business services such as accountancy, finance, consulting and advertising because quality control is difficult to achieve through the licensing or franchising of such services (Dunning and Norman, 1983).

Since it is difficult in the diverse travel and tourism market to organise efficient intermediate product markets, there is a strong incentive for hotel firms to internalise these markets (Go and Pine, 1995). Internalisation is typically practised via the acquiring of control over resources either through ownership of equity capital or through contracts (Dunning and McQueen, 1982). A major reason for the high frequency of non-equity control in the international hotel industry can be well explained by Dunning and McQueen (1982) on the basis of what they call "contract-based control":

"The owners of the hotel may have little knowledge of hotel operations and employ a professional management company to operate the hotel. The management company in turn will only become involved if they can protect their ownership advantage, and in practice this may require a large degree of control of the assets. The hotel management company, however, may be unwilling to invest in the ownership of the hotel either because it regards itself as having little expertise in property development, or because it regards ownership as a high-risk venture, or because expansion would be reduced by the need to borrow large sums of capital. It is often found to be to the mutual advantage of both parties for *de jure* control to be with the hotel owners but *de facto* control to be established through contracts. These contracts are more easily arranged because of the characteristics of the industry, in the sense that unlike manufacturing, there is no need for a policy of market sharing by the affiliates to maximise the global profits of the MNE, nor is there any production specialisation, while there exist ample opportunities to appropriate the economic rent from the MNE's activities (pp.104-105).

The research conducted by Dunning and Kundu (1995) also suggests that many of the benefits of foreign involvement commonly thought to be unique characteristics of FDI can be obtained by judicious use of non-equity arrangements. They highlight that in the international hotel industry, at least, it is not always necessary to own a foreign entity in order to capture the economic rent on the resources and capabilities transferred to it. The study also identifies some variables which can affect the preference of hotel chains for some kind of equity or contractual relationship with a foreign hotel including (1) quality control, (2) coordinating capabilities of the parent firm and (3) host country's inward investment policy, and (4) political and economic stability.

Similarly, Buckley (1983) points out, " It is through the use of internal markets in capital, labour management, technology and intermediate goods that effective control of foreign subsidiaries is exercised, rather than through equity ownership, and it is not necessary to own a production process to control it". Therefore, Boddewyn *et al* (1986) conclude that international services can readily be accommodated by internalisation theory even in the absence of equity investment although this accommodation applies only in the case of *consumer service* (e.g. the hotel industry).

### 3.2.3 Location Advantages

As the growth of hotel sector has been linked to the growth in real income of consumers in many developed and developing countries, location of activities also tends towards countries and regions which are economically stable and where consumers are relatively affluent (Dunning, 1989). Unlike manufacturing, location of many services is more concerned with closeness to customers and adaptation to customers' requirements (Buckley, *et al* 1991). With few exceptions the location is clearly specific to the tourist destination (Boddewyn, *et al* 1986).

A fundamental set of determinants of foreign involvement in the hotel industry will therefore comprise all the factors determining the size and growth rate of tourism to a particular country. The opportunities for tourism and the availability and quality of hotel - related infrastructure are important factors to consider for choosing one country over another. Indeed, government policy towards FDI and involvement in production in general also play an essential role as do political, social and economic stability (Dunning and Kundu, 1995; Baum and Mudambi, 1996). Indeed, as Boddewyn *et al* (1986) have observed "international services encounter no special problems in terms of the locational requirements of FDI / MNE theory, except in the case of location-bound services (e.g. hotel industry) since the choice of host countries is dictated by consumer requirements".

Overall, Dunning's framework is more concerned with the question of why MNEs exist and in what form than their evolution of becoming a MNE. Johanson and

Vahlne (1990) argue that Dunning's theory is more concerned with the outcome of internationalisation than the actual process. Hence, it is static in nature, focusing less on the internationalisation process as such. Although Dunning (1993) recently extended his framework to add dynamic aspects (most recently see Dunning, 2000), his framework nevertheless focuses on the existence of sufficient and necessary factors that explain the pattern of market internalisation by MNEs. The underlying forces of the internationalisation process, the development from a local to a multinational firm, are not explicitly considered.

Additionally, the "eclectic paradigm" assumes rational decision-making based on perfect knowledge by the decision-maker (Johanson and Vahlne, 1990). While the lack of behavioural-related variables, acknowledged by Dunning (1988) as a limitation of his framework, might be less relevant to international experienced MNEs. Clearly, in the case of inexperienced Chinese hotel companies venturing abroad such an assumption is less acceptable, due to their potentially lower level of international experience and expertise.

Hence, taking the above raised points into consideration, it can be concluded that Dunning's theory is not applicable to explain the internal internationalisation *processes* of firms. The Uppsala internationalisation model remains the main framework addressing the actual process of internationalisation.

## 3.3 The Internationalisation of the Hotel Industry

The development of hotels internationally can be seen to have started in the late 1940s and early 1950s. That was a period when the United States was the dominant world economic power (Litteljohn and Roper, 1991). Similarly, Go and Welch (1991) believe that international hotel operations began in the 1940s with the creation of Intercontinental by Pan American World Airways in 1946. This was the start of the internationalisation process, with American-based organisations catering for international travelling markets, although inevitably they placed a heavy emphasis on their American parentage in the style of their operations and management (Go *et al,* 1992).

### 3.3.1 The North American Influence

By the 1970s, American companies largely dominated the international hotel industry, both in ownership and operating terms (Go and Pine, 1995). According to Dunning and McQueen's (1982) survey, by 1978 there were 1025 hotels operated by multinational companies. The 81 transnational corporations which controlled these hotels were from 22 different countries. The United States accounted for 22 companies and controlled 56% of the total rooms. Even as late as 1978 of the top ten international hotel chains, eight were US-owned. The situation could be seen as one where the North American hotel chains played a commanding role. They did this through the provision of a narrow product chain, in that companies invariably operated single brands. Their success in these operations no doubt derived from their ability to appeal to high-spending international travellers, particular the international business traveller (Go and Pine 1995; Litteljohn and Roper 1991).

US type operations had thus remained the yardstick for comparison in the international hotel industry and their main competitive tool was geographic expansion by using management contract and franchising methods. These can be illustrated by the growth of hotel chains – Hilton and Holiday Inn.

#### 3.3.1.1 The Growth of Hilton International

Hilton International was established in 1947 as a separate subsidiary of Hilton Corporation with the opening of the Caribe Hilton International. According to Strand (one of the first employee of Hilton, and the president of Hilton from 1968 to 1986), the genesis of Hilton's internationalisation was a confluence of three factors (almost historic accidents) namely: demand, entrepreneur and financing. The post-war era witnessed a strong US dollar, while most of Europe and much of Asia lay devastated by war. Every country had a critical need to earn hard currency and tourism was the good prospect. During that time, almost the only tourists in any numbers were Americans, and almost the only sources of financing were governments with access to US Marshall Fund aid. Those governments, along with private shareholders, were open to persuasion that an American company with an established name was the most likely means to attract US tourists. This gave Hilton a great opening for international expansion (Lee, 1985).

By contracting the Hilton name, design and management expertise to local owners - Hilton International developed significantly at virtually no investment. By December 1964, Hilton operated 24 hotels in 22 countries and the mechanism of multinational hotel development was through *management contracts*. This led the Hilton International to be spun off as an independent publicly owned company, with shares traded on the New York Stock Exchange (Lee, 1985; Strand, 1996).

*Strong central control* is a theme that emerges in the description of the international expansion of Hilton. It provides the great interest, particular in the description of how much control was manifested as Hilton placed his "Little American" across the world, This is what Barge (1993, p.118) has called "systematised management efficiency". Hilton's expansion overseas came after success in the domestic market, and their international expansion targeted American business travellers by offering them a up-market and home-away-from-home standardised accommodation. This could be illustrated by the example of the Istanbul Hilton which Hilton built with absolutely American flavour in Europe (Strand, 1996) and which opened in 1955. According to Boorstin (1963) the Caribe Hilton and Istanbul Hilton were both models of American modernity, they were as indistinguishable in interior feelings and design as two planes of American Airlines. Indeed, providing uniform accommodation of consistent quality valued by American travellers was a key element for Hilton's successful expansion (Go and Pine, 1995).

The notion of "Little America" is important in delineating a particular way of operating. Arguably, Hilton can be seen as the most representative example of the

"American model" of hotel internationalisation. In entering into a number of management contracts, Hilton provided the operating capital, managerial controls and publicity programs as they attempted to diffuse 'best practice' techniques of modern hotel management (Bell, 1993). Thus, Strand (1996) argues that despite the case of selling American experience, the arrival of the Hilton hotel often played a key role in transferring innovative techniques and facilitating the transmission of new skills to the local workforce.

#### 3.3.1.2 Holiday Inn and Franchising

Kemmons Wilson developed the idea for Holiday Inn after the experience of what he called " the most miserable vacation in my life" (Lee, 1985, p.27). As a result of this, Holiday Inn was based and developed on the notion of *concept standardisation,* to ensure *operational control* and guest *consistency.* In 1952, the Holiday Inn network was founded when the first hotel was opened in Memphis, Tennessee. It had 120 rooms each with a private bathroom, air conditioning and a TV. Amenities included a swimming pool and free parking. Wilson soon enjoyed success with his concept, and began selling franchises in 1955, which made rapid expansion possible.

Indeed, as Teare (1993) noted, the original Holiday Inn concept or 'core brand' gained international recognition for setting and achieving consistently high standards in product design and service. Holiday Inn applied strict operating standards and supplied franchisees with almost everything, apart from the land upon which the hotel would be built, in order to ensure there were no surprises (Luxenberg, 1985). This was the inception of a chain, then, that was to make its reputation on universality, quality and consistency. Go and Pine (1995) view that the franchise strategy pursued by Holiday Inn is among the greatest success stories in US business.

### 3.3.1.3 A Discussion of American Model of Hotel Internationalisation

In the post-war period US hotels quickly established a hegemonic position, as they enjoyed an unchallenged period of growth, expansion and evolution (Barge, 1993). The emergent successful model of hotel management in the United States, based on management efficiency, standardisation, consistency and the systematic rigidities of scientific management.

The overall strategy which seemed to be most popular can be described as which Pearce and Harvey (1990) called concentrated growth, that is a firm direct its resources to the profitable growth of a single product, in a single market, with a single dominant technology. Essentially, companies like Hilton, Holiday Inn, and Sheraton were concerned with creating a, usually up-market, home away from home for American travellers, particularly business travellers, this was reliant on high levels of standardisation, centralisation and consistency (Go and Pine, 1995, Alexander and Lockwood, 1996). The essence of management contracts and franchising (the mechanisms) was the maintenance of high uniform standards, which was accomplished through strict adherence to the overall corporate strategic service concept (Litteljohn and Roper, 1991, Tse and West, 1992). By using non-equity practice methods, American hotel firms spreaded a centralised activity over a large number of units at a low costs (Go, 1996).

Go and Welch (1991) recognise that the American multinationals did initially dominate the international hotel industry and provide a 'best practice' hotel management model until late 1970s. Similarly, Litteljohn and Roper (1991) observe that the past 30 years have been a dynamic period in the internationalisation of the hotel industry. This internationalisation has been characterised by a growth of American-type brands. Why were they so successful and able to gain competitive advantage for such long period of time? Porter (1990) notes that the ways that firms create and sustain competitive advantage in global industries provides the necessary foundation for understanding the role of the home nation in the process. This is because Porter believes that the home base is the platform for a global strategy in the industry in which advantages drawn from the home nation are supplement by those from an integrated worldwide position.

As mentioned before, demand conditions are perhaps the single most powerful determinant of national competitive advantage in service sector. This is quite apparent in travel-related industries where U.S. hotel chains have been the beneficiaries. After the World War II, United States was the dominant world economic power, and at that time American tourists were the main participants in international tourism. According to Go and Pine (1995) and Go and Welch (1991) American hotel chains developed far-flung networks within the nation, they gained the experience of running hotels and serving Americans.

The presence of American accounting, advertising and a wide variety of other industries were international competitive, led to a large number of American business travellers going abroad. American hotel companies were given opportunities to expand and become leaders worldwide. As Porter (1990) notes if a nation's service firms have a base of loyal home customers in foreign countries, the odds of developing a viable competitive position abroad are greatly enhanced.

The United States developed its hotel industry earlier than any other nations. Alexander and Lockwood (1996) and Tse and West (1992) note that the presence of several number of big hotel players at home (e.g. Hilton, Sheraton, Marriott and Holiday Inn), accelerated the saturation process and the competitive pressures and economies of scale encouraged American hotel chains moving overseas to compete in the international arena. This phenomenon is much reflective of Porter's (1990) view that vigorous domestic rivalry creates a fertile environment in which to grow world-class service firms. A group of domestic rivals provided an essential ingredient to American hotel companies' success in the hotel industry. By transferring innovative managerial and operating styles and techniques which had been thought of as a 'best practice' model (Barge, 1993) enabled the geographic expansion of American hotel companies through management contracts and franchising.

This 'best practice' model had not been challenged for about 30 years. As a result, much of the work on hotel internationalisation (see Litteljohn and Roper, 1991; Barge, 1993; Go and Pine, 1995; Nickson, 1998; Alexander and Lockwood, 1998) see the previous modes of internationalisation in the sector have been based on the so-called "American model". Porter (1990) notes that timing plays an important role in which nation's service firms become international. There is little doubt that American hotel companies enjoyed the advantage of being the early starter and through this gained its significant and influential role in the international hotel industry.

American hegemony in ownership and operating terms, in many respects should not be surprising given the economic strength, and political and cultural influence of America at that time. As Ferner (1994) notes, the capitalist economy in the hegemonic position will often provide methods of organising production and work organisation which establish standards of best practice, within which the multinationals is itself the key mode of diffusion of such practices.

Consequently, Hilton, Intercontinental, Sheraton, Holiday Inn and Hyatt continued their expansion by promising certainty and consistency for the guest, exporting standardised products within the strict control of strong centralised management systems (Teare, 1991; Go and Pine, 1995), usually via standard operating procedures (Nickson, 1998). However, this is not to say that the international operations were the exclusive domain of the North American hotel firms, but until the late 1970s, U.S. companies as a group represented a driving force in the phenomenon of international hotel operations (Litteljohn and Roper, 1991).

### 3.3.2 Challenging American Model of Hotel Internationalisation

Porter (1980) defines an industry as the group of firms manufacturing products of a like nature and contends that industries which offer relatively high rates of return generally attract new entrants. The motives of the new entrants may differ, for example, some will wish to diversify, others may want to add new capacity. The 1980s saw significant growth in the hotel industry (Litteljohn and Roper, 1991) with the arrival of newer non-American companies and the dilution of U.S. ownership. This could be illustrated by the cases of three of the major American players that were sold to non-US companies. The Holiday Corporation sold its interests in Holiday Inn to Bass (UK); Hilton International was acquired by Ladbroke (UK) and Intercontinental was sold to Grand Metropolitan (UK), who subsequently sold it to Seibu Saison of Japan. An American model of internationalisation which initially dominated the international hotel industry started to decline (Alexander and Lockwood 1996).

Indeed, improvement and innovation in an industry are never-ending processes, not a single, once-and-for-all event (Porter, 1990). European and Asian hoteliers firstly adopted and then subsequently adapted American management techniques, and in doing this added extral value and re-exported it back to the USA and elsewhere. Consequently, the competitive position of American firms was challenged.

The previous years had mainly seen international expansion coming through the growth of single brands. The 1980s saw a greater sophistication, which some hotel chains, e.g. Accor developing a portfolio of brands, which Go and Pine (1995) termed multi-tier branding. This represents a shift from the provision of a single, luxury brand to a stable of brands that seek to cater for a range of customer tastes. Alexander and Lockwood (1996) suggest that the adoption of multi-tier branding by a variety of bigger players is based on the recognition of two key factors, namely the attainment of market presence to preempt competitor's expansion; and the opportunity to transfer knowledge between markets. To illustrate the rationale of this strategy, it is useful to examine the attempts of French travel, tourism and hospitality transnational, Accor, to attain both geographic and market spread via product development.

#### 3.3.2.1 Accor – Growth through segmentation

Accor could be regarded as the leader in the development of multi-tier branding strategy (Go and Pine, 1995). Over the years, Accor has built the world's leading hotel network, with 3,400 hotels at the end of 1999 (http://www.accor.com). The company is present in all segments of the hotel market from economy and budget (Motel 6, Formule 1, Etap Hotel, Ibis and Red Roof Inns) to business hotels (Mercure, Novotel and Sofitel), as well as resort hotels under the Coralia label.

In order to examine the growth trajectory of Accor with respect to these various approaches, it is worthwhile to outline the development of the firm since its inception in 1967, with the opening of the first Novotel in France. According to Rosenzwig and Raillard (1992), the establishment of the Novotel came from the experience of one of its co-founders Paul Dubrule in the US. Paul Dubrule was impressed by clean and efficient hotel chains and believed that similar hotel chains would have a greater market in Europe. Consequently, on his return to France in 1963, he started working towards a chain of hotels located near airports and alongside the growing national highways, that could serve the growing number of business and leisure travellers (Rosenzwig and Raillard 1992).

Novotel continued to develop throughout the 1970s and added two brands – Ibis in 1974 which was developed organically, and the purchase of the Mercure hotel chain in 1975. The next milestone was Novotel buying an interest in Jacques Borel International in 1980, a move which gave them Sofitel chain. In two years, Jacques Borel International was acquired by Novotel, and the name Novotel was changed to Accor (Accor Annual Report, 1992).

Accor's move into the budget sector came with the organic development of the Formule 1 concept in Europe. In 1990, Accor acquired American based, Motel 6 chain, again a budget offering. The objectives of this acquisition were to consolidate Accor's position as a world leader in the budget segment of the market; and to increase Accor's presence in the US. A key feature of this merger and acquisition was the perceived synergistic benefit to be derived in both product and organizational culture terms (Nickson, 1998). In *1999*, the group acquired *Red Roof* Inns and this acquisition has moved Accor to number one in the economy and budget hotel sector in the USA and thus consolidated its number one ranking worldwide.

Indeed, the rationale behind the acquisition of American based Motel 6 was also apparent in the majority acquisition of the Franco-Belgian company, Compagnie Internationale des Wagon-Lits et du Tourisme at the end of 1991. Accor had minority shareholder in Wagon-Lits in 1990 and this gave them time to evaluate the complimentarity of the two groups' activities, expertise and networks before they committed themselves to becoming majority shareholder when increasing their share to 69.5% in December 1991(Accor Annual Report, 1992). The acquisition had some struggles (Buchanan, 1991; Selwitz, 1994), but the overall effect was to create one of the few vertically integrated companies with interests in the hospitality, tourism and travel sectors (EIU, 1995).

The acquisition of Wagon-Lits allowed Accor to consolidate its traditional activities, such as hotels, restaurants and service vouchers, whilst also allowing for the addition of new activities such as, railway services, travel agencies, and car rentals. Accor later merged the Wagon-Lits travel agencies create Carlson Wagonlit Travel. Since then, the company became European leader and a major international group in travel, tourism and business services, through its two main international activities, a) hotels and complementary travel agency, catering and casino businesses, b )corporate services, including restaurant vouchers with Accor Corporate Services. By the end of 1999, Accor employed 131,926 staff working in 140 countries.

Clearly then, Accor's route to multi-tier branding has meant the use of both organic growth and acquisition and the concomitant use of a range of separate arrangements within those two wider categories and, as Alexander and Lockwood (1996, p.467) note, "This typifies the hotel industry where no one strategy predominates, and individual organisations are prepared to grow through different expansion routes". Such a rapid expansion led Accor from a French company to being a global organisation.

Indeed, Accor is widely cited as being a "genuinely" global company, both in relation to its geographic spread and geocentric intent (Go and Pine, 1995; Rhinesmith, 1993). It is the leading hotel company in the world, the only one present across the whole product range from economy and budget to luxury. The strategic growth of Accor has delineated a qualitatively different approach to internationalisation to that pursued by American organisations (Nickson, 1998). Together with previously discussed a number of key trends emerging in the international hotel industry it raises an interesting question that whether the significant and influential role of American organisations is in declining? Attention now turns to this issue.

### 3.3.2.2 New approach versus American model?

Previous review and explanations of internationalisation trends in the industry held that branding was axiomatic with gaining competitive advantage. Much internationalisation has been on branded, often North American branded, relatively up-market and business travel oriented provision. This traveller was presumed to require some degree of certainty and quality when they travelled to new locations. The acceptable brand could give him just that, particularly if it were tailored in some way to what he was used to when travelling on business at home, so the presumption worked. This is similar to when Boorstin, in the mid-1950s, identified that Hilton International Corporation's attraction to American travellers abroad rested in brand identity and image among Americans (Litteljohn and Roper, 1991). However, such an analysis of branding must be taken in the context of its time and must be updated.

The insistence on rigid standardisation by American hotel chains did have its limits. Despite the success of the brand in pursuing such a policy, Go and Pine (1995) note how the company's obsession with standardisation, combined with the psychological momentum of the founder, stifled change. For example, Luxenberg (1985) notes that American brick facades seemed drab to French and Belgian customers used to variety and regional nuances. Holiday Inn were reputed to have lost $28 million between 1971 and 1975 as a result of their failure to make any concessions to local tastes or ways of operating, (Nickson, 1998).

Learning from the experience of American hotel companies, Accor used different approach. Its flexibility and ability to adapt to the local environment is the big difference that Accor has compared to the Americans. For example, Accor's Novotel in Bangkok is reflective of tailoring its product to local market conditions. Instead of providing a single, up-market brand, Accor came up with multi-tier branding strategy that seeks to cater for a range of customer tastes in order to sustain rapid expansion and gain competitive advantage. Another pronounced shift was reflected in the growth strategies employed by Accor. The company has got involved in equity participation, used organic growth and acquisition, although management and franchising still played an integral part in expansion strategies.

Litteljohn and Roper (1991) identify two internationalisation patterns:

Path 1: Focusing upon 'global' expansion, but only targeting a minimum of locations in any particular country.

Path 2: Penetrating specific countries with a range of hotel brands, internationalisation is therefore a more focused geographical strategy.

The first path is presently being taken by mainly deluxe hotel brands, such as Hilton and Shangri-La. These hotel chains will continue to gain presence in gateway cities and selected secondary cities where they presently lack a hotel property. Therefore, this kind of expansion follows the pattern of that internationalisation witnessed by Dunning and McQueen and Dave back in the 1970s. The main difference will be the need to ensure that the brands evolve with market requirements maintaining competitive edge, and that their geographical distribution is appropriate; that new opportunities are identified and that locations no longer suitable are dropped (Litteljohn and Roper, 1991).

International expansion by Accor is a good example of following the second path with a range of hotel brands covering a wide set of market levels. As mentioned before, Accor could be regarded as the leader in the development of multi-tier branding strategy. The important aspect to consider here is that the clientele for the middle and lower market products will in the main come from the host country. Thus, international hotel firms must be competitively able to penetrate markets by appealing to domestic markets which may not be international in orientation. Interestingly, Go and Pine (1995) termed multi-tier branding, which at one level would seem to connote the continued decline in the previously dominant and hegemonic American model of hotel internationalisation.

An interesting issue is raised here. Has the American model reached the end of its effectiveness in the international hotel industry and can be wholly redundant? Nickson (1998) argues that although, the shift to a multi-tier branding strategy at one level could be seen as a shift away from the American mode, in reality the underlying rationale for this multi-tier branding can, arguably, still be seen, to a greater or lesser extent, as standardisation , certainty, consistency, dependability and predictability. This view is shared by Alexander and Lockwood (1996), who believe that standardisation and the creation of a branded home-away-from-home is still clearly a major part of the competitive strategy of the international hotel groups, whatever the country of origin.

Similarly, EIU (1995) recognise that a consequence of the American hegemony of the early years of the hotel industry is that even though there may have been a shift in ownership, there is, it seems, a residual and somewhat amorphous notion of American influence within such hotels. Consequently, it could be argued that the American influence on the international hotel industry is still major and pervasive and the American model has proved very durable. Nonetheless, the notion of the durability of the American model may be overly static in terms of a change of emphasis. In this sense, Nickson (1998) notes the paradigm of systems, consistency and predictability may have been increasingly reconfigured within the rhetoric of human resource management and the effective management of people.

By contrast, Accor's approach to internationalisation can perhaps be seen as an organisation that is at the forefront of attempts to attain a more global orientation. Nickson (1998) observes Accor's success in part is reliant on drawing on a range of influences. The initial success of Novotel stemmed from Dubrule and Pelisson eschewing high levels of managerial centralisation, whilst, paradoxically, at the same time borrowing the basic concept of certainty and consistency from American hotels such as Hilton and Holiday Inn. In time, this meshing of French and American influences has been supplemented and enriched by other influences as Accor has spread throughout the globe and entered other industry sectors (Rosenzwig and Raillard, 1992).

Porter (1990) argues that firms that gain competitive advantage in an industry are often those that not only perceive a new market need or the potential of a new technology but move early and most aggressively to exploit it. Accor's approach to internationalisation by implementing a multi-tier branding strategy is reflective of Porter's belief. Accor's route to multi-tier branding has meant the use of both organic growth and acquisition and the concomitant use of a range of separate arrangements within those two wider categories and, as Alexander and Lockwood (1996) note, this typifies the hotel industry where no one strategy predominates, and individual organisations are prepared to grow through different expansion routes. What is important is that companies need to focus on their core competencies, what they do best and what differentiates them from the competition in order to gain competitive advantage.

### 3.3.3 Asian Hotel Chains

The development of the hotel sector in the Asia Pacific region has historically been dominated by the major US hotel chains, although now many of them are not US owned and operated. There is, nevertheless, a strong group of regional chains which although not having the international representation of the major international groups, have a significant presence in regional terms, and are actively looking for opportunities to expand internationally.

In Asia, there has been far less of a tradition of either the small private hotel or local hotel chains, and to a large extent the hotel sector reflects the region's economic emergence onto the world arena. This has meant that the region began with something of a 'clean sheet' at a time when the international hotel chains were expanding fast (EIU, 1995). Thus, initially at least, the expansion of accommodation focused on the development of international hotels to cater to the international business travellers and more affluent long haul leisure travellers. This has meant that the region has been a concentration of properties at the upper end of the grading scale. Asian multinationals also prefer to develop luxury hotel products. The following sections will illustrate the growth of Asian hotel companies by describing the growth of Shangri-La and Mandarin Oriental and provide an analysis of this distinctive style of development.

#### 3.3.3.1 Shangri-La International

Shangri-La International could be regarded as one of the most successful Asian-based hotel chains which develops and manages deluxe hotels and resorts, primarily in the Asia Pacific region. Shangri-La is a private company, wholly owned by the Kuok Brothers Group of Companies, a Malaysian family concern. In 1978 the Kuok Group formed a hotel management company called Kuok Hotels. From this relatively small beginning, managing five properties in Fiji and Malaysia, there has followed a period of rapid expansion and acquisition. In 1983, the name of the company was changed to Shangri-La International, a name now synonymous with hotel excellence.

From the beginning, the aim of the group was to offer deluxe accommodation coupled with a superior standard of service in a style that is warm and inviting. The company targets Asia's primary cities to expand its up-market product. The name 'Shangri-La' represents the ambience in each hotel property, which is to provide a haven of peace, tranquillity and comfort. The unique feature of its product leads Shangri-La to have a wide distribution of properties throughout Asia. China features strongly drawing on and utilising the company's business connections. Apart from the deluxe products, the company introduced a 3/4 star brand – Traders, in 1989. The first Traders in Beijing was deemed as particularly successful.

It is important to note that almost all Shangri-La properties are newly built and designed by the company. This phenomenon on one hand might reflect the strong economic background of the company. However, there are exceptions. The Traders

Hotel in Manila, for example, which opened on 1 January 1995 was a management takeover of the Philippine Capital's Holiday Inn. Other management takeovers include the Kowloon and Xian Hotels, which joined the Shangri-La portfolio in 1991 and 1993 respectively.

At the present, Shangri-La only operates in Asia Pacific region, but with the intention to break into North America and Europe (Shundich, 1997). Interestingly, according to Joanne Watkins, Shangri-La 's group director of communications, the hotel group does not believe there is a necessity to partner with another hotel company to achieve international status as leading hotel operator (cited in Shundich, 1997). It is very reflective of the distinctive style of Asian hotel companies which is growing through foreign direct investment and focusing on product differentiation and, indeed, Parker (1995) speculates that by the year 2019 half of the top 10 hotel chains will be Asian owned.

Clearly, Shangri-La's development correlated with the concept of 'psychic distance', it supports the importance of experiential knowledge and incremental internationalisation (Johanson and Vahlne 1977). Together with pursuing Porter's (1980) differentiation focus strategy, Shangri-La has succeeded by offering mainly luxury hotel products in Asia Pacific region.

#### 3.3.3.2. Mandarin Oriental

The Mandarin Oriental Hotel Group is another one of the strongest luxury brands in hotel industry. In 2000, the company operated 19 deluxe and first class hotels in Asia, North America and Europe and with 2 further hotels under development.

The group began with the opening of their flagship property in Hong Kong in 1963. The initial concept was to create a deluxe hotel that would cater to the growing number of business and leisure travellers who were coming to Hong Kong as the territory grew in regional and financial importance. The hotel soon built up an enviable reputation for fine service.

The company's hotel interests expanded through the acquisition in 1974 of a 49 percent interest in The Oriental, Bangkok. The Oriental was already a legendary property and acknowledged as one of the world's great hotels. Through the management of both Mandarin Oriental, Hong Kong, and The Oriental, Bangkok, the Group was in an unusual position of having two flagship hotels whose names represented the best in hospitality. In 1985, the company rationalised its corporate structure by combining these two prestigious properties under a common name – Mandarin Oriental Hotel Group.

The company's aim was, and still is, to concentrate on the development and operation of deluxe and first class hotels worldwide. In markets, that do not support a five-star brand, the group attempts to expand its management expertise with the "Excelsior" brand, which offers four star lodging. It is important to note that the group prefers to have equity in all of its hotels. They typically seek to invest in up to 25% of the share capital of an ownership entity which enables them to achieve certain minority shareholder protections (Annual Marketing Meeting, 1995).

The Group developed hotels mainly in South East Asia's gateway cities by the end of 1995 (Annual Marketing Meeting, 1995). In November 1996, the Group broke into the European market by acquiring an hotel in London, later renamed Mandarin Oriental Hyde Park which is perhaps one of London's most prestigious deluxe hotels. According to Mandarin Oriental Annual Report (1999), the growth strategy of the group is to leverage its brand to become one of the strongest in the luxury hotel industry by progressing year on year towards achieving its goal of operating hotels worldwide. In order to do so, in September 1999, Mandarin Oriental announced two joint venture agreements to build a luxury Mandarin Oriental hotel in New York City and one in Miami.

The Group's other development milestone was the purchase of Refael group. In May 2000, the acquisition of the Refael group for approximately US$140 million gave Mandarin Oriental critical mass presence in three continents, adding seven distinctive luxury hotels in North America and Europe into its portfolio. This acquisition fits the Group's growth strategy to double the number of rooms under management and to capitalise on its luxury brand, also providing the Group with a more balanced geographic presence.

Mandarin Oriental is a very aggressive Asian hotel player towards internationalisation. Its route to internationalisation was the use of both organic growth and acquisition to penetrate luxury hotel properties worldwide which again demonstrated another different expansion route in comparison to American and European hotel companies. Again, this typifies the hotel industry where no one strategy predominates, and individual organisations are prepared to grow differently.

#### 3.3.3.3 An Analysis of Asian Hotel Companies

What makes firms competing in an industry, differ from one another is their competitive strategy, which enables them to react to their environment and to achieve their goals. The competitive strategy that will be pursued is directed by the firms' main strengths and weaknesses. Therefore, it could be inferred that firms which follow similar strategies are likely to have similar strengths and weaknesses. That assumption allows clustering the firms in an industry into specific groups, the strategic groups (Feka, *et al* 1997).

Strategic groups were introduced by Hunt (1972, cited in Nath et al 1997) to describe intra-industry structure, a level of analysis between the individual firm and the entire industry. In few years later, Porter (1985) gave a similar definition, claiming that strategic groups is a group of firms in an industry following the same or a similar strategy along common strategic dimensions. Interestingly, some authors have raised concerns about the validity of the strategic group concept. Hatten and Hatten (1987) claim that strategic groups do not exist and they are merely an analytical convenience. Despite the debate about the strategic group, it is interesting to consider their usefulness and determine how can we take advantage of the concept to analyse the hotel industry.

According to Porter (1985), the strategic group is an analytical device designed to aid in structural analysis. It is an intermediate frame of reference between looking at the industry as a whole and considering each firm separately. Grouping firms into strategic groups one can examine and analyse the group's structure, appraise its attractiveness, and assess the competition both within the group and between groups.

According to the market coverage (products and not geographic coverage) and branding strategies, strategic groups in the international hotel industry can be clustered (see Figure, 3.1). It is important to note that all these hotel companies are multinationals, the category of resort hotels is categorised into the up-market sector. The hotel industry is very dynamic, changes (ownership, branding strategies) happen everyday, and this may challenge the validity of the strategic groups presented here. However, it can enrich the understanding of the hotel industry by describing and analysing firms according to their positions.

**Figure 3.1 Strategic groups in the international hotel industry according to market coverage and branding strategies**

| | | Market Coverage | | | |
|---|---|---|---|---|---|
| | | Total | Partial | | |
| | | | Up-markct | Mid-Market | Budget |
| Branding | Single Branding | **Accor**<br>Sofitel, Coralia<br>Novotel, Mercure<br>Ibis, Formula 1, Motel 6<br>**Choice Hotels**<br>Clarion<br>Quality Inn and Suites<br>Comfort Inn and Suites<br>Sleep Inn | **Hilton**<br>**Mandarin-Oriental**: Mandarin-Oriental<br>**Shangri-La**: Shangri-La | **Mandarin-Oriental**: Excelsior<br>**Shangri-La**: Traders | |
| | Umbrella Branding | **Holiday Inn**<br>Crown Plaza<br>Holiday Inn Garden Court<br>Holiday Inn Express<br>**Marriot**<br>Marriot<br>Courtyard Marriot<br>Marriot Residence Inn | **Intercontinental**: Intercontinental<br>**Hyatt**: Hyatt Grand Park | **Intercontinental**: Intercontinental Forum<br>**Hyatt**: Hyatt Regency | |

Figure 3.1 shows that the international competition in hotel industry is concentrated in the up-market and mid-market segments, although some big players cover the budget segment. There is no single hotel company primarily in the mid-market or providing exclusively budget products. American brands gained competitive advantage mainly through the successful practice of just one up-market product, which were later challenged by multi-tier branding. As a consequence, international hotel companies recognised the importance of implementing that strategy and thus tended to cover a wider range of products in a highly competitive environment (e.g. Holiday Inn).

However, Asian hotel companies still prefer to focus on luxury lodging development and becoming important luxury brands in the hotel industry. It is interesting to analyse their competitive advantage over other competitors from the same group. Historically, the last 20 years in the Asia Pacific region has featured luxury hotels, in many instances built at the gateway cities and resorts to cater to business and leisure travellers. Many international travellers would agree that the level of personal service in American and European hotels is lower than in Asian luxury hotels. Because the labour cost in Asia is relatively cheaper this enables Asian hotel companies to take advantage of it and, by providing more personalised service to international business travellers, they gained competitive advantage. Asian hotel companies compete in an industry segment where high levels of personal service are provided. In comparison, the present labour shortage in the Western democracies remains a critical factor for Western hotel chains seeking to compete.

Instead of providing standardised hotel formulas which was regarded as the 'best practice', Asian hotel companies emphasise their products synonymous with hotel excellence and differentiation. For example, Shangri-La's name represents the ambience in each hotel property, which is to provide a haven of peace, tranquillity and comfort. The unique feature of its product has led the firm to become one of the most important names in the hotel luxury product market. Following the same thinking, Mandarin Oriental is another strong brand in that luxury category achieving this by exploiting differences (e.g. guest rooms) in its prestigious deluxe hotels. Clearly, Asian hotel companies' competitive strategy reflects Porter's (1990) generic strategy of differentiation focus. Shangri-La and Mandarin Oriental have been successful by providing a narrow line (niche market) of differentiated, more exclusive products for the price-insensitive quality conscious customers who are willing to pay premium prices for perceived higher quality hotel products.

There is another specific feature emerging from Asian hotel companies which is that they make aggressive international expansion by foreign direct investment. Tse and West (1992) note that the capital sources for the industry seem to be concentrated in the Asia Pacific region. The strong economic background facilitates the development, they break into new international markets via acquisitions, organic growth and/or joint ventures (e.g. Mandarin Oriental), which lead to the increased market share and profit.

In comparison to other strategic groups, Asian hotel companies do not to cover wider market segments. It is important to note that oversupply of properties at the up-market level has not been uncommon, particularly in countries such as China, Hong Kong and the Philippines. Although there are fewer and fewer reasons to develop this market, except in some resort destinations, the regional based hotel chains put great emphasis on this category. However, as Go and Pine (1995) note that successful hotel companies will depend on increased market segmentation, in particular the introduction of mid-scale hotel products and more carefully targeted marketing. As noted earlier, Although Shangri-La and Mandarin Oriental mainly focus on deluxe hotel products offering, they have developed mid-range products which reflects the recognition of this development issue.

The rapid economic growth that occurred in some countries in Asia Pacific since the 1980s led to rapid hotel development, particularly in the 5 star category. In some cases, and with the tougher conditions of global environment, there is an increasing trend for the Asian developers to rationalise the potential of the mid-market, the growing demand in non-gateway cities and the importance of implementing multi-tier branding strategies. Indeed, many Asian based hotel chains have followed which Litteljohn and Roper (1991) identified internationalisation path – focusing upon 'global' expansion, but only targeting a minimum of locations in any particular country. They might attain both geographic and market spread via segmentation in the future when there is not some competitive advantage to be gained by providing a single up-market product.

## Conclusion

This chapter reviewed and analysed the internationalisation of the hotel industry. The internationalisation of the hotel industry has been characterised by a growth of American-type brands and their 'best practice' model since late 1940s until early 1980s. It is apparent that American hotel companies gained competitive advantage and succeeded against the rivals for about 30 years. By applying Porter's (1990) theory of competitive advantage of nations, this chapter argued that the success of American hotel chains derived from its home base. They benefited heavily from the internationalisation of American domestic demand, having strong domestic rivals, being early starters and its economic strength and political and cultural influence of America at that time.

Since 1980, the American model of internationalisation was challenged by non-American companies. Accor's route to internationalisation illustrated that successful international expansion requires hotel companies to understand the expansion strategy is not just moving into new regions and locations, but seeking to enter new market segments. The multi-tier branding strategy which was developed and implemented by Accor, has quickly infused the strategic approaches of the major players in which they offer several product lines that are aimed at every type of traveller.

However, Asian hotel companies still prefer to compete in a single luxury brand, in comparison to American players (standardised hotel formulae) who are in the same strategic group, Asian hotel companies emphasise their products synonymous with hotel excellence, differentiation and more personalised service to gain their competitive advantage. Interestingly, the evidence shows that the internationalisation of reviewed hotel companies in this chapter all correlate with a gradual internationalisation process of organisational learning which was developed by Johanson and Vahlne (1977).

Different routes to internationalisation that were practised by international hotel companies reviewed in this chapter demonstrate that in the hotel industry no one strategy predominates, and individual organisations are prepared to grow through different expansion strategies. What is important is that companies need to focus on their core competencies, what they do best and what differentiates them from the competition in order to compete in the global market and gain competitive advantage (Alexander and Lockwood, 1996).

Following the introduction of the "open door policy" in China, hotel development was dramatic and some Chinese hotel companies have started developing their brands with the intention to compete in international markets. In the next chapter, a review of hotel development in China is presented.

# Chapter 4: A Review of Hotel Development in China

## Introduction

One of the most dramatic international tourism developments that figures prominently in the Chinese cultural landscape is the development of tourist hotels. The creation of a tourism landscape demonstrates the search by modern tourists for novelty, escape, nostalgia and variety (Eckbo, 1969). The hotel industry, as an element of the total tourism landscape, can be variously studied as an indicator of economic growth, morphological identity, and social change in values and fashion (Ayala, 1991). This chapter starts with a review of China's political dimension because as a developing country with a socialist economy, it has a significant effect on changing social and economic structure of the society. In order to address this issue, this chapter examines the impact of economic reform on China's tourism development. In tandem with tourism growth, there has also been a corresponding boom in hotel industry. The development of China's hotel industry is also closely linked to government policies and involvement. The interesting issues of the relationship between government policies and the development, manpower and training are examined. The chapter also discusses and analyses the hotel development problems at the end.

## 4.1 China's Political Dimension

Before considering areas of concern regarding hotel development in China and Chinese hotel chain's internationalisation, it is essential to understand China's political dimension because it will help to explain the associated behaviour in conducting business. China has been a developing country with a socialist and centrally-planned economies since 1949. It was and still has the structured hierarchy of a Confucian-based society, in which those on the lower rungs of the ladder defer unquestionably to those higher up (Wong and Maher, 1997).

In 1978, China opened its door to the outside world, and adopted economic reform policies. The country was in transition from centrally-planned economy to a market economy. It is worth noting that, after the Cultural Revolution (1966-1976), China faced backward economic conditions and a serious shortage of capital. The country was in deep need of foreign exchange to finance its economic development activities. According to Jenkins and Henry (1982), in developed, mixed economy countries, most of the entrepreneurial investment has been generated by the private sector with government providing infrastructure and other selective help. But in most developing countries, governmental responsibility is much wider and has to undertake an entrepreneurial role to ensure that 'pioneer' activities are initiated. A greater degree of intervention by government is common in order to achieve material objectives because of the absence of a developed and innovative private sector.

In the Chinese context, the role of the government is essential and it was common to see the combination of government with business/enterprise function in the process of China's economic reform (until as recently as 1997, the Party Congress announced a separation of the roles of government and enterprises). To explain this phenomenon, it is important to understand that China adopted a planned-economy in the post-1949 period and resources allocation was fully controlled by the government with managers having little autonomy. Due to the traditional politics-command structure, branch secretaries of the Communist Party of China were responsible for operations rather than professional managers. These factors led to decision-making not necessarily based on economic rationality (Lu and Child, 1996; Zhang, 1999).

Wang (1990) makes this point strongly by claiming that China is still a Marxist state in which parallel decision making structures of party and state exist. Most obviously, this means that at all levels organs of government are shadowed and monitored by corresponding organs of the Communist Party, which have until very recently tended to dictate policy on all essential matters, and supervise its implementation. It has also meant, however, that individual party members and sometimes party cells have performed a similar function within state-owned enterprises (see for example, Huang, 1993; Lin, 1996; Lu and Child, 1996). Therefore, it can be argued that the Chinese approach to management and decision making were (and still are) shaped under the pre-reform centrally-planned economy.

In relation to the purpose of decision making in business, it is assumed in the West – though this may not always prove to be the case in practice – that decisions are made in a business organisation to improve production or sales or business methods in some way so as to increase the effectiveness and profitability of the firm (Porter

1996). In many enterprises in China this may only apparently be the objective, or may be only a partial objective (this can be seen in the case study presented in Chapters 6 and 7).

On the cultural side, the need to satisfy imperatives and the importance attached to family relationships also impact on decision making processes (Child and Lu, 1996; Porter, 1996). According to Porter (1996), cultural imperative in professional or business life in China is the need to promote the interests of the family and even of the extended family. Under the dynastic system, which prevailed until the early twentieth century, China was ruled by scholar bureaucrats who in practice sought to advance the interests of their extended families alongside the performance of their official duties. The philosophical justification of this lay with Confucius (551-479BC), who maintained that the family unit should be the foundation of all social and political life. Therefore, as a consequence, far more than is generally the case in the developed world, family interests have a great impact on decision making which can detract from the rationality of decision processes defined in organisational terms (Porter, 1996).

Many researchers who conducted studies of Chinese business share the view that *guanxi* is such an important element in decision making and foreign business people have become aware of the usefulness of *guanxi*. *Guanxi* implies special relationships or having connections with important or influential people for a continual exchange of favours (Chen, 1995). The relationship strongly implies a willingness to help out and acceptance of the right to ask favours, in return for which loyalty will be given.

In a society which has always been heavily bureaucratic, both in traditional and in modern times, *guanxi* is determining sources of information on which decisions are based, the scope and nature of routines followed in reaching a decision, and to a large extent the actual choice made. In this sense, a systematic and objective approach to the decision has been undermined (Porter, 1996; Zhang and Bulcke, 1996; Sergeant and Frenkel, 1998).

Child and Lu (1996) support this view. They further argue that apart from guanxi and the importance attached to family relationships, respect for age and authority, group orientation and 'face' (*mianzi*) are also the prominent elements of traditional Chinese culture. Together with the intervention of the governmental bureaucracy, often contribute to lengthy processes of negotiation both in the formation and the operation of foreign ventures in China.

Indeed, it is more difficult than in the West to see the development process as essentially rational, defined in terms of the goals of the organisation. Many development experiences of Chinese enterprises clearly demonstrate this phenomenon (Gang 1992; Huang, 1993; Lin 1996). The following chapters will examine the impact of Chinese political nature on the development of the hotel industry in general and its significant influence on a Chinese hotel company's internationalisation in particular.

## 4.2 The Effects of China's Economic Reform on the Tourism Development

Political factors play a critical role in the changing social and economic structure of contemporary society. China's reform and opening up provides a powerful motive for its economic development and for the development in all other domains. Twenty years ago, China was among the world's poorest countries, with 80 percent of the population living on incomes of less than US$1 a day and only a third of all adults able to read or write (World Bank, 1999). Prior to 1978, tourism in China primarily served the political purpose of promoting the achievement of Socialist China, to expand China's political influence, and to promote international understanding and friendship through receiving invited guests and tourists (Han, 1994).

After the Cultural Revolution (1966-1976), Deng Xiao-ping and Chen Yun became the supreme leaders of the Communist Party of China facing a serious situation of China's backward economic conditions and a shortage of capital. In 1978, the Third Plenary Session of the 11$^{th}$ Congress of the Communist Party (CPC) marked a crucial turning point of far-reaching significance in the history of the Party since the birth of the People's Republic of China. The policy of opening China's door to the outside world was introduced by Deng Xiao-ping and the principle economic decisions made by the Session were:

- To shift the focus of work to the economic construction of socialist modernisation,

- To reform the structure and system of management of the economy, and to enlarge the enterprise's initiatives in management,
- To solve the problem of serious imbalance in the national economy,
- To make active efforts to promote equal and mutually beneficial economic and technical co-operation with other countries and to strive for the introduction of foreign advanced technology and equipment.

China was involved in a highly centralised, planned economy before 1979. As the national economy developed, the rigidity of the planned economy structure and operating mechanism had retarded the development of socially productive forces. To correct this, China started to practise reform in the economic field from 1978. At first the contracted household responsibility system with remuneration linked to output was carried out, and socialised service systems were set up in rural areas. Reform was carried out in urban areas after 1984, trying to transform the operating mechanism of large and medium state-owned enterprises, to make them respond to the market and competition. Meanwhile, corresponding comprehensive reform has also been carried out gradually in the state's functions: economic management, planning, pricing, banking, wages and social security (Wang, 1994). China's economic reform involves two transitions which are from a *centrally-planned* to a *market-oriented economy,* and from a *rural and agricultural* to an *urban and industrialised* country.

The 10-year period of the Cultural Revolution from 1966-1976 made tourism development a non-issue (Zhang, *et al* 1999), and China was in deep need of foreign exchange to finance further economic development activities which was being promulgated in an era of economic reform. China, the world's third largest country with a huge population, glorious history, spectacular landscapes and splendid cultures, is a county which enjoys rich tourism resources. Tourism is a major generator of hard currency as most tourists come from the developed countries of the world which invariably have hard, that is, readily convertible currencies. Tourism is often seen as a labour intensive activity which provides more employment opportunities per unit of investment than other sectors of the economy. Tourism is also a contributor to Gross Domestic Product and National Income and government revenues (Jenkins, 1982).

The importance of tourism as a means for accumulating foreign exchange was recognised and emphasised by both Deng and Chen. Both of them delivered important speeches about the economic benefits of tourism. Deng argued that in developing tourism the priority should first be to develop those businesses which could earn more money. Chen supported this view by saying that tourism was just like the export of scenic spots, earning foreign exchange more quickly than the export of goods (Han, 1994).

In line with Deng and Chen's attitudes towards tourism, a call for 'a major effort to develop tourism' was made by the second session of the Fifth National People's Congress in 1979. In response to this call, the State Council held a national conference on tourism in September in Beidaihe. At this conference the policy of making 'a major effort to develop tourism' and making tourism serve the country's modernisation programmes were reaffirmed and a long-range plan of receiving 3.5 million international tourists up to 1985 was worked out. The Beidaihe conference can be taken as the starting point of China's tourism boom (Wang, 1994).

In 1983, the first China International Tourism Conference was held and China became a member of World Tourism Organisation (WTO). A close relationship with tourism professional bodies has also been developed since then (Wang, 1994) and national tourist offices abroad, such as London, Paris, Tokyo, and New York have been established. However, it is worth noting that during the period 1979-1985, the Chinese leaders regarded the nature of tourism as both political and economic to achieve a "double harvest" in both the political and economic spheres (Han, 1994). Similarly, Zhang (1995) notes that the nature of tourism was politics plus economics from 1978 to 1985.

It is important to note that the management system for tourism operation units had also been changed due to economic reform. According to Han (1994), the corporate management concept was initiated by Deng Xiao-ping, which meant

a) separation of tourism enterprises from administrative bodies where autonomy on personnel, finance and operational matters was granted to a certain degree from higher administration;
b) manager command rather than the Party secretary command where the manager replaced the Party secretary with the responsibility for overall management; and
c) rewarding staff based on their performance.

Since then, most travel services, companies and hotels have become enterprise bodies, to avoid bureaucracy and to improve the quality and standard of the service by expanding their business and maximising the economic benefits for the country.

From the 1980s, Chinese tourism policy became increasingly concerned with the economic benefits to China of foreign tourism whereas the main emphasis used to be on the political benefits to China. The Chinese central government has made tremendous efforts to promote the development of tourism in which special economic zones were established, coastal cities were opened and many other cities and government units were also opened to the outside world.

In December 1985, the Seventh Five-Year-Plan of China's national economic development (1986-1991) allocated US$3.5 billion for investment in tourism resources development and infrastructure provisions. Tourism was declared to be a comprehensive economic activity with the direct purpose of earning foreign exchange for China's modernisation (Han, 1994). This event was a significant benchmark for tourism development in China as the attitude of central government shifted from both politics and economics to economics over politics (Zhang, *et al* 1999). A complete tourism administration system was built in the whole country and tourism organisations have been strengthened.

It is worth noting that in the spring of 1992, Deng Xiao-ping delivered his speech of speeding up and intensification of economic reforms during his trip to the south of

China. Consequently, the policy of establishing a 'market economy under socialism' was adopted by the 14th Communist Party Congress in October 1992 and resulted in tourism became an economic activity which is driven by market forces.

**Table 4.1: Annual International Visitor Arrivals, 1978-1998**

| Year | Total | Foreigners | Overseas Chinese * | Compatriots * | Taiwan |
|---|---|---|---|---|---|
| 1978 | 1,809,221 | 229,646 | 18,092 | 1,561,483 | |
| 1979 | 4,203,901 | 362,389 | 20,910 | 3,820,602 | |
| 1980 | 5,702,536 | 529,124 | 34,413 | 5,138,999 | |
| 1981 | 7,767,096 | 675,153 | 38,856 | 7,053,087 | |
| 1982 | 7,924,261 | 764,497 | 42,745 | 7,117,019 | |
| 1983 | 9,477,005 | 872,511 | 40,352 | 8,564,142 | |
| 1984 | 12,852,185 | 1,134,267 | 47,498 | 11,670,420 | |
| 1985 | 17,833,097 | 1,370,462 | 84,827 | 16,377,808 | |
| 1986 | 22,819,450 | 1,482,276 | 68,133 | 21,269,041 | |
| 1987 | 26,902,267 | 1,727,821 | 87,031 | 25,087,415 | |
| 1988 | 31,694,804 | 1,842,206 | 79,348 | 29,773,250 | 437,700 |
| 1989 | 24,501,394 | 1,460,970 | 68,556 | 22,971,868 | 541,000 |
| 1990 | 27,461,821 | 1,747,315 | 91,090 | 25,623,416 | 948,000 |
| 1991 | 33,349,757 | 2,710,103 | 133,427 | 30,506,227 | 946,632 |
| 1992 | 38,114,945 | 4,006,427 | 165,077 | 33,943,441 | 1,317,770 |
| 1993 | 41,526,945 | 4,655,857 | 166,182 | 36,704,906 | 1,526,969 |
| 1994 | 43,684,456 | 5,182,060 | 115,245 | 38,387,151 | 1,390,215 |
| 1995 | 46,386,511 | 5,886,716 | 115,818 | 40,383,977 | 1,532,309 |
| 1996 | 51,127,516 | 6,744,334 | 154,601 | 44,228,581 | 1,733,897 |
| 1997 | 57,587,923 | 7,428,006 | 99,004 | 47,943,337 | 2,117,576 |
| 1998 | 63,478,401 | 7,107,747 | 120,704 | 56,249,950 | 2,174,602 |

Source: The Yearbook of China Tourism Statistics (1999).
Note: * Overseas Chinese from elsewhere
*Compatriots from Hong Kong and Macao.

Given the emphasis upon tourism as a part of China's development strategy, international tourism markets have been expanded and tourist flows increased. The number of the international arrivals increased every year and by the end of 1997, the total number of international visitor arrivals reached 57, 587, 923 million (see Table

4.1). The total international tourism receipts was increased from US$263 million in 1978 to US$12,6 billion in 1999 (The Year Book of China Tourism Statistics, 1999). Indeed, since the tourism industry was established as an economic business, it has developed significantly and made a great contribution to the Chinese economy.

Wood (1979) states that the heart of the mass tourism industry is the hotel sector. One of the most dramatic international tourism developments that figures prominently in the Chinese cultural landscape is the construction of tourist hotels (Yu, 1995). It is worth noting that when China first opened its doors to international tourists in the late 1970s, the sudden influx of overseas tourists created great demand for China's undeveloped lodging industry. China suffered from a shortage of suitable hotels for foreign tourists. In accordance with the expansion of tourism in China, there has also been a corresponding boom in the hotel industry which will be reviewed and examined in the following sections.

## 4.3 The Development of China's Hotel Industry

### 4.3.1 Historical Background

When China first embarked on international tourism development after the introduction of its open door policy, it suffered from a shortage of lodging accommodation which could meet western hospitality standards. This was due to the fact that in China, most hotels were built either before 1936 by Westerners or during the 1950s by the Soviets. There were a few accommodation units of international standard called not hotels but 'guest houses' which were used by the Chinese government to host invested guests. In China two words describe different hotels – the word *Luguan* refers to the lower standard accommodations used by Chinese citizens, and *Binguan* refers to high-level lodging facilities used by foreign visitors (Zhao, 1989).

Before 1978 only a few cities in China had *Binguan*, and these *Binguan* were not commercially operated, most of them were built in the 1950s in Russia architectural style and equipped with 1950s technology. The *Binguan* staff did not know what functions a hotel should have or what a hotel is, not surprisingly, they were unable to provide international standard services to foreign visitors. The figure of total hotel beds in 1978 was 88,100 (China National Tourism Administration, 1990). Without any doubt, lack of equipment, facilities and services required for modern mass tourism hindered tourism development.

Due to the shortage of suitable hotels, it was difficult for foreign tourists to find lodging accommodations, particularly in the most-visited destination areas, such as in Beijing, Shanghai, Xian, Guilin, and Hangzhou. Many tourists who had reservations at the Beijing Hotel were told upon arrival that it was overbooked and that they had to look for lodging facilities elsewhere in the city, or even in the small towns outside Beijing. Sometimes, these unlucky tourists had to be transported to Tianjin, a municipality 138 km from Beijing, for overnight accommodations (Yu, 1992). The lack of adequate lodging facilities drew constant complaints from international tourists and criticism from the international travel industry (Cook, 1989; Schrock, *et al* 1989). The development of lodging facilities with western standards thus became an urgent and critical issue concerning the future success of China's burgeoning international tourism industry.

In 1979, in order to meet the needs of tourism development, the State Council invested US$44 million to build 30 hotels with a total of 17,000 beds. At the same time, the state council ratified the plan to build some hotels by joint venture with foreign countries (Uysal *et al* 1986). The hotel sector was the first industry permitted foreign investment. At that time, tourism infrastructure and facilities could not cope with the development of tourism as an economic activity mainly because demand outstripped the supply of facilities and service (Zhang *et al*, 1999). In relation to the hotel industry, it is clear that a serious problem at that time seemed to be the undercapacity of the hotel industry.

### 4.3.2 Government Policies and the Hotel Development

In order to cope with increasing international arrivals, to accelerate hotel development and to meet the demands of international tourists, the Chinese government initiated strategies for : a) attracting foreign investment b) opening up of state guest houses, and c) encouraging the domestic investment.

#### 4.3.2.1 The Role of Foreign Investment

Due to the market situation, building enough hotel rooms was a top priority in China's international tourism development during the early part of the 1980s. At that time, the Chinese government encountered substantial financial difficulty in financing hotels with western amenities, services and management, and the private sector was unable to support. Facing all these problems, a preferential policy towards hotel investment was established by the government in which all foreign invested hotels were exempt from tax for the first three years and this exemption was reduced to 50% for the following two years. However, only two forms of foreign investment were permitted namely joint ventures and co-operatives, where ownership of these investments would be transferred to the Chinese side after 10-20 years (Han, 1994).

The joint venture programme was first initiated in July 1979, when China's National People's Congress passed the Law of the People's Republic of China on Joint Ventures with Chinese and Foreign Investment (Liu, 1980). Joint ventures can offer a number of economic and managerial advantages. Partners investing in a joint venture can share risks, seek complementary contributions of technology and know-how, overcome barriers to entering a host-country market, and establish a strategic position which reduces opportunities for competitors (Root, 1987; Contractor and Lorange, 1988; Young *et al,* 1989). Joint ventures can also be an effective vehicle for improving management by transferring tacit knowledge from one partner to another (Hennart, 1988).

A joint venture is a partnership between foreign investors and Chinese counterparts for the purpose of developing and operating international standard hotels. Typically, the foreign partner provides half of the capital investment, building design, equipment, and management expertise; while the Chinese counterpart contributes land, building materials, labour and construction. The share stocks were generally divided 51% / 49%, with the Chinese partner controlling the larger share, and both parties share profits as well as risks (Yu, 1992)). In management, expatriates were generally appointed to manage and supervise the operation and to train Chinese managerial personnel and service employees in the initial five years of hotel operation. After five years management responsibility becomes primarily Chinese. As Pine (1992) highlighted, this policy served not only to attract badly-needed financing from overseas, but also service management know-how as technology transfer.

Foreign investors were attracted to China by the size of the market, enticing tax and investment incentives, and low labour costs. According to Liu (1980), under the joint venture investment policy, once the occupancy rate reaches 80%, all investment costs can be returned in three or four years and the investment interest rate was over 30%.

The government investment capital was usually provided as interest-free loans so there was little incentive for investment organisations to consider the best time and place for constructing hotels, or the reasonable size or class of hotels. Despite the fact that this policy has made a remarkable change in China's hotel industry, and brought great opportunities to foreign investors to invest in China, it also caused many problems.

The first joint venture hotel, Jianguo Hotel in Beijing, built in 1982 with a total capital investment of US$22.29 million, proved to be an instant success. In the first six months of operation the hotel generated a gross income of US$7.66 million (Yu 1992). With the success of the pilot project, many overseas developers and hotel management chains have shown great interest in the Chinese market. By the end of 1987, six years later, 162 joint ventures came to the market, and a further 160 joint venture hotels were under construction or to be built (Zhang, 1989). As Yu (1992) summarised, the years from 1978 to 1982 were a period of rapid development in which demand greatly exceeded supply. Beginning in 1984, lodging development caught up with levels of overseas tourist arrivals, and the annual growth rate of hotel beds kept pace with tourists arrivals in 1985. After 1986, the balance between tourist demand and hotel supply titled, and for the first time, hotel overprovision became a development problem confronting the Chinese government.

This is because China's old system of economics and politics failed to control hotel development in the right way. The ministries and higher government officers are at liberty to decide hotel projects in the main tourist cities at will, and the organisation of hotel construction is irrational. It is important to note that there is no central institution charged with hotel affairs. In his study, Zhao (1989) indicates that the tourism authorities are charged with the reception of foreign visitors. The Commission of Foreign Trade is charged with introducing foreign capital. China Bank has responsibility for managing and dealing with foreign currency. Not one of them is really concerned with hotel construction. As a result, more and more hotels are planned and built without an overall planning scheme. Few hotel projects were planned using suitable market research.

It is worth noting that when the growth rate in number of hotels exceeded the growth rate of foreign arrivals, the development of transportation could not keep pace with the hotel boom. The transportation capacity in and between most tourist cities was still limited which caused low occupancy rates at top tourist cities like Shanxi and Guangxi (Tisdell and Wen, 1991). This development phenomenon demonstrates that in China's tourist industry, tourist hotel policy is made under the government leaders' incorrect assumption that the tourist industry is mainly the hotel industry. Other tourism components were ignored or not being given the proper attention.

With the levelling-off of overseas arrivals and political turmoil in 1989, joint venture hotels (most of them are luxury products) were the first to be affected by a drastic decline in room sales, and hotel occupancy rates dropped substantially in the major destination cities (see Table 4.2). Occupancy rates of joint venture hotels between 1988 and 1989 decreased by 10-30% in the popular tourist destinations. In response, average hotel tariffs were drastically reduced, and luxury hotels in China offered overseas travel agencies very cheap rates, for example, the Xian Jianguo Hotel charged only US$15.00 for a double room in 1989 (Hunt, 1990). Some hotel closed part of their operations and laid off some expatriate staff members to reduce operational costs.

During that time, there were many accounts of conflict and disagreement between joint venture partners. As Beamish and Speiss (1992, p.160) state "The joint venture process in China is different from that in developed countries and different than with joint ventures in developing countries which have market economies. These differences stem as much from politics as they do from short time period in which the regulatory infrastructure has been enacted". What caused the strained relationship between the joint venture partners will be further analysed in section 4.3.1

**Table 4.2: Occupancy Rate of Selected Joint Venture Hotels in China, 1988-1989**

| | | | | Occupancy (%) | |
|---|---|---|---|---|---|
| **City** | **Hotel** | **Total Rooms** | **Total Beds** | **1988** | **1989** |
| Beijing | Beijing-Toronto Jinglun | 695 | 1350 | 83.9 | 58.8 |
| | Holiday Inn Lido | 1029 | 1581 | 82.5 | 58.7 |
| | Jianguo | 461 | 570 | 87.9 | 64.5 |
| | Shangri-la International | 775 | 1212 | 76.0 | 48.0 |
| | Sheraton Great Wall | 1007 | 1659 | 73.3 | 43.5 |
| Guangzhou | China Hotel | 891 | 2000 | 79.8 | 67.2 |
| | Garden Hotel | 1112 | 2224 | 57.6 | 44.4 |
| Guilin | Guilin Garland Hotel | 300 | 600 | 53.1 | 25.7 |
| Hangzhou | Dragon Hotel | 557 | 1049 | 54.4 | 38.4 |
| | Shangri-la International | 387 | 686 | 61.7 | 50.3 |
| Shanghai | Huatin Sheraton Hotel | 1094 | 2168 | 54.6 | 33.0 |
| Xian | Golden Flower Hotel | 200 | 400 | 56.4 | 38.4 |

Source: The Yearbook of China Tourism (1990).

Besides direct foreign equity participation, contractual agreements is the other form of foreign involvement in China's hotel development (Oudiette, 1990). Multinational hospitality corporations are the product of rapid globalisation of trade and tourism which began in the 1970s (UNCTC, 1988). In order to capture a share of the growing global hotel industry market and to develop brand loyalty worldwide, many hotel chains have crossed national boundaries to expand their markets (Go, 1989).

However, transnational hotel corporations have been cautious in expanding business into developing countries. Political risk, uncertainty of the economy, and market potential are the major concerns confronting multinational hotel companies. As a development strategy, many hotel chains prefer contractual arrangements to direct equity ownership (McNulty and Wafer, 1990; Go *et al.*, 1995;). Therefore, multinational hotel companies vigorously promote management contracts and franchising in developing countries. In China, the practice of management contracts is very common in the hotel industry. Multinational hotel chains were considered as the supplier of contemporary management expertise, one of the strategic aspects of China's open door policy. This form of co-operation, therefore, was particularly encouraged by the Chinese government in the early 1980s.

Before the arrival of foreign hotel management companies, China's hotel industry had little exposure to international management and service standards. Poor hotel management and inadequate hotel service were the major complaints from overseas tourists. Foreign management companies can provide systematic management practice and provide adequate training for local employees serving international tourists. Moreover, foreign management companies can also tie the hotels in China into their international reservation system and increase hotel sales to overseas travel agencies. Therefore, the Chinese government promoted this form of hotel development and management enthusiastically in the early and mid-1980s.

The introduction of foreign investment and management know-how made a great impact on China's hotel development (Yu, 1992). However, this also resulted in some development problems in which the industry was heavily dominated by foreign hotel chains and leakage of tourism revenue emerged. The preferential treatment of foreign investment also led to the issue of unequal competitive position (Pine *et al* 2000) which affected the development of Chinese-owned hotels. Concerns about these issues led China to start developing its own hotel companies. Therefore, it can be argued that the domination of multinational hotel chains in China acted as a stimulator for developing indigenous Mainland Chinese hotel chains.

**4.3.2.2. Opening up State Guest Houses**

Opening up of the state guest houses and exclusive resorts was one of the first measures taken by the Chinese government to ease the hotel shortage problem. Since the founding of the People's Republic of China in 1949, the Chinese Communist Party (CCP) and the central government have developed many large, world-class lodging facilities and resorts in the country for the purpose of accommodating foreign leaders and dignitaries. They were also used by the top party and government leaders as vacation homes and travel accommodation. These lodging facilities and resorts are commonly known as "state guest house". They were equipped with modern amenities and luxuries, and were guarded by uniformed soldiers who kept them off limits to the general public (Yu, 1995).

When the shortage of hotels became a big obstacle in the late 1970s, the central government decided to open up parts of many state guest houses for international tourists, in part because most state houses were under-utilised. Consequently, state guest houses throughout the country adjusted their operations to service international tourists. This strategy has had considerable impact on the development of China's hotel industry. Obviously, the opening up of China's most exclusive state guest houses alleviated international tourists demand for lodging facilities. More importantly, the policy of opening up these guest houses has turned these heavily subsidised government enterprises into profit making properties. This partial conversion from diplomatic to commercial use reduced the financial burden on the government (Yu, 1995).

Between 1979 and 1982, the speed of hotel construction was moderate, and the increasing rate of provision of hotel beds were lower than the increasing rate of tourist arrivals. From 1978 to 1982, a total of 25,760 new beds were added, and 14,000 beds were acquired by the tourist industry from the Chinese government's state guest houses. Table 4.3 shows the changes in numbers of hotel beds and visitor arrivals in China in 1978-1989.

**Table 4.3: Hotel Beds and Visitor Arrivals, 1978-1989**

| Year | Beds Total | Annual Changes (%) | Total Visitor Arrivals | Annual Changes (%) |
|---|---|---|---|---|
| 1978 | 88100 | - | 1809221 | - |
| 1979 | 91210 | 3.6 | 4203901 | 132.4 |
| 1980 | 95300 | 4.5 | 5702536 | 35.5 |
| 1981 | 104410 | 9.6 | 7767096 | 36.2 |
| 1982 | 113860 | 9.0 | 7924261 | 2.0 |
| 1983 | 122696 | 7.8 | 9477005 | 19.7 |
| 1984 | 171888 | 40.1 | 12852185 | 35.6 |
| 1985 | 242664 | 41.2 | 17833097 | 38.8 |
| 1986 | 332114 | 36.9 | 22819450 | 27.9 |
| 1987 | 400727 | 20.7 | 26902267 | 17.9 |
| 1988 | 478321 | 19.4 | 31719348 | 17.9 |
| 1989 | 580913 | 21.5 | 24501394 | -22.8 |

Source: The Year Book of China Tourism 1990.

#### 4.3.2.3 Domestic Investment

Prior to 1978, civil aviation, travel agencies and hotels were funded and operated by the central government. In 1984, the State Council decided that central government, localities, individual government departments, collectives and even individuals could invest in and operate tourism development projects (Han, 1994).

The decentralisation policy stimulated domestically owned hotel development. This was reflected in provincial and local government tourism agencies' involvement in developing new hotels, other government departments and even private investors seized the opportunity and invested in the lodging industry. Hotels built by the collective farmers and the People's Liberation army are examples to illustrate such development. (Yu, 1995). However, with the emergence of luxury and western-style hotels through foreign investment and joint ventures in the late 1980s, many hotels built by non-tourism government agencies and collective investors, were reduced to receiving only domestic tourists and conferences due to their inadequate management and services.

Hotel development by various government agencies at different levels, and by collective and private investors, has contributed the most to the formation of the contemporary hotel landscape in China (see Table 4.4). Of the 5,782 hotels recorded in China by 1998, over 62 percent were state-owned. This indicates that China is still a largely socialised economy with central planning and public ownership. As a developing country, the Chinese government has played an essential role in developing China's hotel industry. The increased hotel numbers and hotel beds can be regarded as one indicator of the growth. As mentioned before, there were only 88,100 hotel beds in 1978 when China just opened its door to the outside world, and by the end of 1998, the number increased to 1,524,224. Apart from State-owned and foreign investment, more bodies are permitted by the government to participate in the hotel development.

**Table 4.4: Breakdown of Hotels by Ownership 1998**

| Ownership | Number of Hotels | Number of Rooms | Number of Beds | Percentage % of hotels |
|---|---|---|---|---|
| State Owned | 3,639 | 456,300 | 930,379 | 62.9 |
| Collective | 859 | 74,528 | 151,453 | 14.9 |
| Private | 153 | 8,729 | 17,612 | 2.6 |
| Alliance | 155 | 57,538 | 122,220 | 2.7 |
| Stock | 282 | 34,507 | 66,216 | 4.9 |
| Foreign invested | 458 | 87,308 | 154,427 | 7.9 |
| Hong Kong, Macau and Taiwan invested | 236 | 45,888 | 81,917 | 4.1 |
| Total | 5,782 | 764,797 | 1,524,224 | 100 |

Source: The Yearbook of China Tourism (1999).

### 4.3.3 Manpower and Training

During the 1980s, the international hotel industry exploited market segmentation, product differentiation, corporate diversification and other sources of competitive advantage to the fullest. However, in the early 1990s, conditions have changed significantly because, with across-the-board deregulation, a boom in new technologies, and foreign competition, a company's technological or financial edge can be lost overnight. As a consequence, survival in the international hotel industry depends upon developing well-qualified, thoroughly-trained staff focused on providing quality service to customer (Normann, 1984; Heskett, 1986).

The hotel industry is a labour intensive industry with an emphasis on personal service. To provide quality service employees have to be properly trained, motivated and supervised. Though it is costly, training is a necessity because the moments of truths or the impression, both positive and negative, an employee makes on the guest have a direct influence on whether the guest will return. Nowadays, customers are becoming more sophisticated and demanding, especially as far as receiving 'value for money' is concerned. The level of competency and sophistication of hotel employees requires that their training and skill levels have to match the more complex and demanding tasks to be performed. Thus, the hotel industry is likely to become more 'knowledge-intensive' and personality-intensive' (Go and Pine, 1995).

Therefore, as Horwath and Horwath (1988, p.24-25) state " education and training are seen as the cornerstones of future success in hotel keeping.... Education is not just within hotels and hotel colleges, it starts with educating the public and career advisors that hotels are worthwhile in terms of successful long term employment. Then there is the need for adequate and professional education and training tailored to the needs of each category with hoteliers playing a significant role in liaison with education.... The resources that need to be devoted to human resources need to be increased and must be viewed as worthwhile long term investment."

Training is a critical factor in the long-term success of international hotel corporations, because well-trained staff enhance the customer experience, add value to the travel and tourism product, improve the image of the corporation, and advance their own career development (EIESP, 1991). Strictly speaking, there was no tourism education in China before 1978, and at the college level, there was not a single course or a single textbook about tourism and hospitality. It has developed from scratch with the growth of tourism. Up to the end of 1986, there were 4 tourism institutes, 10 universities and colleges, 4 tourism secondary schools and 189 vocational schools which offered courses relating to tourism (Zhang, 1987). Among the employees recruited between 1980 and 1989, only 27,800 or 6.3% received formal education in the schools or colleges conducting hospitality and tourism education programmes (Tao and Chang, 1989). The low percentage many indicate that the total number of graduates is inadequate to meet the demands of the dramatic growth of international standard hotels. In order to fully develop the tourism industry, educators have proposed that formal training in a hospitality discipline is the key link (Editorial, Tourism Tribune, 1988).

In the hotel industry, to provide quality service, employees have to be properly trained, motivated and supervised. Training, is essential because the 'moment of truths' or the impressions, both positive and negative, an employee makes on the guest have a direct influence on whether the guest will return. Therefore, along with the growth of tourism, hospitality and tourism education in China has developed at a rapid pace. Currently, there are three levels of hospitality education in China:

- Vocational schools train hotel attendants at the senior high school level. Students divide their course time equally between general education and hotel and restaurant service application course.

- Secondary professional schools are special skill-training schools, which concentrate on training hotel personnel in service, supervision and culinary arts. The course work is made up of 3-4 years of professional level special skills training. Most of the graduates become salaried professional employees in the industry.

- Institutes of higher education (universities and colleges) train personnel for higher level industry management positions (Zhao, 1991).

Few developing countries can expand and sustain the hotel industry without using foreign expertise. The use of foreign expertise is often the only means of jumping the development gap between the level of indigenously available management and technical skills and the level of experience and competence needed to organise and sustain an international standard industry. In the short term, the use of foreign nationals in the tourist sector must be regarded as one of the costs of development, although terms of contract might well create an identifiable elite which can cause social and political pressure. In the long term, an integral part of development strategy will be, wherever and whenever possible, to replace foreign employees by local people (Jenkins and Henry, 1982).

It is unlikely that the potential opportunities for local employment will be fully realised without active government intervention. There is an argument that governments should have policies for tourism both at the national and local level (Hall, 1994). In countries with a newly developing tourism industry, governments often incorporate manpower planning as an integrated part of national or regional tourism development planning (Inskeep, 1994). Using foreign nationals came to be regarded by the Chinese government as one of the costs of hotel development, and an integral part of development strategy is possibly to replace foreign employees by local people. In order to accomplish this objective, the Chinese government gave priority to progress higher education for the hospitality industry.

Higher education in hospitality began in 1980, when the China National Tourism Administration invested RMB 1.8 million (Chinese currency, equal to 1 million U.S. dollars in 1980) in the Beijing Second Foreign Language Institute to establish the first Tourism Economy Development in China (Zhao, 1991). The rapid growth of the hotel industry increased interest in establishing hospitality programmes in universities and colleges throughout China. In 1986, China had 14 higher learning institutions offering hospitality programmes with a total enrolment of 2,426 students (Zhang, 1987). The Year Book of China Tourism (1999) indicates the figure of total universities and colleges by the end of 1998 was 187, with a total number of students of 32,737. These figures probably could predict that China is going to have more qualified hospitality personnel with a college or university education background. It is worth noting that the numbers of vocational and professional schools were also increased, from 193 in 1986 with an enrolment of 28,828, to 722 schools in 1998 with a total number of students of 201,060.

Since 1980, many faculty from tourism and hospitality departments have visited the U.S., Europe, Hong Kong and Southeast Asia to study their hospitality programmes and experience (Zhao, 1991). Many imported teaching materials of tourism and hotel courses have been used in the universities and colleges. Foreign experts and professors have been invited to give lectures, particularly in the fields of marketing, strategic management, human resource, and hotel operational management.

The Chinese government emphasised training skilled and qualified hospitality personnel. This active intervention aimed to increase the skills and efficiency of the workforce, to deploy the trained manpower properly, so that eventually the indigenisation of management can take place. Thus, several hotel groups had a strong localisation policy in their owned or managed hotels in China. McQueen (1983) suggests that both formal education and experience of working in international-oriented hotels are essential in developing hotel personnel who are capable of providing an international standard of hotel service.

Jenkins and Henry (1982) suggest that specialist training must be sought abroad because of the lack of advanced training facilities in most developing countries. In order to localise management effectively, most multinational hotel chains (MNHCs) invested a substantial amount of resources in training. Cross-training by sending local Chinese to Hong Kong and Singapore for management training and international exposure was common in, for instance, New World, Sheraton and Holiday Inn.

Also, several MNHCs established their own hotel training school in China. For instance, the Palace Hotel School of the Peninsula Group in Beijing, the Holiday Inn

University of the Holiday Inn Group, the Hospitality Management Training Centre of the New World Group in Guangzhou. Most of the hotel schools provide training for operational skills, and there are also management development programmes in some of them (Go and Pine, 1995).

One of the main attractions of tourism development is said to be the relatively labour-intensive nature of the activity. To make certain that nationals are able to take advantage of career opportunities in tourism, government must ensure that there are suitably educated and trained people available. It does not necessarily follow that government has the sole responsibilities for education or vocational training. The private sector can also participate in this programme and give certain support.

As the local-for-foreign labour substitution takes place in China, one would expect to see a reduction in the foreign exchange used to employ foreigners. The position is complicated, because the foreign exchange saved by labour substitution will not be without a cost. It is probably true that much of the training for local people will have to be done by foreigners and this should be offset against the saving made. In the long term, probably more significant than the saving of foreign exchange will be the nonquantifiable effect of having an indigenous management cadre (Jenkins and Henry, 1982).

## 4.4 Lessons to Learn

### 4.4.1 Development Problems

Over the period 1978-1987 China has experienced a boom in hotel construction which has outstripped the growth rate of tourist arrivals from abroad. But, at the same time the development of air, rail and road transport could not keep pace with the hotel boom, it induced transport bottlenecks which caused pressure on the accommodation. The organisation (government) of the hotel industry was irrational and resulted in overcapacity of hotels in main tourist cities. One area of oversupply was in joint venture hotels (luxury hotels). Hotel overprovision became a development problem confronting the government, and the hotel industry moved from a buyer's market to a seller's market (Yu, 1992).

In order to solve the problem, on 17 April 1988, the China National Tourism Administration (CNTA) announced that joint venture hotels with foreign investors will not be permitted to be built in the main tourist cities of Beijing, Shanghai, Guangzhou, Guilin, Xi'an and Hangzhou in the short-term. Meanwhile, the CNTA called for a readjustment in the structure of hotel industry in China, all hotels had to obtain a license from CNTA before they could operate (Zhao, 1989, EIU, 1989). This announcement heralded a new phase in the development of the hotel industry in China with the hotel boom being brought to a temporary close.

A direct effect of the hotel boom was the irrational structure of the hotel industry as demonstrated by the oversupply of high standard hotels. Because of the high investment cost per room for luxury amenities, these hotels have to charge a high room rate. This includes the moderate and budget travel market segments, leaving their appeal exclusively to business travellers, high - income individual tourists, and deluxe leisure groups. Zhao (1989) indicates that of hotels in 15 tourist cities, 70.4% were in the four-star and deluxe category. His study also found that 35% of the tourists stayed in economy class hotels, 60% in middle class accommodation and only 5% in luxury hotels. Consequently, this led to low occupancy rates of high standard hotels, and some luxury hotels had to drop their room rates to attract customers.

In spite of the oversupply of hotels in terms of buildings, hotels in the tourist season were still not available, especially low and middle class hotels were in short supply. *Luguan* (lower standard for Chinese citizens) were also in short supply. In 1987, the in-out flow of domestic tourists to Beijing was one million per day while the number of *Luguan* reached 3900 with 430,000 beds. Obviously, the demand greatly exceeded the supply (Zhao, 1989). In most cities, the same situation occurred, oversupply of hotels versus undersupply of low and middle class accommodation.

This was an inefficient time for the Chinese hotel industry resulting in a vicious circle – in the main tourist cities, most hotel beds are idle in the off-season implying an oversupply of hotels, and the peripheral areas will then not be considered for development. Hotel shortage of low and middle class hotels still remain while more luxury hotel rooms stand vacant (Zhang, 1989; Zhao, 1989; and Tisdell *et al* 1991).

It is interesting to note that according to the Year Book of China Tourism Statistics (1999), there were 6.94 billion Chinese people participated in the domestic travel in 1998, but the total number of economic and budget hotels in China was 5,542 with 1,364,670 beds. If taking Chinese people's income into the consideration, they are unlikely to consume expensive lodging. Paul Dubrule, the chairman and founder of Accor group in Accor Annual Report (1998) notes that the most profitable segment is economy and budget hotels because it is the least capital-intensive and the least subject to cyclical variation. It is hoped that this can draw a lesson to the Chinese government and Chinese hoteliers in relation to the China hotel industry's future development.

Over-expansion of accommodation (often of a type not in popular demand) and the imbalance in the provision of tourist facilities have arisen for a variety of reasons. First, there was a wave of optimism among Chinese Communist Party leaders about the economic prospects for foreign tourism in China. This can be illustrated by the widespread availability of soft loans and grants for hotel construction. As mention in section 4.2.2, loans have been at interest rates below the rate of inflation. Inability to repay loans rarely results in foreclosure of political considerations. Thus hotels were under little pressure to take account of market realities, which led to the building of hotels without adequate analysis of demand or adequate project appraisal and did not make for economic responsibility (Zhao, 1989).

Decentralisation in decision making in these circumstances resulted in severe lack of co-ordination in decision making in the provision of hotels especially since so many different bodies within China can build hotels, e.g. foreign investment, Chinese central government, local government, government departments, collectives. While in principle, bodies building hotels are required to obtain the approval of the Chinese central government, this has not always been necessary and constraints do not appear to have been systematically and strongly imposed (Tisdell and Wen, 1991). So, lack of economic discipline both by markets and the Chinese central government occurred.

Tisdell (1990) identifies a further factor leading to poor decision making in the supply of hotels - failure to separate hotel management and ownership (that is, the trustees of the investment for the people). Since the trustees were motivated by political rather than economic considerations, it led them to favour the building of hotels in their own locality, or in areas favoured for personal reasons. It resulted in their detrimental interference with management, and it caused cultural conflicts, which led to very unpleasant relations between the two parties. Howell (1992) notes that government agencies play a most significant role, and they can generate some inflexibility in both the negotiation and operation of foreign invested firms.

While China maintains socialist principles in economic development, Chinese managers were generally political appointees, they had to reach physical performance targets and their decisions had to take account of multiple criteria which derived from social and political considerations as well as economic requirements. The authority system under which many Chinese managers spent their formative years was characterised by a considerable level of vertical dependency, and there was only a small amount of formalisation in terms of procedures, definitions of responsibility, performance criteria and the like (Child and Lu 1996). By contrast, the approach to management which has developed in the market economy emphasises competence for the job, devolved strategy-formulation, formalised organisational procedures, and financial performance criteria. In the case of joint venture hotels, the Chinese approach was largely shaped under the pre-reform centrally planned economy, which led to strained relationships, conflicts and disagreements. The key differences between the Chinese approach to management and that fairly typical of the Western international corporation are set out in Table 4.5.

**Table 4.5: A Comparison of Chinese and Western Approaches to Management**

| **Concepts and practices** | **Chinese management under a centrally planned economy** | **Western management under a market economy** |
|---|---|---|
| Corporate governance structure | Planning authorities acting on behalf of state ownership | Boards of directors acting on behalf of shareholders |
| Decision-making authority | Industrial bureaus or ministries | Boards of directors and CEOs |
| Managerial autonomy | Little before the reform, much improved now | CEO enjoys autonomy under the board |
| Organisational performance criteria | Multiple rationality – economic, political and social obligations | Economic rationality tempered by social responsibility |
| Degree of procedural formalisation | Low formalisation, but highly personalised processes | Highly formalized and relatively impersonal |
| Information communication | Mainly vertical; little horizontal flow | Multi-directional |
| Management training and development | Not emphasised before mid-1980s | Highly emphasised |
| Reward policies and incentive systems | Rewards dependent on age and long service; incentives not closely related to performance | Performance-related |

Source: Child and Lu (1996).

In the case of luxury hotels oversupply, government officials heavily influenced the type of hotels being constructed. The Chinese government wrongly estimated foreign tourists demand for luxury hotels and believed the high tariff of luxury hotels would bring more foreign exchange. However, a lack of co-ordination and the unintended consequences of the hotel mismatch were acknowledged by the government (Zhang, *et al*, 1999). In relation to future development, the government should focus its attention on the planned and co-ordinated development for a real economic gain.

### 4.4.2 Quality of Service and the Issue of Education

The lack of international service standards is a pervasive problem throughout China. Many writers are critical about the standard of service in Chinese hotel industry. Choy *et al* (1986) note that by comparison with world standards, Chinese tourist conditions and service standards are low. Culllen (1988) comments that China's major problem in developing viable international hotel businesses would seem to be in these very areas of service and standards. He further states that, while there are some exceptions, few hotel and restaurant employees in China have any idea of international standard. Mediocre food, facilities and service are common.

Cook (1989) blames a variety of factors for the problems and delays in developing the industry, among which are infrastructure, poor communication systems, lack of national investment, poor sanitation, and levels of training and education. He argues that the lack of adequate training and vocational schools, government funding and a Western-style real estate industry inhibits the growth of the Chinese tourism industry.

Indeed, serving others in a formal employment context in China has traditionally been regarded as demeaning because it has been associated with servitude. A consequence of this was the lack of standards of service on which many foreign visitors commented. There is not a tradition of hospitality towards foreign visitors of the type which many of them come to expect. Interacting with service personnel was a primary way in which visitors from impressions and make judgements about the Chinese hotel industry. The differences in expectations regarding service level left many negative impressions of China among foreign visitors.

Commentators (Choy, 1984; and Choy *et al* 1986) suggested three primary reasons for the poor quality of service in addition to the traditional perceptions that service jobs are demeaning. First, there is a lack of understanding and appreciation of international service standards and visitors expectations – a reflection of the small number of Chinese citizens who have experienced travelling, working or living abroad. Second, individuals are assigned by the government to work in specific occupations without having education and experience in the hospitality industry. Third, it has become difficult to maintain the morale of service personnel as foreign tourists receive special treatment, are accommodated in the more modern facilities, and demand services which residents themselves do not receive.

Zhang (1989) suggests that the problem of poor service is conspicuous in the Chinese tourist industry and argues that while social factors play a role, lack of education and training is the major source of the problem. He argues that hospitality education in

China should be expanded and made more relevant to the Chinese tourism industry. In China, there needs to be a greater recognition of the importance of hospitality education. It is generally recognised that quality of service in the industry is related to education, and adequate funding is needed for education. As revenues and employment increase annually, funding of education programmes needs to increase accordingly.

Along with globalisation of the hotel industry, hospitality education needs to develop a global orientation. Since the programmes in China are relatively new, it is possible to learn from successful foreign programmes. To expedite this learning, the government should promote more faculty exchanges, and more specific courses should be introduced such as: Strategic Management, Human Resource Management, Financial Management and Hotel Marketing. It may be possible to select several of the world's best programmes and set up joint *MSc* and *PhD* programmes in China to educate qualified teachers for hospitality and tourism education (Zhao, 1991).

Because of the limited experience of most of the faculty and limited laboratory facilities, the curriculum in institutes of higher learning generally places more emphasis on classroom instruction and de-emphasises skill development (Zhao, 1991). Students need more opportunities in laboratory practice. It is essential to note that additional hours in foreign languages is required because foreign language is not only a tool for access to western skills and technology, it also can be regarded as an essential skill for quality service. Improved communication skills are desirable in China's hotel industry.

Although hospitality education has made progress in quantity (see section 4.2.3), it still requires significant changes to improve quality in the delivery of education. It is believed that strengthening hospitality education in China would be beneficial to both its educators and industry, it could also help educators from other developing countries who are in the early stage of shaping their own hospitality programmes to drew on the experience of China. It will change the negative image of poor quality service in China's hotel industry and make a significant impact on its development.

## Conclusion

China's hotel development has been unique and complex. The government played the roles of investment stimulator, regulator and educator, receptively (Zhang *et al,* 1999). Although, the industry experienced a lack of co-ordination, poor levels of service provision, a mismatch between luxury class hotel provision and visitors' need and the domination of foreign hotel chains, the role of the government can not be ignored. It is important to consider the fact that tourism has transformed from being initially a political tool which was centrally controlled to, an economic one which is now driven by market forces.

For the hotel industry's future development, low and middle class accommodation needs attention in order to establish a complete hotel system with various class to satisfy customers' needs. Yu (1992) notes that the state tourism bureaus can concentrate on designing macro control measures and monitoring the equilibrium of demand and supply. Systematic educational and training programmes need to be strengthened to produce more qualified managerial personnel and service employees. It is worth noting that planned and co-ordinated development is the key to the success.

Following the appearance of international hotel chains, China has started developing its own hotel companies (e.g. Jinjiang in Shanghai, and the GD Hotel Group in Guangdong). As one of the impacts of open door policy, the GD Hotel Group has already become a multinational company. The firm's growth, to a certain extent, has benefited from the policy which allowed Chinese nationals to join overseas tours organised by the China Travel Services to Hong Kong and neighbouring countries. In Chapter 6 will provide detailed information in relation to this Chinese hotel chain's route to internationalisation.

# Chapter 5: Research Methodology

## Introduction

This chapter will demonstrate that the research strategy adopted for the collection of primary data accurately reflects the key research issues and is congruent with the research aim and research objectives. It will first start with issues of research philosophies. The strengths and weaknesses of each philosophy are discussed in order to justify the chosen research strategy which was applied to this project, namely a case study approach. The rationale behind choosing the case study organisation selected is explained. The chapter will then engage with the chosen methods of data collection, i.e. semi-structured, in-depth type recorded interviews and using secondary documentation, the justification of selected interviewees is provided. The implementation of this case study, the procedures of analysing the qualitative data –within-case displays, cross-case displays and the development of grouped cognitive maps –and limitations will be discussed at the end.

## 5.1 Research Philosophies

The term paradigm refers to the progress of scientific practice based on people's philosophies and assumptions about the world and the nature of knowledge (Hussey and Hussey, 1997). In this context, this concerns consideration of how research should be conducted. Paradigms offer a framework comprising an accepted set of theories, methods and ways of defining data. Guba and Lincoln (1994, p.105) define a paradigm as 'the basic belief system or world view that guides the investors, not only in choices of method but in ontologically and epistemologically fundamental ways'. Morgan (1979) suggests that the term can be used at three different levels, namely: philosophical, which reflects basic beliefs about the world; social, in terms of how the researcher should conduct their endeavours; and technical, which relates to the methods and techniques used for data generating. All are of relevance. However, philosophical issues are given greater attention and studied in more detail in this chapter.

There is a long-standing debate in the social science about the most appropriate philosophical position from which methods should be derived. One of the most important distinctions between types of research encountered in texts on research methods especially in management and the social sciences is that between positivism and phenomenology (Easterby-Smith, Thorpe and Lowe 1991; Hussey and Hussey, 1997; Clark *et al* 1998). Both philosophies of research are based on a common desire to understand behaviour but each approach makes different assumptions about the world of phenomena (Clark *et al* 1998). Easterby-Smith *et al* (1991, p. 22) note that 'Each of these positions has to some extent been elevated into a stereotype, often by opposing sides'. The key elements of the positivistic and phenomenological paradigms which represent stereotypes of the main traditions associated with research methodologies are illustrated in Table 5.1.

**Table 5.1: Key Features of Positivistic and Phenomenological Paradigms**

| | Positivistic | Phenomenological |
|---|---|---|
| **Basic Belief:** | The world is external and objective<br><br>Observer is independent<br><br>Science is value-free | The world is socially constructed and subjective<br><br>Observer is part of what is observed<br><br>Science is driven by human interest |
| **Researcher should:** | Focus on facts<br><br>Look for causality and fundamental laws<br><br>Reduce phenomena to simplest elements<br><br>Formulate hypotheses and then test them | Focus on meanings<br><br>Try to understand what is happening<br><br>Look at the totality of each situation<br><br>Develop ideas through induction from data |
| **Preferred Methods:** | Operationalising concepts so that they can be measured<br><br>Taking large samples | Using multiple methods to establish different views of phenomena<br><br>Small samples investigated in depth or over time |

Source: Easterby-Smith *et al* (1991).

## 5.2 Quantitative Research

Quantitative research is founded on the belief that the study of human behaviour should be conducted in the same way as studies conducted in the natural sciences. Quantitative research is primarily concerned with ways in which data has been created and with its validity. It seeks the facts or causes of social phenomena, with little regard to the subjective or the individual and, it is often associated with predictive objectives (Hussy and Hussy, 1997). Thus, the key idea of quantitative study is that the social world exists externally and its properties are best measured through objective methods. Causality and fundamental laws are used to explain regularities in human social behaviour using large samples from a parent population, and implementing a hypothetic-deductive approach, which in turn generates objective, usually statistical data. Resultant knowledge is based on observed facts and reality is external and objective and as (Easterby-Smith *et al* 1991, p.22) note ' the knowledge is only of significance if it is based on observations of this external reality'.

### 5.2.1 Quantitative Research and its Strengths

With quantitative research, in general, sample sizes are greater than other approaches and controlled in such a way as to be representative of the population from which they are drawn. This allows greater confidence in accepting the reliability or generalisability of the findings. Its obvious strength lies in its comparability due to its standardised numerical format (Hart, 1987), thereby reducing the potential bias of subjective interpretation.

Easterby-Smith *et al* (1991) argue that quantitative methods and a positivist paradigm have the strengths of providing wide coverage of the range of situations and probably being fast and economic to implement. Moreover, when statistics are aggregated from large samples, they may be of considerable relevance to policy decisions.

Miles (1979) notes that as there are well-documented guides for quantitative analysis and thus less room for subjective interpretation, the research findings' internal validity can be assessed more easily.

### 5.2.2 Quantitative Research and its Weaknesses

There have been numerous criticisms of the positivist approach particularly in the social and behavioural sciences. Quantitative methods are able to investigate only the more rational aspects of behaviour and motivation, and therefore miss the subtleties and idiosyncrasies of individual or organisational behaviour. Easterby-Smith *et al* (1991) suggest that quantitative methods tend to be rather inflexible and artificial. They are not very effective in understanding processes or the significance that people attach to actions. Indeed, the social sciences deal with action and behaviour which are generated from within the human mind. It is impossible for the social scientist to be wholly objective in conducting value free research because social sciences are socially constructed and given meaning by people. Smith (1983, p.7) argues that the 'interrelationship of the investigator and what was being investigated was impossible to separate'.

The increased numerical accuracy offered by employing quantitative sets of data has to be related to its loss in perspective. Just as a magnifying glass increases the accurate representation of its limited focus area by revealing more details, it decreases the scope at the same time. Applied to this context, quantitative data can capture details more accurately and precisely, but usually lacks the contextual and situational sensitivity and scope of qualitative data.

A general sentiment is echoed throughout the literature that quantitative methods – surveys in particular are more inclined to describe and interrelate verbally expressed sentiments and beliefs rather than describe actual conduct. This increases the likelihood of rationalising behaviour after the event (Hart, 1987).

Despite the above limitations, quantitative research is particularly appropriate in certain circumstances. Hart (1987) concludes that quantitative methods are appropriate for:

a) testing hypotheses;

b) synthesising a large number of variables to determine associations (and the strength of associations);

c) controlling for generalisablility

Easterby-Smith *et al* (1991) state that the task of the social scientist should not be to gather facts and measure how often certain patterns occur, but to appreciate the different constructions and meanings that people place upon their experience. One should therefore try to understand and explain why, rather than search for external causes and fundamental laws to explain their behaviour. The phenomenological paradigm is concerned with understanding human behaviour from the participant's own frame of reference.

## 5.3 Qualitative Research

The major difference between quantitative research and qualitative research is that the starting point for all qualitative research is the idea that reality is socially constructed rather than objectively determined. Thus, the qualitative approach rejects the positivist assumption that descriptive concepts are simply a first step towards the testing of explanatory hypotheses (Hart, 1987). This approach stresses the subjective aspects of human activity by focusing on the meaning, rather than the measurement of social phenomena (Hussey and Hussey, 1997). Researchers are unavoidably part of the research process and will bring their values and beliefs to the research (Clark *et al*, 1998). The qualitative approach rejects positivism's assumption of value free phenomena. Consequently qualitative research is concerned with how people experience social phenomenon and the world in which they live.

### 5.3.1 Qualitative Research and its Strengths

At the most simplistic level Gordon and Langmaid (1988) suggest that qualitative research answers such questions as *what, why or how,* but it cannot answer the question *how many?* More specifically, Strauss and Corbin (1990) describe qualitative research as that which produces findings not arrived at by means of statistical procedures or other means of quantification. Thus they refer to qualitative research as a non-mathematical analytic procedure that results in findings derived from data gathered by a variety of means, including observations, interviews and so on.

Van Maanen (1983, p.9) notes qualitative methods as 'an array of interpretive techniques which seek to describe, decode, translate and otherwise come to terms with the meaning, not the frequency of certain more or less naturally occurring phenomenon in the social world'. Similarly, Chisnall (1986) defines the essence of qualitative research as diagnostic, attempting to discover what may account for certain type of behaviour, seeking a deeper understanding of factors, sometimes covert, which influence decisions. Thus, qualitative methods are frequently used in the social sciences and rarely, if at all, in the natural sciences.

Manson (1996, p.3-6) addresses common factors to develop a sense of what qualitative research is about. Thus, qualitative research is:

a) grounded in a theoretical position which is broadly 'interpretivist', i.e. how the social world is interpreted, understood, experienced or produced;
b) based on methods of data generation which are flexible and sensitive to the social context in which data are produced, i.e. it is collected in the 'real life' or 'natural' social context and does not rely on standardised or structured experimental methods; and
c) based on methods of analysis and explanation building which involve understanding complexity, detail and context, based on rich, contextual and detailed data.

Qualitative research is therefore best used for problems where the results will increase understanding, expand knowledge, clarify the real issues, generate hypotheses, identify a range of behaviour, explore and explain individual's motivations, attitudes and feelings, and thus identify distinct behavioural groups (Gordon and Langmaid, 1988). The attempt to investigate feelings, attitudes, ideas, values and perceptions means that qualitative research is more reliant on the skills of the researcher as interviewer or observer (Clark *et al*, 1998).

There are many valid reasons for doing qualitative research, one being the nature of the research problem. Some areas of study naturally lend themselves more to qualitative types of research, for example, research that attempts to uncover the nature of persons' experiences with a phenomenon (Strauss and Corbin, 1990). It is suggested that qualitative research may provide the most reliable and valid means of identifying the issues for the management of cultural diversity associated with internationalisation and that a holistic view of any situation is essential (Hampton, 1999). Qualitative methods can be used to uncover factors that may account for certain types of behaviour, seeking a deeper understanding and insight of these potentially influential factors (Chisnall, 1986). Qualitative data can thus provide a richer representation of the phenomena, which are difficult to achieve with quantitative methods.

Miles and Huberman (1984) state that qualitative data are attractive. They are a source of well-grounded, rich descriptions and explanations of processes occurring in local contexts. With qualitative data one can preserve chronological flow, assess local causality, and derive fruitful explanations. Similarly, Hart (1987) concludes that the strength of qualitative methods is usually associated with the depth and richness of the data it provides. Qualitative data are more likely to lead to serendipitous findings and to new theoretical integration; they help researchers go beyond initial preconceptions and frameworks (Miles and Huberman, 1984).

### 5.3.2 Qualitative Research and its Weaknesses

However, despite its strengths, qualitative research has been criticised. The overriding problem facing qualitative researchers is that in contrast to quantitative data analysis, analysis is the most serious and central difficulty in using qualitative data, because methods are not as well formulated (Miles and Huberman, 1984). Whereas quantitative data is associated with clear analytical conventions, qualitative analysis is generally self-generated and controlled. Therefore, compared to quantitative methods, the 'soft' data produced by qualitative research efforts are often viewed as lacking in both reliability and validity (Gordon and Langmaid, 1988), while the influence of the researcher is seen to result in highly subjective, rather than objective data analysis. Clark *et al* (1998) recognise the fact that researchers are an unavoidable part of the research process and will subjectively bring their own values and beliefs to the research. Thus, researchers can never be sure that they have got the world view of their respondents or that they have correctly interpreted the meanings of people's behaviour.

Furthermore, from a practical perspective, collecting qualitative data is often labour intensive; it requires a good deal of skill to be carried out correctly; it can be time consuming and expensive (Hart, 1987). Qualitative data itself is copious, comprising as it often does, of innumerable observations and recordings. The ensuing analysis –

unguided – is lengthy. As Easterby-Smith *et al* (1991 p.32) note 'Qualitative data collection can take up a great deal of time and resources, and the analysis and interpretation of data may be very difficult, harder to control their pace, progress and end-points'.

**Discussion**

Many authors simply subsume the terms qualitative and quantitative within the wider ones of phenomenology and positivism. Nonetheless, Easterby-Smith *et al* (1991, p.31) argue that 'Although the distinction between the two paradigms may be very clear at the philosophical level...when it comes to the use of qualitative or quantitative methods and to the issues of research design the distinction breaks down'.

Some techniques, such as interviews, can be used to gather data in either a quantitative or a qualitative way. Questionnaires and survey methods are not always quantitative methods, but they are easily used in a quantitative way, and they therefore provide a framework around which to discuss issues of quantitative methods. Brotherton (1999) argues that although the case study is most appropriate where the nature of the research to be conducted will be qualitative and inductive, this type of research can also be conducted on a quantitative basis and this orientation does not represent a lack of value. Indeed, although the positivistic approach is synonymous with quantification, increasingly it seems as though phenomenological approaches, whilst primarily qualitatively based, do still admit the possibility of also using quantitative methods.

Clark *et al* (1998) note that it is often the case that one starts with qualitative analysis, does some quantitative work based on ideas which have come out of the initial analysis, and then finally see how the findings of the quantitative analysis relate to further qualitative studies. Increasingly, authors and researchers who work in organisations and with managers argue that one should attempt to mix methods to some extent, because it provides more perspectives on the phenomena being investigated (Easterby-Smith *et al* 1991). Thus, there appears to be increasing support for a multimethod approach, which has the potential to gain from the strengths and minimise the weaknesses of both qualitative and quantitative approaches combined. However, this is not an appropriate method for this research and the following section will justify the approach for this study.

## 5.4 Justification of Approach

A good research design will make sure that the information gathered is consistent with the study objectives and that the data are collected by accurate and economical procedures. There is no standard or idealised research design to guide the research, since many different designs may accomplish the same objective (Kinnear and Taylor, 1991). Similarly, Morgan and Smircich (1980) observe that the appropriateness of a research approach derives from the nature of the social phenomenon to be explored. Saunders *et al* (1997) assert that neither approach should be thought of as better than the other. They are better at different things. It depends where the research emphasis lies.

The emphasis of this research lies in attempts to generate new, analytical insights into the social phenomenon of a Chinese hotel chain's internationalisation and to develop a theoretical framework of internationalisation of Chinese hotel companies. A key theme in emergent work on internationalisation is issues of management mind set, attitudes and beliefs of key top management bodies. By recognising Oviatt and McDougall's (1994) view that the skills and knowledge of the top decisionmaker(s) are likely to be more predictive of, and influential on, patterns of internationalisation, this research has been undertaken by seeking the views of key informants in the case study organisation. In order to obtain more comprehensive and in depth views, hotel consultants from the major consulting companies in Hong Kong who have been involved projects with Chinese organizations are also regarded as key informants.

Thus, this research adopts a phenomenological approach by seeking the meaning attached to the process of internationalisation by the case study organisation. A methodology has developed which is appropriate to the nature of the data sought in relation to the stated aim and objectives of this study (see chapter 1). As noted before, although the *positivistic approach is synonymous with quantification*, increasingly it seems as though phenomenological approaches, whilst primarily qualitative based, do still admit the possibility of also using quantitative methods. Nevertheless phenomenological approaches are still largely concerned with qualitative approaches. This research is a qualitative work.

Bryman (1989, p.152-61) offers a four-fold typology of qualitative research:

Type 1: Total participant – where the researcher is a full or nearly full observer in one or two firms. This participant observation is also usually coupled with some interviewing and examination of documents.

Type 2: Semi-participant – where the researcher is an observer in one or two firms, but in an indirect role. Again, this research is usually accompanied with interviewing and examination of documents.

Type 3: Interview-based – this approach has its chief emphasis on interviews in 1-5 organisations, along with examination of relevant documents. Observation may occur, but if it does so it tends to be in periods between interviews.

Type 4: Multi-site – chief emphasis on interviews with, or observation of, individuals in 6 or more different firms, but usually more than 10 and there is usually some examination of documents. Interviewers usually do some observation and observes some interviewing.

Type 3 has been adopted by this research with the emphasis on interviews in one organisation. In comparison to Type 1 and 2, the researcher's relative lack of participation and involvement in the firm means the fidelity of the perspectives and interpretations of those being studied is less pronounced (Bryman, 1989). It is worth noting that total participant and semi-participant were not permitted by the case study organisation. Consequently interviewing was the major technique to collect data in this research work apart from the examination of internal company documentation.

The semi-structured interviews conducted with the key informants, this type of interview provided the opportunity for the interviewer to raise additional questions and to make sure the desired information has been obtained. The interview questions were based on the literature review, company documents, and some informal observation prior to and between interviews.

This research attempts to engage with participants to understand the meaning they attach to the social phenomenon of internationalisation, this is linked to the specific characteristics of the Chinese state owned hotel company which is operating in an economic system in transition to a market economy. In this respect, a phenomenological approach was pursued. Indeed, the use of interviews may reflect the researcher's preconceptions of what is interesting and worth pursuing, which a positivist may see as potentially 'journalistic', 'soft science', 'unscientific', very subjective, personal and 'full of bias' (Denzin and Lincoln, 1994). Nonetheless it is these very things which give qualitative research its richness and allows for the nuances of the phenomenon to be studied which is appropriate for this research.

This study is an organisational research which involves an empirical investigation of the social phenomenon of a Chinese hotel chain's internationalisation. Attention now turns to the use of case study as a research strategy.

## 5.5 The Case Study as a Research Technique

The case study has long been stereotyped as a weak sibling among social science methods. Investigators who do case studies are regarded as having deviated from their academic disciplines, their investigations as having insufficient precision (that is, quantification), objectivity, and rigor (Yin, 1994). Despite this stereotype, case studies continue to be used extensively in social science because it allows an investigation to retain the holistic and meaningful characteristics of real-life events-such as individual life cycles, organisational and managerial processes, neighbourhood change, international relations, and maturation of industries.

As a research strategy, the case study is used in many situations (Yin, 1994), including:

a) policy, political science, and public administration research
b) community psychology and sociology
c) Organisational and management studies
d) City and regional planning research
e) The conduct of dissertations and theses in the social sciences the academic disciplines as well as professional fields such as business administration, management science, and social work.

### 5.5.1 What is a Case Study?

A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when boundaries between phenomenon and context are not clearly evident (Yin, 1994). Denzin and Lincoln (1994) describe a case study as a phenomenon of some sort occurring in a bounded context – the unit of analysis, in effect. Normally, there is a focus of attention and a more or less vaguely defined temporal, social and / or physical boundary involved. The importance of the context is essential and Eisenhardt (1989) refers to the case study as a research study which focuses on understanding the dynamics present within a single setting. Bonoma (1985) notes that it must be constructed to be sensitive to the context in which management behaviour takes place.

Hussey and Hussey (1997) note that a case study is an extensive examination of a single instance of a phenomenon of interest and is an example of a phenomenological methodology. It can be descriptive, illustrative, experimental and explanatory, as the research draws upon existing theories to explicate what is happening. Gummensson (1991) observes that the case study method allows in-depth and holistic understanding of multiple aspects of a phenomenon and the interrelationships between different aspects. In relation to this organisational research, it allows the researcher to gain, as Saunders *et al* (1997) note, a rich understanding of the context of the research and the process being enacted.

Despite the strengths of a case study approach, there are weaknesses. For instance, access to a suitable organisation is often difficult to negotiate and the process of the research can be very time consuming. Although the researcher may focus on a particular organisation or group of individuals, they do not exist in a vacuum, but interact with the rest of society. Whatever the unit of analysis, it will have a history and a future which will influence the researcher's understanding of the present. Nobody could deny that understanding the events in a particular period of time without knowledge of what went before and what may follow is not easy. However, although such a study may be limited to just a few aspects of organisational life, the results can be extremely stimulating and original (Hussey and Hussey, 1997). The criticism of case study research is also found on the claim that case studies cannot be regarded as representative, and are incapable of generating findings which can be validly generalised to wider instances of the phenomenon in the population at large (Brotherton, 1999).

### 5.5.2 Choosing Case Study Research

Each research strategy has peculiar advantages and disadvantages, depending on three conditions, namely: the type of research question; the control an investigator has over actual behavioural events, and; the focus on contemporary as opposed to historical phenomena (Yin, 1994). Saunders *et al* (1997) assert that neither approach should be thought of as better than the other. They are better at different things. It depends where the research objectives emphasis lies. Similarly, Brotherton (1999) notes that the value of any research strategy, approach or design lies in its potential for assisting the researcher to meet the aims and objectives of the research in the most effective and appropriate way possible. In this sense, the decision is largely one of fitness for purpose. It raises the question that for what purpose is the adoption of case study research the most appropriate?

The case study is a preferred strategy when 'how' or 'why' questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context (Yin, 1994). If the research is seeking to answer why and how type questions in any meaningful level of depth, it is difficult to see how this can be effectively achieved through the use of either an experimental design or a large-scale survey. But there is no compelling reason to suggest that case study research could not be conducted on a quantitative basis, or that such an orientation would lack value. However, as Brotherton (1999) suggests, the selection of case study research, as a preferred method, is far more likely in research studies having a qualitative orientation, as it is concerned with uniqueness of the particular, rather than the universality of the general.

Indeed, case study research is widely regarded as more appropriate when the research purpose, and associated questions are concerned with the development of deeper understanding rather than superficial description (Brotherton, 1999). Similarly, Yin (1993) notes that case studies are an appropriate research method when you are trying to attribute causal relationships-and not just wanting to explore or describe a situation. Hartley (1994) claims that case study research is especially valuable for exploring unfolding processes, via an in-depth analysis, in order to develop a deep understanding of these processes within their context of occurrence.

In this study, the researcher's intention is to undertake an inductive and evaluative study to generate new, analytical insights into the social phenomenon of a Chinese hotel chain's internationalisation. The goal of the study is therefore to expand and generalise theories from the study of an empirical case, which Yin (1989) called analytical generalisation and not to enumerate frequencies (statistical generalisation). The nature of this research has determined that the case study approach is the most appropriate.

### 5.5.3 Justification of the Case Selection

It is impossible to sample an entire population in examining any given social phenomenon (Clark *et al* 1998). Indeed, researchers have to decide which part of the population is going to be sampled. In a case study research, there are choices to be made as to which organisations are chosen and who are to be interviewed. Mason (1996) notes that sampling and selection – appropriately conceived and executed – are vitally important strategic elements of qualitative research. Hussey and Hussey (1997) suggest that a key stage in case study is in selecting the case(s) and that to fully understand this issue there is a need to acknowledge the rationale behind the selection of the chosen firm. In this respect, attention now turns to the issue of sampling.

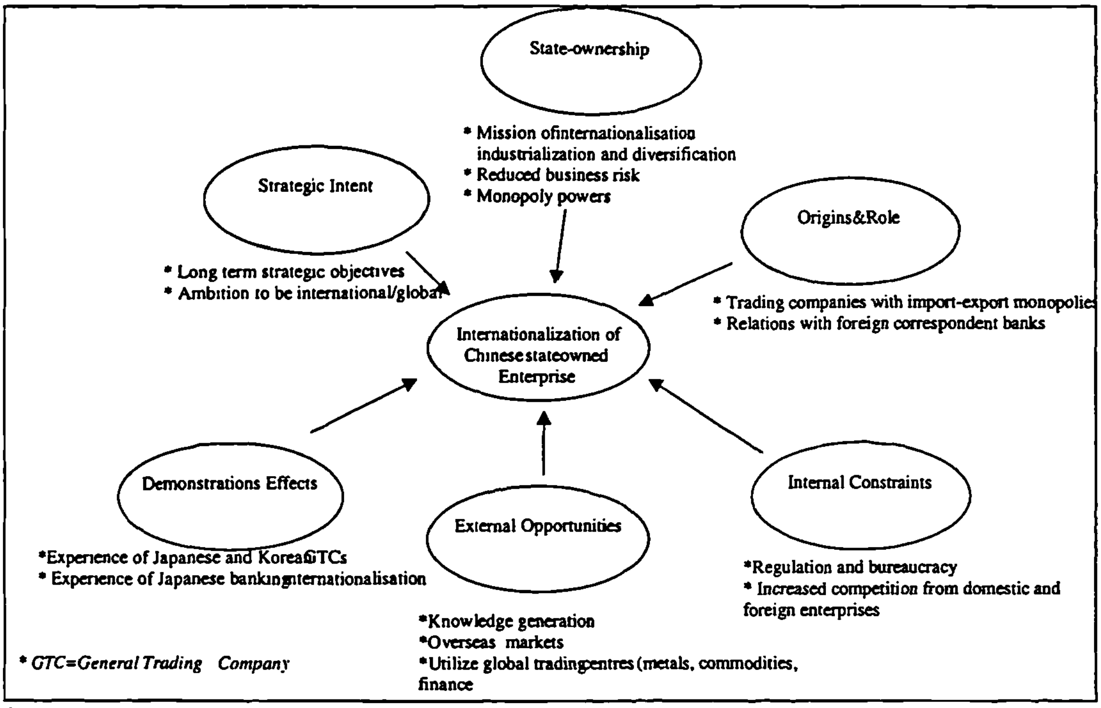
The choice of this case was based on the following reasons. First, the internationalisation specifics of state owned location bound service firms from developing countries –in transition to a market economy-have not yet been empirically investigated. Much of the literature on international business has paid relatively little attention to the internationalisation of Chinese enterprises. Although, some researchers have paid interest to the international expansions of Chinese multinational enterprises (see Young, *et al* 1996; Zhang and Bulcke, 1996; Young, *et al* 1998), they focus on the manufacturing sector. The internationalisation of Chinese service enterprises is still wanting for attention. Since China opened its door to the outside world in the late 1970s, tourism development has been significant. As the heart of mass tourism, hotel development in China is unique and phenomenal. Under the conditions of luxury hotels oversupply, with the industry dominated by foreign hotel chains, China started developing its own hotel chains.

Within a changed global environment, internationalisation is viewed as inevitable if corporation expansion goals are to be achieved. Root (1994) highlights that that all companies should plan for growth and survival in a world of global competition, the most promising strategy for growth and survival is to become an international player. But in entering the international hotel industry, Chinese hoteliers face a very competitive environment in which most of the major players have already achieved strong market positions. How to develop Chinese hotel chains and to compete in the global market is a critical issue that Chinese hoteliers and the Chinese government are concerned about and this theme needs to be studied.

Second, in China political factors play a critical role in the changing social and economic structure of the Chinese society. Government policies determine the dimensions of economic development. In relation to the issue of internationalisation of Chinese enterprises, the state owned enterprises (SOEs) were the first companies to be granted the right both to engage in international trade, and to invest directly abroad to support trade or to bypass trade barriers (Young, *et al* 1998).

The drivers of Chinese outward internationalisation are very different to those influencing MNE activity in industrialised nations. Figure 5.1 highlights a range of interrelated drivers, which emanate initially from state-ownership. Since 1985, the State Council determined that the large trading enterprises should pursue a strategy of "business diversification, industrialisation and internationalisation" in order to facilitate China's economic development. State support could facilitate rapid internationalisation and enable the companies to take a long-term strategic perspective on their investment.

**Figure 5.1: The Influences on the Foreign Investment Activities of Chinese State Owned Enterprises**




Source: Young *et al*, 1998.

The case study organisation - Guangdong (International) Hotel Management Limited (GD Hotel Group) is a *state-owned* company which operates hotels in areas of Hong Kong, China, Southeast Asia and Europe. It is worth noting that the firm is the only multinational Chinese hotel chain with the experience and expertise of running hotels outside Mainland China. Other Chinese hotel companies only operate in the domestic market. Because no alternatives are in existence, the GD Hotel Group has gained prominence and was the only choice for this study. Despite its advantage in terms of the age and the size of the firm in comparison to other Chinese hotel chains, the GD Hotel Group enjoys limited brand recognition. By recognising the importance of being an international player, the firm is seeking opportunities to expand its market share in the international market.

Bryman (1988) notes that luck and serendipity often play a major part in research projects. The route into this firm stemmed from a contact with the Managing Director of this hotel chain. A formal discussion with the director was held in April 1997 regarding the firm's development objectives and its attempts to enlarge its foothold in the international market. Two hours discussion led to the agreement that GD Hotel Group would like to support this research if the researcher was interested, and provide the researcher access for data collection. As Buchanan *et al* (1988) noted, the practice of field research is the art of the possible. The supportive attitude from the case study organisation to a great extent made the research possible, which might also reflect their attempt to become a more global orientated organisation.

Another important reason for choosing this case is because the author is interested in this double identity enterprise. From the beginning of the reform period, China established overseas firms, notably those firms located in Hong Kong. The GD Hotel Group's parent company – Guangdong Enterprises Group was one of the firms registered in Hong Kong in 1980. Consequently, the GD Hotel Group is also a socialist firm operating in a capitalist society. Which means, from one aspect, they are constrained by the government as to the practices they adopt and, as a result, their management bears some similarity to that of state enterprises. On the other hand, they have to accept the business value, norms and practices of a market economy. How this specific feature affects the internationalisation process of this Chinese hotel chain is an interesting issue that needs to be investigated.

While a lot of attention has been devoted to the expansion of foreign owned enterprises in China since 1978, the interest of this study has extended to the Chinese owned service firm which is venturing abroad, with a particular focus on a Chinese hotel chain - Guangdong (International) Hotel Management Limited. This new interest is linked to the specific characteristics of the Chinese state-owned firm which is operating in an economic system in transition to a market economy. The case selection was driven by both theoretical and practical considerations, and with the aim to encompass the issues in which the researcher is most interested.

Obviously, evidence drawn from a multi-case study is far more powerful because of the ability to compare and contrast findings. The results of that comparison can strengthen the validity of theories, help identify other cases to which the results are generalisable (Clark, et al 1998). However, as mentioned before, GD Hotel Group is the only Chinese hotel company who has businesses outside China. There are no other comparable companies. Therefore, the fact determined that a multi-case approach is impossible.

Rose (1993) articulates the concept of lesson-drawing in the context of public policy formulation. Lesson-drawing is about the diffusion of what was once an innovation elsewhere. It seeks to establish the circumstances and extent to which effective experiences from one context can be transferred to that of others. What is the relevance of this concept to this single case study? Rose (1993 p. 24) highlights that 'a lesson is a shortcut that relies on experience elsewhere as a source of knowledge.' There is no doubt that more Chinese hotel organisations will sooner or later start their internationlisation programmes. They do not have to pay the price for being the first to try a novel idea by learning from the experiences and the mistakes of the GD Hotel Group. In another word, those firms can avoid making the same mistakes and wasting resources that is important for the firms which are from the developing countries like China.

Moreover, this research is intended to develop a theoretical framework of internationalisation of Chinese hotel companies. The key ideas of this framework can also be transferable to enterprises which are from developing countries. However, Rose (1993) notes that in the real world we would never expect a programme to transfer without some adaptation, but equally we would not expect public officials to develop a major programme in total ignorance of what is being done by counterparts elsewhere. By adopting this single case study, themes, lessons and strategies emerged that can be adapted by other Chinese hotel companies and companies from the less developed world in relation to their future internationlisation, and this has given this work potential value and justified the approach adopted.

## 5.6 The Implementation of the Case Study Research

### 5.6.1 Data Collection

Interviews are a crucial element of a phenomenological/qualitative approach because knowledge, beliefs, views, understanding, interpretations, experiences and interactions are meaningful properties of the social reality which allows the researcher to explore their research questions / objectives (Mason, 1996). Easterby-Smith *et al* (1991) also note that in-depth interviewing is the most fundamental of all qualitative methods. It probes deeply to uncover new clues, open up new dimensions of a problem and to secure vivid, accurate, inclusive accounts that are based on personal experience. By recognising this view, the use of interviews was the chosen method for collecting primary data.

In relation to data collection in qualitative research, Van Mannen (1989) favours an unguided data collection method, but it could be very ineffective and inefficient for an inexperienced researcher using qualitative methods. Therefore, interview guides were developed (see Appendix A & B) to structure the direction in which interviews could progress. The interview guide which was designed for the case study organisation were divided into a number of topic areas which derived from the literature review and the objectives of the study. In this research, the sources of data, besides the secondary data from the literature review, included primarily interviews with key informants from the case study organisation; hotel consultants from major hotel consulting firms, and analysis of company's documentation like annual reports, operational performance data, marketing plans, and published information.

Saunders *et al* (1997)'s framework for assessing some of the key issues which surround the use of interviewing can be used here to demonstrate how the empirical data was collected in this research.

- Preparation and planning encompassing issues of access and the best ways to secure access. After the interview guide for the case study organisation was completed, the researcher faxed it to the Managing Director of the firm. He distributed the interview questions to the interviewees. This was the best way to secure access. The primary purpose of these interviews was to assist in understanding the meanings that interviewees attached to issues and situations. The interviewee selection was based on the understanding that apart from political influence, internationalisation is issues of the management attitudes and beliefs of key top management bodies in any organisation. Oviatt and McDougall (1994) note that the skills and knowledge of the top decision-maker(s) are likely to be more predictive of, and influential on, patterns of internationalisation. Therefore, Senior Corporate Members, Senior Functional Members and General Managers (GMs) of GD who have experience and knowledge in relation to internationalisation were chosen. Prior to the fieldwork, the researcher read detailed secondary data on GD Hotels and reviewed many articles regarding the conduct of interviews and how to become a good case study researcher.

- Level of information supplied to the interviewee - interviewees from the GD Hotel Group reviewed the interview questions two months before the interviews took place. Many of respondents were well prepared, although for some sensitive issues they felt uncomfortable in answering but some insightful views were obtained. The two hotel consultants were also aware of the interview guide prior to the interviews.

- Appropriateness of appearance at the interview – the researcher was wearing appropriate dress during all interviews. In order to gain creditability, the researcher sought to retain an open and inquiring mind, sought to be a good listener, general sensitivity and responsiveness to contradictory evidence. The nature of communication skills of the researcher led to the establishment of trust or as Merriam (1988) called 'rapport' with respondents. Some key informants from the case study organisation offered substantial information which supported the research objectives.

- The nature of the opening comments was important, due to the fact that the researcher was aware that some questions might cause respondents to feel uncomfortable to answer or were outside of their knowledge. Therefore, the researcher first engaged in the conversation with the respondents about their personal background and role in the organisation in order to develop a relaxed atmosphere which was considered important in moving to later sensitive issues. Permission to tape-record the interview was sought at the beginning. The confidentiality and non-identification of individual interviewee were promised to the respondents in the case study organisation with the aim to encourage them to answer the questions.

- Approach to questioning – before starting the questions which were designed to explore the research objectives, the researcher told the respondents that it was an academic-orientated research for her PhD. She was interested in developing a theoretical framework of internationalisation, this framework would be communicated back to the organisation at the end of the study. She believed the relevance of the research to the interviewees was high, the true and high quality of information therefore was expected. This statement resulted in the free flow of information from some interviewees. During the interviews, the researcher blended in terms of her industry knowledge and personality with those of the respondents, the respondents were encouraged to answer the questions in their own terms without feeling constrained by the pre-formulated ideas of the researcher. Sometimes, the researcher pretended not to understand the answer in order to prompt the interviewee to say more. The overuse of theoretical concepts and jargon was avoided. Rapport was generally established. It is important to note that some important information was also obtained after the interviews, like when the researcher was having a meal with interviewees or when they went out for a drink. This might because they felt freer to talk about things when what they said was not typed.

- Approach to recording data – all the respondents allowed the researcher to tape record the whole interview. In this sense, it allowed the researcher to concentrate on questioning and listening. The researcher could later re-listen to the interview, and it also allowed direct quotes to be used. All interviews were transcribed by the researcher before the data analysis which was useful in beginning to make some sense of the data, and some key themes were also emerged.

### 5.6.2 Analysing Qualitative Data

The analysis of such data required the researcher to bring order, structure and meaning to a mass of relative non-standard information. As Robson (1993) noted, the main challenge to qualitative data analysis is that there is no clear and accepted set of conventions for analysis corresponding to those observed with quantitative data. Similarly, Morse (1994) argues that despite the proliferation of qualitative methodology texts detailing techniques for conducting a qualitative project, the actual process of data analysis remains poorly described. Indeed, the problematic nature of qualitative data analysis is one which is widely noted in the research literature.

However, a number of authors have attempted to identify what they regard as the main elements of an analysis of qualitative data (see Lindlof, 1995; Morse, 1994; and Hampton, 1999). The analysis of this empirical research was based on the four processes described by Morse (1994), as follows:

a) **Comprehending** – is the acquisition of a full understanding of the setting, culture and study topic *before* the research commences. There is a debate in phenomenological research which argues that the researcher should not approach the study with pre-knowledge and the mind should be uncluttered by previous theories and concepts which might block out perspectives and discoveries. In relation to this particular case study research, being familiar with the literature and some company information helped the researcher to become a competent interviewer on the subject matter which then facilitated obtaining high quality data and making new discoveries by deeply probing into interviewees' responses.

b) **Synthesising** is the drawing together of different themes and concepts from the research and forming them into new, integrated patterns. The researcher was reducing, categorising, coding, and summarising transcripts to provide a coherent organising framework for analysis. The final structure of the thesis is largely reflective of issues emerging from the data. The section that follows below discusses this analytical phase in more detail.

c) **Theorising** – relates to the theory which gives qualitative data structure and application and involves confronting the data with alternative explanations. At this stage, the researcher has identified the beliefs and values in the data and then attempted to make links with theory.

d) **Recontextualising** – at this stage, the researcher went back to existing theories to (re-)place the synthetical results into the context from which the results have emerged.

### 5.6.3 Qualitative Data Synthesis

The first analytical stage of synthesising the gathered qualitative data followed the guidelines of Miles and Huberman (1994). First, thematic categories as coding units for the extended text (the transcribed interviews) were established for the various questions and areas to be explored. Content analysis was the technique used to reveal these thematic categories (Erdemer and Dunn, 1990 and Miles and Huberman 1994). These categories were defined *ex ante* and *ex post*. The *ex ante* defined categories were directly derived from the literature review and company documents. The *ex post* defined thematic categories are categories that emerged while the interviews actually took place. Based on these categories, within-case displays (Miles and Huberman, 1994) were developed first to enable exploring and describing the themes under investigation. These within-case displays should also help to identify possible linkages across themes and questions that might exist within each case (each interviewee). Cross-case displays followed next. These displays allowed the researcher to compare and group interviewees according to thematic similarities and dissimilarities that emerged across interviewees. The cross-case displays were then used as the basis for the second analytical procedure, namely the development of grouped cognitive maps (Swan, 1997).

The qualitative data analysis technique of cognitive mapping is essentially a tool to visually map how people (managers, employees etc.) view the complexities of a given social phenomenon of interest (Huff, 1990; Easterby-Smith et al, 1991; Fiol and Huff, 1992). The importance here is that the maps represent the mental models of the interviewee (or interviewees) as he or she sees them, *not* how the researcher sees them (Easterby-Smith et al, 1991). Its theoretical base is Kelly's personal construct theory (Kelly, 1955, cited in Huff 1990). This theory suggests that people make sense of the world in order to understand it, enabling them to predict future states and using their mental models – their personal constructs - as guides for behavioural pattern. Researchers using the cognitive mapping technique try to externally visualise these internal mental modes and their various linkages (Huff, 1990; Fiol and Huff, 1992).

There are essentially five different ways of how to map these mental modes (Huff, 1990):

1. Maps that assess attention, association and importance of concepts
2. Maps that show dimensions of categories and cognitive taxonomies
3. Maps that show influence, causality and system dynamics
4. Maps that show the structure of argument and conclusion
5. Maps that specify schemas, frames and perceptual codes

Taking the research objectives of this study into consideration, it is apparent that the most fruitful way of mapping the interviewees' cognitive perceptions are maps that show influence, causality and system dynamics (map type 3, see above). Since it was noted that the internationalisation of firms is essentially a dynamic developmental process, this way of mapping should enable the researcher to model the causal flows that influence this very dynamic process. As stated above, the previously developed within-case and across-case displays formed the basis for developing the cognitive maps. Again, content analysis was used to develop these maps (Erdemer and Dunn, 1990).

Each respondent's cognitive map was then compared to create grouped cognitive maps of similar structure (Eden, 1993; Scheper and Faber, 1994; Swan, 1997). The resultant grouped maps, therefore, present visually, the shared subjective beliefs of the group in question. This procedure was considered useful because in organisational contexts shared beliefs could be considered to be more directly related to decision-making and strategy making than is the case in isolated, individual contexts (Jelinek and Litterer, 1994). In addition, analysing the underlying differences (e.g. managerial differences, functional differences, differences in age etc.) between the groups of similar cognitive structures provides a valuable additional insight.

The developed cognitive maps formed the basis for the subsequent analysis and interpretation, more precisely the theorising and retextualising stage as outlined above. The cognitive maps are presented in chapter 7. In order to enrich the understanding of the cognitive maps, complementary quotes were used when applicable. It is important to note that the quotes will not identify the specific names and positions of respondents from GD as a commitment to confidentiality was given at the interviews. Instead, interviewees will be categorised into three groups according to their positions which are – as mentioned before – Senior Corporate Member (SCM), Senior Functional Member (SFM) and General Manager (GM)of

Hotels. Due to the fact that the managers and one of the hotel consultants interviewed were not English native speakers, errors might appear on these quotes reflecting their language skills rather than errors made by the researcher in the transcription process.

## 5.7 Limitations

Limitations are discussed here both in terms of methodological and practical levels.

### 5.7.1 Methodological Limitations

As mentioned before, with quantitative research, in general, sample sizes are greater than other approaches and controlled in such a way as to be representative of the population from which they are drawn. This allows greater confidence in accepting the reliability or generalisability of the findings with which qualitative research cannot compete.

Manson (1996) addresses an important question as to what the qualitative researcher can claim on the basis of the results from their research, in other words, to what extent the findings of the research are representative and can be generalised to the wider sector. This research adopts a case study approach, from a positivistic standpoint this research cannot be regarded as representative and are incapable of generating findings which can be validly generalised to wider instances of the phenomenon in the population at large. There is recognition of the difficulties of generalising on the basis of a case study approach (see Bryman, 1988, Clark, et al

1998), due to case study lacks scientific weight and general applicability, this lack of statistical validity makes generalisation difficult.

However, Brotherton (1999) argues that the selection of a particular case for inclusion in a study is normally purposive rather than random in nature. Thus, the basis for selection is not usually governed by the concerns of statistical probability but by theoretically informed judgement. In case study research, it is considered more appropriate to treat representativeness in terms of a qualitative logic for the selection of cases for study, rather than a quantitative logic of sampling from a population.

This study attempts to expand and generalise theories and not to enumerate frequencies by investigating a Chinese hotel chain's internationlisation. The research seeks to establish aspects of behaviour in the process of the only multinational Chinese hotel chain's internationlisation; lessons and experiences from this case can be learned by other Chinese hotel chains. Furthermore, the key ideas of the to be developed theoretical framework of internationalisation of Chinese hotel companies might be transferable to enterprises from the less developed world where the government is the key body in changing the social and economic structures of the society through what Rose (1993) called 'Lesson-drawing'. This reflects the view of Bassey (1981 cited in Brotherton 1999) who believes the relatability of a case study is more important than its generalisability... if they are relatable, and if by publication of the findings they extend the boundaries of existing knowledge, then they are valid.

Indeed, by adopting the case study approach, this research does not have the strengths of providing wide coverage of the range of situations and probably being fast and economic to undertake in comparison to quantitative research. Using a single case study did not allow a direct comparison, although general comparison is attempted with the internationalisation processes of other hotel companies. Thus the evidence and theories drawn from the case is less powerful compared to a multi-case approach. However, as mentioned before that each research strategy has its own strengths and weaknesses, the appropriateness of a research approach derives from the nature of the social phenomenon to be explored (Morgan and Smircich, 1980). The nature of this research has determined the case study approach is the most appropriate.

### 5.7.2 Problems during Fieldwork

As mentioned before, the researcher intended to incorporate external primary data relating to the views of hotel consultants into the study in order to increase its validity. In relation to the selection of respondents from hotel consulting firms, the researcher faced the problem in which she was based in the U.K. with limited connections in Hong Kong. However, she got the help from her associates who had contact with the Managing Director of Lintel Hospitality Consultants (HK) Limited. He was a great interviewee, apart from the valuable information he provided, he also told the researcher that there are not many hotel consulting firms in Hong Kong especially who have worked with China. Horwath Consulting was one organisation the researcher could contact. The researcher contacted the major consulting firms in Hong Kong and explained the nature of the research. Unfortunately, these firms either do not have a hospitality division, or they have had never undertaken any work which is Chinese hotels related. This resulted in the limited number of interviews with hotel consultants.

When the researcher wanted to contact Horwath Consulting her visa expired. That was one of the problems during the interviews. The researcher was holding a Chinese passport that determined her duration of stay in Hong Kong as seven days each time. It was impossible to conduct 15 interviews within a week. The researcher had to leave Hong Kong for home in Beijing which was about 3 hours flying time from Hong Kong. The fieldwork was forced to stop, an inconvenience which made the field work not only time consuming but also very costly. The researcher flew back to Hong Kong two weeks later to complete the interviews. However, when the researcher was in Beijing, she contacted Horwath Consulting Hong Kong via Horwath Consulting Office in Beijing and the Managing Director was very helpful indeed which eventually led to a good data collection experience.

Another problem of conducting interviews was that some interviewees (government appointed) from the case study organisation did not feel free to provide the information relating to the sensitive issues. As a state owned enterprise, GD shares some similarities in which the corporate members were appointed by the government and its management style is still largely shaped by the bureaucratic system. They did not feel comfortable to talk about their failure and provide insights, this reflects the traditional Chinese cultural influence of maintaining secrecy (Child and Lu, 1996). Thus, the researcher changed the way of asking these questions, instead of asking why and how, the researcher asked if you were the decision-maker what would you do? She then prompted the respondents to say more. However, the free flow of information was not provided by all interviewees. Although the researcher tried her best, a few respondents were still very diplomatic.

It is true that there is no guarantee that what people say in an interview is a true account of what they actually do, whether they are intentionally lying or whether they genuinely believe what they are saying (McNiel 1991). That is a concern that every interviewer encounters. Clark *et al* (1998) recognise the fact that the researcher is an unavoidable part of the research process and will subjectively bring their own values and beliefs to the research. Thus researchers can never be sure that they have got the world view of their respondents or that they have correctly interpreted the meanings of people's behaviour since there are no well-documented guides for qualitative analysis in comparison to quantitative research. The qualitative data analysis is generally self-generated and controlled, the 'soft' data produced by qualitative research are often viewed as lacking in both reliability and validity (Gordon and Langmaid, 1988).

However, this research is valid to the extent that the researcher has tried her best to collect the data as true as possible and sought to provide the interpretation of the data as it was, and accurately representing what was happening during the time of the data collection. The approach pursued in this research was congruent with the research objectives and conducted in a careful, thorough, honest and accurate way, which

Mason (1996) suggests are the key criteria for judging the reliability of a qualitative research.

## Conclusion

This chapter has outlined the method which was adopted for conducting this piece of research. A case study approach was chosen as the research strategy to investigate a social phenomenon of the Chinese hotel chain's internationlisation. The reasons for choosing this case study organisation were explained, and the related research technique utilised for this research was also discussed. The implementation of the case study approach consisted of developing interview guides, preparation before interviews, conducting interviews, and analysing the qualitative data. The limitations of the study both at the theoretical and practical levels were also stated.

The experience of using case study as the research strategy has led the researcher to support Brotherson's (1999 p.136) view: "although there may be a temptation for some commentators in the research methodology literature to regard case study research as a 'softer' option than the more quantitative, experimental or survey approaches, it clearly is not. The case study researcher not only needs to possess a significantly greater range and degree of interactional skills than is the case in non-interactional approaches, but must also be capable of implementing a multiple-method study in relation to data collection, analysis and interpretation. Far from being a 'soft' option it is perhaps one of the most difficult and demanding for the researcher".

# Chapter 6: Case Study - Guangdong (International) Hotel Management Limited

## 6.1 Background of the Parent Company – Guangdong Enterprises (Holdings) Ltd.

China started to open its door to the outside world at the end of the 1970s. In order to better effect reform and opening up policy and to stimulate economic development, starting in 1980 China has established special economic zones (SEZs) in Shenzhen, Zhuhai and Shantou in Guangdong Province, Xiamen in Fujian Province, and in the entire province of Hainan, and opened access to/ from coastal cities. Indeed, both the economic zones and the coastal cities were designated as the windows for developing foreign economic activities. At the same time, the Chinese government recognised the fact that, to some extent, Hong Kong could be treated as an existing window with much more potential, and hence stressed the need to promote China's economic involvement in the territory (Lin, 1996).

As a consequence, apart from the centrally-administered companies which increased their investment in Hong Kong, local government at various levels and domestic firms have obtained greater autonomy in their economic operations. Guangdong Enterprises (Holdings) Ltd was registered in Hong Kong in June 1980 and started business on 5 January 1981. To a great extent, it is a representative of the provincial (Guangdong) governmental in Hong Kong. In other words, it is a Hong Kong China-invested company (CIC).

Li (1992) and Luo *et al* (1993) classify Chinese overseas investors into four categories according to their business scope. Investors who belong to Foreign Trade Corporations which are part of the Ministry of Foreign Trade and Economic Co-operation or the Department of Foreign Trade and Economic Co-operation of provincial governments are classified into the first category.

The second category consists of a number of Foreign Business Oriented Companies or Conglomerates, which were set up by the central and local governments in the early 1980s to develop and extend their foreign business activities. The third group is composed of some large industrial corporations and hi-tech enterprises which were designed as 'showcases' with regard to ownership and management reform in China. The last category is the small and medium sized firms (SMEs), in particular from Guangdong and Fujian provinces, and which were also quite active in establishing foreign operations in neighbouring countries.

Taking this classification into the consideration, it is clear that Guangdong Enterprises (Holdings) Ltd. fits into the second category. In 1981, the pioneers of the firm brought HK$16 million to Hong Kong to start its business as a single trading company. It is a firm located in Hong Kong, arguably a foreign market, and they are also rooted in China. This two-site locational characteristic allows Guangdong Enterprises to enjoy the advantages of institution and information asymmetry over both domestic and foreign firms, given the significant impact of both factors on saving transaction costs when doing business in China's transitional economy. By operating in Hong Kong, Guangdong Enterprises is subject to lower administrative constraints and even to receiving favourable policy treatment only given to foreign firms, as well as enjoying better access to international market information.

Under this supportive business environment, Guangdong Enterprises has experienced rapid development, the scope of operation has extended to both manufacturing and service industries, with total value of assets of HK$40 billion (Heng and Ke, 1997). In order to survive in the environment of the market economy, Guandgong Enterprises realised that they must develop their own businesses apart from trading. Together with its better China environment knowledge, stronger local administrative support, and better access to the domestic market, they started undertaking some manufacturing investment in China. The products they manufacture in China include metal products, construction materials, timber and furniture, electronics, textiles, foodstuffs and beverages. The non-manufacturing activities with which the firm is involved are transportation, real estate, hotels and travel agents, department stores, financial services, and an insurance company. Like many other foreign investors, Guangdong Enterprises prefers to invest in special economic zones and coastal regions within China. The overseas investments are located in France, U.K. Poland, Canada, U.S.A., Australia, Vietnam, Singapore, Malaysia, and Thailand (Heng and Ke, 1997).

Since China began to pursue a policy of opening its door to the outside world, foreign tourism was seen as a means to accumulate funds for modernisation programmes, to increase Chinese income and employment levels. The importance of tourism as a means for accumulating foreign exchange was recognised and emphasised by both Deng Xiaoping and Chen Yu who delivered important speeches about the economic benefits of tourism. Deng Xiaoping argued that developing tourism should first develop those businesses, which could earn more money (Han, 1994; He, 1992). Indeed, Deng and Chen's supportive attitudes led to the positive changes in tourism policy. In the 1980s, Chinese tourism policy became increasingly concerned with economic over political benefits. In line with the Chinese government's call to develop China's tourism, Guangdong Enterprises started its tourism and hotel business.

In late 1981, The Guangdong (Hong Kong) Tours Company Ltd. was established by Guangdong Enterprises. Since 1983, Chinese citizens have been allowed to join organised tours to visit their relatives in Hong Kong. The first international tours offered in China were called 'relative-visiting' tours to Hong Kong. Due to the geographic closeness and close cultural and family ties between Hong Kong and Guangdong province, people from this province have been the major source of business. Later, the scope of the business expanded. Guangdong (HK) Tours offered Chinese travellers more destinations in countries like Malaysia, Singapore and Thailand. Apart from this, Guangdong (HK) Tours also arranges international tours for Hong Kong residents and China tours for residents of Macau and Taiwan.

It is important to note that Guangdong (HK) Tours was the first travel agent in Guangdong Province to organise tours to Hong Kong. In fact, only designated China-owned, but Hong Kong-based tour companies - China Travel Service (HK) and Guangdong (HK) Tours have been licensed by China to operate these tours (Zhang, 1999). But the situation has changed dramatically, by 1998, there were 63 travel agencies in all of China licensed to handle outbound travel (Bailey, 1998), and GD has good connections with Mainland Chinese travel agents.

In accordance with the development of tourism, Guangdong Enterprises started thinking about running hotel businesses. Consequently, the first GD Hotel – Guangdong Hotel was opened in December 1986 in Tsimshatsui, the main shopping area for tourists in Hong Kong. Since then, they have enjoyed rapid hotel development. In 1993, Guangdong Enterprises separated its hotel business component and Guangdong (International) Hotel Management Limited was established.

## 6.2 Guangdong (International) Hotel Management Limited

Guangdong (International) Hotel Management Limited (GD Hotel Group) was established in 1993. The corporate objectives of the Chinese hotel chain are to provide quality service to the customers and to play an active role in the global hotel industry. The organisation has been developing hotels in areas of Hong Kong, Mainland China, Southeast Asia and Europe. Currently they manage the following hotels:

**Mainland China**: The Guangdong Regency Hotel (Zhuhai), Yuehai Hotel (Guangzhou), Guangdong Hotel (Shenzhen), Guangdong Hotel & Resort, Lianhuashan (Panyu).

**Hong Kong**: Guangdong Hotel, The Wharney Hotel, New Cathy Hotel, Guangdong Tours Hotel and Irving Court;

**Thailand**: The Regina Hotel in Bangkok; and

**France**: Chinagora Hotel in Paris.

All these properties are wholly-owned by the Group. They were new build hotels except those in Hong Kong (which were acquired because it is difficult to build hotels in Hong Kong due to the high land cost) and the Regina Hotel in Bangkok. Table 6.1 illustrates the development of the GD Hotel Group.

**Table 6.1: GD Hotel Group's Investment**

| Year | Name of Hotel | Country | Ownership Stance | Hotel type |
|---|---|---|---|---|
| 1986 | Gongdong Hotel | Hong Kong | Wholly-owned | mid-market |
| 1986 | New Cathay Hotel | Hong Kong | Wholly-owned | mid-market |
| 1987 | Guangdong Tours Hotel | Hong Kong | Wholly-owned | Guest house |
| 1988 | Irving Court | Hong Kong | Wholly-owned | Guest house |
| 1988 | Guangdong Hotel | Shenzhen (China) | Wholly-owned | mid-market |
| 1988 | Chinagora Hotel | Paris (France) | Wholly-owned | mid-market |
| 1990 | Yuehai Hotel | Guangzhou (China) | Wholly-owned | mid-market |
| 1991 | The Regina Hotel | Bangkok (Thailand) | Wholly-owned | mid-market |
| 1991 | The Wharney Hotel | Hong Kong | Wholly-owned | mid-market |
| 1991 | Guangdong Regency Hotel | Zhuhai (China) | Wholly-owned | 5-star |
| 1991 | Guangdong Hotel & Resort, Lianhuashan | Panyu (China) | Wholly-owned | mid-market |

Source: Internal company documentation

From Table 6.1 it can be seen that most of the properties GD Hotel Group operates are middle market and budget hotels except the one in Zhuhai which offers a luxury product. Regarding the type of ownership, the group prefers the wholly-owned method. It is true that most of the hotels have grown through the combination of owner/operator being the same entity. This situation has meant, in the long run, a maximum return to the GD Hotel Group through operating profit and capital gain. Conversely, of course, the group has to take all the operating risks.

In fact, for some hotel projects, a joint venture entry mode was selected in the initial stage, but the organisation failed to go through such a co-operative route with its partners. Apart from the properties addressed in Table 6.1, the group used to have more hotels under its name, but due to various reasons, they failed to keep them as part of their portfolio to date. This issue will be raised and analysed in the next section.

In entering the international hotel marketplace, the GD Hotel Group faced a very competitive environment in which most of the major players have already achieved a strong market position. As a Chinese hotel firm, in the early stage it had the clear vision that development must be towards economic benefits, instead of political considerations. In order to compete and survive in the market, they put great emphasis on training a rational and rigorous management team which are able to understand the market with solid knowledge and experience, aiming to develop a cost effective Chinese hotel chain with commensurate specification and facilities.

GD Hotel Group is a socialist firm, but its operational base is in the environment of a market economy, rather than a transitional one in which domestic firms operate. This specific operational site – Hong Kong - and their consequent identification as a foreign investor when they invest back in China, could be regarded as the firm's great competitive advantage.

## 6.3 Unique Features of the GD Hotel Group's Development

In comparison with other hotel chains from developed or some developing countries (see chapter 3), The GD Hotel Group, to a great extent, is an absolutely new player in the field and confronted an increasingly competitive environment. However, as mentioned in Chapter 3 for location-bound services, where interaction between supplier and customer is essential, location of many services will tend towards areas of high population density (Enderwick, 1989). In the case of hotel businesses, with few exceptions the location is clearly specific to the tourist destination as it is a location-bound service (Boddewyn, *et al* 1986).

GD Hotel Group is a Hong Kong based Chinese hotel chain. Hong Kong is a leading financial, trade, shipping and tourist centre. Despite the recent decline caused by the Asian economic crisis, the hotel industry greatly benefits from the Territory's economic growth and the support of complementary real estate developments such as office buildings, retail malls, and a world-class convention centre. These real estate developments draw both commercial and leisure tourists and help to create room demand. Thus, the size and the growth rate of tourism, to a certain extent, are guaranteed. As Go and Pine (1995 p.168) noted 'Tourism is Hong Kong's second most important earner of foreign currencies'.

The GD Hotel Group first started its business in Hong Kong by acquiring a hotel in Tsimshatsui which was later named Guangdong Hotel. Apart from enjoying a locational advantage, the remarkable growth of China outbound travel to Hong Kong has had significant impact on the development of the GD Hotel Group.

China outbound travel to Hong Kong has experienced significant growth over the past decade with an average growth of over 20 percent (Zhang, 1999). The growth began in the early 1980s following the open door policy, the introduction of Visiting Friends and Relatives visits through two-way permits, and later on with 8 day and 7 night package tours. Foreign exchange relaxation and the visa-free policy for transit passengers resulted in the surge of Chinese arrivals. The major breakthrough in outbound travel came in May 1991, when the Chinese government allowed more destinations to Chinese citizens to visit. However, the China market still remains the number one market for Hong Kong (see Table 6.2)

### 6.3.1 Initial Market Entry

Go and Pine (1995) give three major forces for the development of mid-market hotels in Hong Kong. First, visitor arrivals from China and other Asian countries are increasingly rapidly due to their fast economic growth. Tourists from these countries are less willing to spend as much on accommodation than their Western counterparts. Second, high labour costs and labour shortage have been major barriers hindering the growth of the hotel industry. Luxury hotels– providing labour-intensive services– are particularly hard pressed under the current circumstances to retain good staff members and expand. Third, due to constraints on travel and entertainment budgets, executive travellers seek less expensive and more functional accommodation. Due to these market conditions and high land prices, GD Hotel Group made a strategic decision in the early stage of its development that its properties in Hong Kong are mid-market and budget sector orientated (see Table 6.1).

One of the important factors to make a successful operation is that supply matches demand. As mentioned before, in 1991, the Chinese government launched a policy towards China outbound travel. This breakthrough allows Chinese citizens to join tours organised by China Travel Service to Hong Kong and its neighbouring countries which to a great extent has affected Hong Kong's tourism industry (see Table 6. 2).

**Table 6.2: Comparison of Total Visitors from Mainland China and all other Countries to Hong Kong 1984-1998**

| Years | Total arrivals from Mainland China | % Growth | Total arrivals from other countries | % share from China |
|---|---|---|---|---|
| 1984 | 214,854 | - | 3,303,719 | 7% |
| 1985 | 308,978 | 43.8 | 3,656,717 | 8% |
| 1986 | 363,479 | 17.6 | 4,052,641 | 9% |
| 1987 | 484,592 | 33.3 | 4,917,044 | 10% |
| 1988 | 683,604 | 41.1 | 6,167,221 | 11% |
| 1989 | 730,408 | 6.8 | 5,984,501 | 12% |
| 1990 | 754,376 | 3.3 | 6,580,850 | 11% |
| 1991 | 875,062 | 16.0 | 6,795,413 | 13% |
| 1992 | 1,149,002 | 31.3 | 8,010,524 | 14% |
| 1993 | 1,732,978 | 50.8 | 8,937,500 | 19% |
| 1994 | 1,943,678 | 12.2 | 9,331,156 | 21% |
| 1995 | 2,243,245 | 15.4 | 10,199,994 | 22% |
| 1996 | 2,311,184 | 3.0 | 11,702,735 | 20% |
| 1997 | 2,297,128 | -0.6 | 10,406,261 | 22% |
| 1998 | 2,597,442 | 12.9 | 9,574,711 | 27.1% |

Source: A Statistical Review of Tourism 1993-1999, HKTA

Table 6.2 illustrates that China outbound travel to Hong Kong has experienced a remarkable growth over the past decade. After the introduction of outbound tourism policy in 1991, the number of arrivals increased significantly with an average annual growth of over 20% per cent. In 1995, tourist arrivals from Mainland China to Hong Kong reached over 2.2 million, accounting for 22% per cent of the total and became the biggest market. As of 1998, Mainland China still remains the largest source market for Hong Kong (see Table 6.3).

**Table 6.3: Top Ten Markets in Hong Kong**

| Ranking in 1998 (1997) | Markets | No. of Arrivals | Share of Total % |
|---|---|---|---|
| 1 (1) | Mainland China | 2,597,442 | 27.1 |
| 2 (2) | Taiwan | 1,812,634 | 18.9 |
| 3 (3) | Japan | 945,334 | 9.9 |
| 4 (4) | U.S.A | 773,309 | 8.1 |
| 5 (7) | Singapore | 331,610 | 3.5 |
| 6 (6) | United Kingdom | 325,738 | 3.4 |
| 7 (9) | Australia | 272,454 | 2.8 |
| 8 (10) | Malaysia | 235,928 | 2.5 |
| 9 (8) | Philippines | 214,556 | 2.2 |
| 10 (13) | Canada | 194,351 | 2.0 |

Source: A Statistical Review of Tourism 1998, HKTA

The GD Hotel Group has been targeting this huge growing market, together with the assistance of Guangdong (HK) Tours who deliver group demand from Mainland China. From Table 6.3 we can see that the Mainland China, Taiwan and Japan together constitute almost 56% of Hong Kong total arrivals. Indeed, the GD Hotel Group's reliance on these major source markets has persisted (see Table 6.4).

## Table 6.4: Major Market Areas of GD Hotels in Hong Kong

| | Guangdong Hotel | | | | The Wharney Hotel | | | |
|---|---|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1995 | 1996 | 1997 | 1998 |
| | % | % | % | % | % | % | % | % |
| Mainland China | 8.8 | 9.0 | 16.28 | 25.25 | 5 | 7 | 11 | 41 |
| Taiwan | 4.35 | 3.16 | 3.29 | 2.34 | 15 | 2 | 8 | 3 |
| Japan | 32.57 | 34.18 | 26.76 | 23.98 | 8 | 11 | 8 | 6 |
| South-East | 42.01 | 43.93 | 37.3 | 20.05 | 22 | 13 | 17 | 20 |
| Europe | 1.75 | 1.47 | 4.22 | 8.94 | 25 | 37 | 26 | 10 |
| US&Canada | 2.53 | 2.74 | 3.51 | 3.93 | 1 | 1 | 1 | 1 |
| Others | 7.03 | 5.52 | 8.64 | 11.04 | 24 | 29 | 29 | 19 |

| | New Cathay Hotel | | | | Irving Court | | | |
|---|---|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1995 | 1996 | 1997 | 1998 |
| | % | % | % | % | % | % | % | % |
| Mainland China | 71.52 | 71.34 | 70.96 | 66.27 | 100 | 99 | 99 | 98 |
| Taiwan | 1.74 | 1.96 | 1.99 | 1.96 | | | | |
| Japan | 2.74 | 2.93 | 3.07 | 2.94 | | | | |
| South-East | 12.17 | 11.09 | 10.87 | 8.95 | | | | |
| Europe | 3.04 | 3.02 | 2.99 | 3.61 | | | | |
| US&Canada | 2.55 | 2.79 | 2.81 | 2.82 | | | | |
| Others | 5.84 | 6.87 | 7.30 | 13.45 | | 1 | 1 | 2 |

| | Guangdong Tours Hotel | | | |
|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 |
| | % | % | % | % |
| Mainland China | 95.91 | 92.72 | 92.49 | 96.65 |
| Taiwan | 2.06 | 3.97 | 4.55 | 1.35 |
| Japan | 0.01 | 0.02 | 0.02 | 0.09 |
| South-East | 1.88 | 2.99 | 2.74 | .63 |
| Europe | | | | |
| U.S&Canada | 0.14 | 0.27 | 0.19 | 0.21 |
| Others | | 0.04 | 0.01 | 0.07 |

Source: Internal Company Documentation

Go and Pine (1995) note that tourists from South-east Asia, Japan, and Taiwan spend 25 percent or less on accommodation. Table 6.5 shows that the spending pattern by major items for the China market within which hotel bills only represent less than 20% of total spend. The products which the GD Hotel Group offers are that of mid-market to budget hotels and these have perfectly matched the demand of its target markets. It is interesting to note that according to HKTA (1998), lower grade hotels enjoyed growth in occupancy rates over the year due to the buoyant Mainland China market, and many visitors are more price-conscious. Conversely, the average occupancy rates in high tariff hotels dropped.

**Table 6.5: Spending Pattern by Major Items for China Market 1994-1998 (Million HK$)**

| Major Items | 1994 | % | 1995 | % | 1996 | % | 1997 | % | 1998 | % |
|---|---|---|---|---|---|---|---|---|---|---|
| Shopping | 6007 | 56.5 | 8386 | 61.0 | 9652 | 63.5 | 10140 | 65.1 | 9213 | 64.6 |
| Hotel Bills | 2187 | 20.6 | 2567 | 18.7 | 2541 | 16.7 | 2322 | 14.9 | 2212 | 15.5 |
| Meals outside hotels | 1491 | 14.0 | 1783 | 13.0 | 1707 | 11.2 | 1836 | 11.8 | 1395 | 9.8 |
| Entertainment | - | - | - | - | 171 | 1.1 | 189 | 1.2 | 192 | 1.4 |
| Tours | 364 | 3.4 | 346 | 2.5 | 684 | 4.5 | 598 | 3.8 | 795 | 5.6 |
| Others | 582 | 5.5 | 664 | 4.8 | 455 | 3.0 | 493 | 3.2 | 441 | 3.1 |
| Total | 10631 | 100 | 13746 | 100 | 15209 | 100 | 15579 | 100 | 14252 | 100 |

Source: A Statistical Review of Tourism 1994-1998, HKTA.

Details of tourist receipts from Mainland Chinese were first reported by the Hong Kong Tourist Association in 1993, owing to the liberalisation of currency restrictions which made it possible for them to contribute economically to the territory's tourism industry (Zhang, 1999). Table 6.6 illustrates the significant growth of Chinese visitors consuming ability. According to HKTA (1997), although Hong Kong's total tourism receipts kept dropping from HK$ 84.5 in 1996 to HK$ 69.9 in 1997, the total spend of the China market has seen a moderate 2.4% increase. In 1998, the total Mainland visitor spending was HK$14252 million accounting for a significant 26.9% of the total receipts (see Figure 6.1), although it was down 8.5% over 1997. This is due to the shorter average stay –3.9 nights in 1998, a 22% drop over 1997.

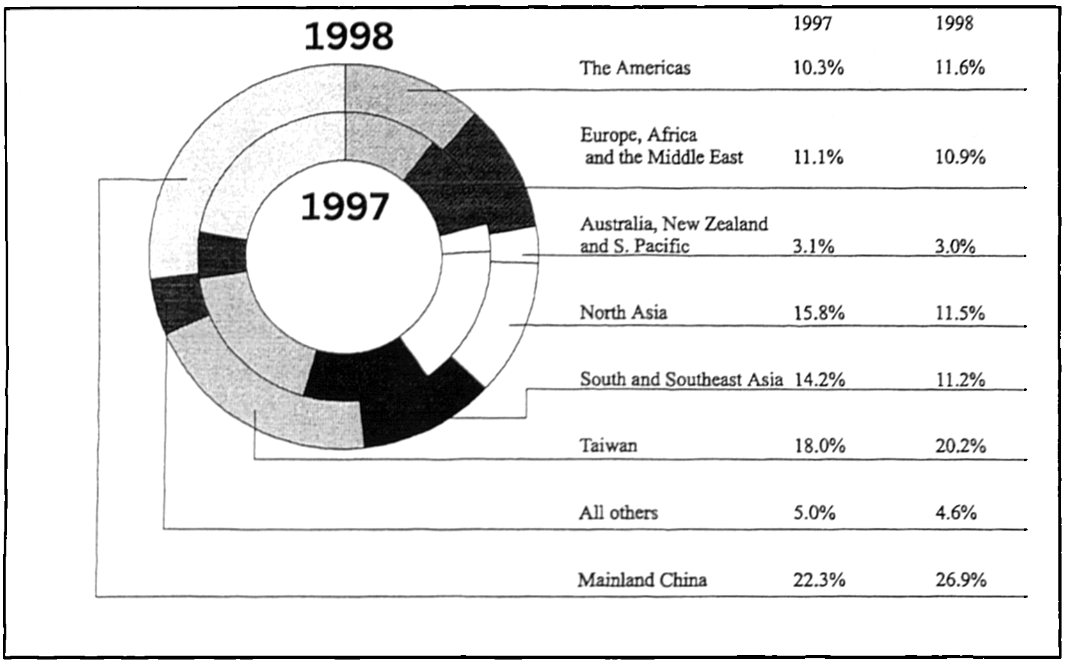
**Table 6.6: Tourist Receipts of Mainland Chinese Visitors 1993-1998 (Million HK$).**

| Year | Total | % Growth | Per Capita Spending | % Growth | Per Day Spending | % Growth |
|---|---|---|---|---|---|---|
| 1993 | 8004 | -- | 5270 | -- | 921 | -- |
| 1994 | 10630 | 32.8 | 5469 | 3.8 | 904 | -1.8 |
| 1995 | 13746 | 29.3 | 6128 | 12.0 | 1048 | 15.9 |
| 1996 | 15209 | 10.6 | 6581 | 7.4 | 1203 | 14.8 |
| 1997 | 15579 | 2.4 | 6782 | 3.1 | 1363 | 13.3 |
| 1998 | 14252 | -8.5 | 5487 | -19.1 | 1411 | 3.5 |

Source: A Statistical Review of Tourism 1993-1998, HKTA.

Due to the stable economic growth in China, and the increasing level of wealth and disposable income, the China market has become the biggest contributor to Hong Kong's total visitor receipts among all major markets. Figure 6.1 presents the total expenditure of the China market accounting for 22.3 per cent in 1997, and increasing to 26.9 per cent in 1998, which again overtook Japan's position as the number one contributor (HKTA, 1998).

**Figure 6.1: Receipts from visitors by Major Market Areas 1997&1998**




Total Receipts
1997: HK$69,946.03M 1998: HK$53,078,70M
Source: A Statistical Review of Tourism 1998, HKTA.

Not surprisingly, GD Hotels in Hong Kong also have significantly benefited from the growth of the Mainland China market. Table 6.7 shows the operational performance of GD Hotels in Hong Kong. In 1996 The Wharney Hotel which had the highest average room rate of HK$901 made the highest gross operating profit of HK$56,396,538; that was a 11.2% increase over the previous year. In 1995, the average room rate of the Guangdong Hotel was HK$782,61 and the average occupancy rate was 83.66%. Despite an increase in average room rate to HK$842,25 in 1996, the occupancy rate did not drop, instead, it reached to 87.84%. The performance of the New Cathay Hotel also showed increase in terms of room rate and occupancy. The Irving Court and the Guangdong Tours Hotel are guest houses which cater especially to Mainland Chinese tourists. In 1996, Guangdong Tours Hotel had the highest average room occupancy 92.55% within the group, and the turn over of Irving Court reached HK$32,473,794, which represented a 17.7% increase over 1995.

**Table 6.7: Operational Performance of GD Hotels in Hong Kong (HK$)**

| 1995 | The Wharney Hotel | Guangdong Hotel | New Cathay Hotel | Guangdong Tours Hotel | Irving Court |
|---|---|---|---|---|---|
| Turn over | 130,504,392 | 95,641,807 | 39,698,626 | 15,292,955 | 26,715,122 |
| Gross Operating Profit | 50,032,049 | 32,051,563 | 18,324,496 | 6,053,239 | 15,465,191 |
| Average Room Occupancy | 80.71% | 83.66% | 83,43% | 88.92% | 76.06% |
| Average Room Rate | 820.29 | 782.61 | 470.05 | 557.55 | 518.03 |
| 1996 | | | | | |
| Turn over | 140,483,635 | 98,390,524 | 40,558,366 | 17,575,958 | 32,473,794 |
| Gross Operating Profit | 56,396,538 | 33,099,479 | 17,802,959 | 7,033,152 | 20,011,156 |
| Average Room Occupancy | 85.03% | 87.84% | 85.96% | 92.55% | 85.88% |
| Average Room Rate | 901.36 | 842.25 | 499.20 | 578.71 | 537,43 |
| 1997 | | | | | |
| Turn over | 110,687,695 | 77,293,544 | 33,325,707 | 14,334,684 | 29,815,032 |
| Gross Operating Profit | 28,593,022 | 12,327,794 | 10,140,419 | 4,102,488 | 17,503,919 |
| Average Room Occupancy | 60.95% | 74.51% | 66.67% | 76.60% | 65.92% |
| Average Room Rate | 967.42 | 762.43 | 511.32 | 567.85 | 563.89 |
| 1998 | | | | | |
| Turn over | 73,915,508 | 53,676,137 | 19,547,806 | 8,956,480 | 26,569,871 |
| Gross Operating Profit | 4,231,398 | 1,268,213 | 844,384 | 437,895 | 16,518,361 |
| Average Room Occupancy | 62.25% | 78.33% | 67.28% | 80.59% | 70.34% |
| Average Room Rate | 479.34 | 374.59 | 269.84 | 323,90 | 290.81 |

Source: Internal Company Documentation

Since 1997, the operating results show falling revenues and profits. This followed a decline in tourist arrivals following the reversion of sovereignty and the onset of the Asian financial crisis in mid-1997. Occupancies plunged to unprecedented levels. Like many other hotels in Hong Kong, the real impact of the downturn is most evident in the 1998 operating performance presented in Table 6.7. The occupancy rates fell to 71.8% in 1998 compared to 87.6% in 1996. This performance was achieved on the back of a 49% fall in average daily room rates. Indeed, GD Hotel Group has experienced a difficult time. However, according to the Hong Kong Hotel Industry (1999), 1998 was the bottom of the current cycle. Profits in the next few years should recover gradually.

Apart from the external threat which caused the downturn, another emerging factor which reduces the demand for accommodation also needs to be taken into the consideration. According to HKTA (1998), the overall length of stay in Hong Kong by visitors has declined since 1996. In 1998, the average length of stay was 3.4 nights, compared with 3.9 nights, 3.7 nights and 3.6 nights in 1994, 1996 and 1997 respectively. The overall shorter average stay recorded in 1998 was influenced by Mainland visitors' stay of 3.9 nights, a 22% drop over 1997. Mainland China is GD Hotels' major market, the negative result thus is not a surprise.

In fact, Mainland visitors have been staying for increasingly shorter periods over the years, ranging from 6.1 nights in 1994 to 5.5 nights in 1996 and 5.0 nights in 1997. This phenomenon occurs with reason. Visitors from Mainland China are tending to travel to a wider range of destinations as more destinations are approved by the Chinese government. Many visitors therefore travel on multi-destination tours, with Hong Kong as only one of the cities visited during the trip.

Despite the negative impact on accommodation demand in Hong Kong, it is important to bear in mind that if a firm intends to compete in this increasingly competitive market, it has to take a practical view that long-term growth is more important than short-term gain. In fact, this phenomenon can be regarded as a good sign in relation to GD Hotel Group's long-term growth. This is because as a Chinese hotel chain, it is facing many difficulties if competing with leading hotel companies. In order to reach the objective of being an international player, targeting the huge growing Mainland China market is a practical strategy. There continue to be more destinations approved by the Chinese government, which means more opportunities will be opened up for the GD Hotel Group to make its further international expansion.

Douglas and Craig (1989) postulate that the process of internationalisation involves a firm moving through three successive stages: initial market entry, local market expansion, and global rationalisation. Applying this process in the case of GD Hotel Group's development, it can be argued that due to its specific operational site, the firm's initial market entry was in Hong Kong. Continuous expansion in Hong Kong and breaking into China's market can both be fitted into Douglas and Craig's local market expansion stage.

### 6.3.2 Reverse Investment in China

Rapid economic development in China as the biggest emerging market has attracted many overseas companies. Since the beginning of the economic reform, the Chinese government has encouraged foreign investment and opened industry after industry.

As mentioned before, from the very beginning of the reform period, China established overseas firms for outward investment. Subsequently and interestingly the overseas firms, notably those firms located in Hong Kong, have returned to the China market to initiate more and more reverse investment, which is counted officially as FDI regardless of the domestic background of the investors (Lin, 1996). The GD Hotel Group was one of them who started investing back to China from 1988.

China has been a market in transition that has evolved from the introductory stage to the growth stage in many product categories (Wong and Maher, 1997). It represents tremendous opportunities for growth and expansion. Figure 6.2 illustrates the major historical events in China's economic reform and foreign investment policy during the past two decades. As Cui (1998) noted, these milestones highlight four periods of China's market evolution process: open-door, experimentation, austerity and re-alignment. Major political events and new policies in each stage represent the external triggers that brought opportunities as well as challenges for foreign investors.

**Figure 6.2: Milestones of China's Economic Reform and Foreign Investment Policy (1977-1998)**

**1977**
Deng came to power and began reform, first in the countryside

**1980**
Special Economic Zones (SEZ) established in Shenzhen, Zhuhai, Shantou and Xiamen

**1986**
China passed law on foreign capital enterprise

**1988**
Austerity program began after 10 years of heated growth

**1990**
Pudong New Zone opened in Shanghai. Martial law lifted.

**1993**
Jiang Zemin became president and continued the reform. First copy right law passed.

**1996**
Service industry open: banking, insurance and trading company.

**1998**
Zhu Rong-ji became vize president.
Economic Reforms continue, focusing on
a) economic growth
b) higher living standards

**1979**
China reestablished its formal diplomatic relationship with the US and passed its first law on Chinese-foreign joint enterprise

**1981**
Gang of Four sentenced.
Reformers consolidated power.

**1984**
Fourteen open cities announced.

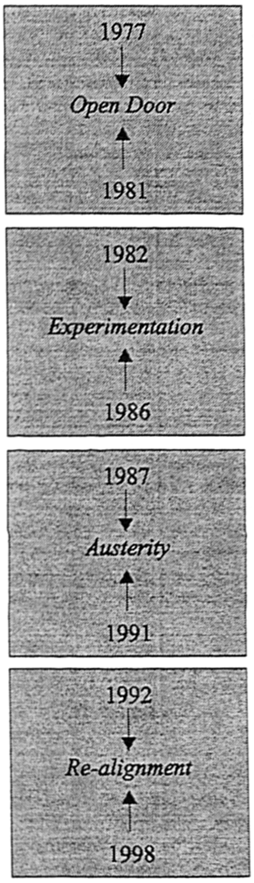
**1987**
Anti Bourgeois Liberalization.
Hu Yaobang dismissed.

**1989**
Tiananmen Square bloodshed.
China's MFN status has since become an annual debate.

**1992**
Deng visited Shenzhen and pushed reforms further and faster. China and US signed the IPR MOU.
Retailing industry opened.

**1995**
Tariff reduction for 5000 items.
Preferential tax treatment ended.

**1997**
Deng died in February. Hong Kong handover to China. Hang Seng index reached record high.




Source: Adapted from Cui (1998)

#### 6.3.2.1 Special Economic Zones and Development

The years between 1977 and 1981 marked the initial period of the open door policy when China opened its four coastal cities as Special Economic Zones (SEZs) for foreign investment. When the GD Hotel Group invested back in China, as many foreign investors did, the markets they chose were SEZs also GD's home territory.

Because the SEZs were opened to the outside world earlier than the interior regions– private enterprise is the dominant economic force – the economy was growing faster. Consequently, they drew more investors and leisure travellers both from overseas and domestic markets, which resulted in demand for the lodging industry.

In 1988, GD Hotel Group established its first hotel – Guandong Hotel, Shenzhen in China, which was a green-field investment. Since then, the group with its strong financial background, better China environment knowledge, better connection to administrative bodies, more China business experience, has continued its investment in other SEZs. At one stage GD Hotel Group had 6 properties in the SEZs and its brand name 'GD' has spread through out the areas.

The group started its business by providing mid-market orientated products. In order to survive in this increasingly competitive environment, GD Hotel Group has recognized the importance of implementing a multi-branding strategy, which is designed to attract clearly defined market segments and enhance the firm's opportunity to raise market share. Consequently, in 1991, the Guangdong Regency Hotel, Zhuhai was opened. This is a hotel providing a luxury product. In 1992, Deng Xiaoping made his important journey to south China, and gave an important speech – in the Guangdong Regency Hotel, Zhuhai – about furthering the economic reform and attracting FDI on a nation-wide scale. This big event to a great extent promoted the brand of 'GD Hotel. In June 1997, phase II the west wing of Guangdong Regency Hotel, Zhuhai was completed. It is a 98.5 meter high, 28 storey skyscraper, with 3 levels underground, adding 6,636 square meters gross floor area for service. Phase II doubles the existing hotel operation and fulfils a higher level of service, energising and broadening its business.

**Table 6.8: Major Market Areas of GD Hotels in China**

| | Guangdong Regency Hotel, Zhuhai | | | | Guangdong Hotel, Shenzhen | | | |
|---|---|---|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1995 | 1996 | 1997 | 1998 |
| | % | % | % | % | % | % | % | % |
| **Domestic** | 41.5 | 25.38 | 16.68 | 17.4 | 32 | 30 | 30 | 30 |
| **Taiwan** | 7.04 | 35.82 | 52.53 | 54.6 | 5 | 2 | 4 | 2 |
| **Japan** | 10.61 | 15.26 | 5.6 | 6.1 | 44 | 48 | 50 | 53 |
| **Hong Kong and Macau** | 37.0 | 20.41 | 23.39 | 18.8 | 14 | 15 | 11 | 10 |
| **Europe** | 0.15 | 0.42 | 0.18 | 0.26 | - | - | - | - |
| **Others** | 2.5 | 1.94 | 0.98 | 1.55 | 5 | 5 | 5 | 5 |
| | **Yuihai Hotel, Guangzhou** | | | | **Guangdong Hotel&Resort, Panyu** | | | |
| | 1995 | 1996 | 1997 | 1998 | 1995 | 1996 | 1997 | 1998 |
| | % | % | % | % | % | % | % | % |
| **Domestic** | 79.86 | 77.56 | 81.13 | 79.66 | 94.8 | 96.9 | 95.7 | 96.53 |
| **Taiwan** | - | - | - | - | 0.1 | 0.04 | 0.3 | 0.55 |
| **Japan** | - | - | - | - | - | - | - | - |
| **Hong Kong and Macau** | - | - | - | - | 4.12 | 2.27 | 3.39 | 2.52 |
| **Europe** | - | - | - | - | - | - | - | - |
| **Others** | 20.14 | 22.44 | 18.87 | 20.34 | 1 | 1 | 2 | 0.4 |

Source: Internal Company Documentation

Japan, Taiwan, Hong Kong and Macau are major market sources for GD Hotels in China apart from the domestic market. Taiwan remains the largest source market for Guangdong Regency Hotel, Zhuhai, in 1998 accounting for 54.6% of the total. As was the case in 1997, the share represented by Hong Kong and Macao and the domestic market ranked second (18.8%), and third (17.4%), respectively. Hong Kong and Macau market share dropped 4.59 percentage points compared to 1997. This is due to the Asian economic crisis which resulted in people from these areas participating less in short breaks to China during weekends.

In the case of the Guangdong Hotel, Shenzhen, Japan has been the major market, accounting for an average 48.75% of the total. The Asia economic turmoil does not seem to have affected the market share of Japan. Instead, its market share rose 3 per cent. The domestic market remained stable and Hong Kong and Macao's share declined one percentage point. Regarding the Yuihai Hotel and Guangdong Hotel & Resort, the domestic market is their major source. Table 6.8 shows that the domestic market is relatively stable.

Table 6.8 also illustrates that GD Hotels in China do not appear to attract customers from outside Asia. This might be due to the fact that GD Hotel Group has not created brand recognition among Westerners. In selecting leading hotel chains, Westerners like to go for the products of which they are aware. It will take a long time for GD Hotels to be ready and able to compete with Western hotels in terms of attracting Western customers. The issue is whether it is necessary.

#### 6.3.2.2 Breaking into Interior Regions

Table 6.1 shows the number of hotels GD Hotel Group has, as well as the stance of ownership. The Table gives the idea that GD Hotel Group wholly owns all its properties, and after 1991 the organisation has not undertaken any further expansion. In fact, the firm used to have more in its portfolio than the Table presents, joint venture and management contract entry modes were also pursued, but the group failed to keep them to date due to various complex reasons.

Table 6.1 shows that the group has no presence in China's major cities such Beijing, Shanghai, Xian. Actually, the organisation has undertaken investments in interior regions, but unfortunately, two projects with which they have been involved did not succeed and these are discussed below.

In 1993, GD Hotel Group signed a joint venture contract with China Federation of Returned Overseas Chinese (CFROC) to operate the Guangdong Regency Hotel, Beijing. CFROC is a centrally-administered organisation. In addition to enjoying more administrative support by working with CFROC, GD Hotel Group could also promote mutual trust with CFROC because of shared roots, that is, the government authorities at various levels.

This raises the issue of running business in China where you must have *guanxi* (personal relationships). Chen (1995) describes *guanxi* as relationships that imply a continual exchange of favours which need not be founded on friendship. When applied to organisations, *guanxi* obligations tend to run counter to universalistic, performance-based values and systems. As Wong and Maher (1997) argue, central government's political bureaucracy is bound up in any project. One of the interviewees in their study pointed out that his trips to meet with Chinese officials at highest level resulted in marked improvement in the company's fortunes.

In the case of GD Hotel Group's investment in Beijing, unfortunately, the group did not benefit from its partner's support. The Guangdong Regency Hotel, Beijing was owned by CFROC. Before signing the contract with GD Hotel Group in 1993, CFROC had another joint venture partner – Sara Hotel Management Group, a Sweden-based organisation. The hotel had been operating for two years with a bank debt of HK$468 million.

The unexpected performance resulted in CFROC and Sara Hotel Management Group terminating the contract. CFROC was looking for a new partner who would be able to pay the debt. At the same time, GD Hotel Group was also looking for the opportunities in interior regions. Beijing is the capital city, one of the most attractive destinations in the world, and the hotel is located in the centre of the city. It is a good quality hotel in terms of hardware. GD Hotel Group was attracted to this project under the condition that CFROC offered a 70% share to the group, and the group would be responsible for the entire management. GD Hotel Group committed to this investment by paying off the debt before it started getting involved in the operation.

Under the philosophy of running business for economic gain, in 1994, the Guangdong Regency Hotel, Beijing after a year under the management of GD Hotel Group had achieved the gross operating profit (GOP) of HK$23,208,169 which represented a 165% increase over the previous year. This achievement was remarkable and the GOP further grew to HK$26,367,209 in 1995. The average occupancy rate reached 71.20% in 1995 compared to 49.90% in 1993. This was achieved with an increase of 43% in average room rate (see Table 6.9).

**Table 6.9: Operational Performance of Guangdong Regency Hotel, Beijing (HK$)**

| | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|
| Turn Over | 43,139,013 | 74,920,442 | 84,257,755 | 69,123,818 |
| Gross Operating Profit | 8,729,122 | 23,208,169 | 26,367,209 | 18,587,253 |
| Average Occupancy | 49.90% | 67.10% | 71.20% | 62.37% |
| Average Room Rate | 308.27 | 438.30 | 542.60 | 503.14 |

Source: Internal Company Documentation

Interestingly, the owner CFROC was not satisfied with the GD Hotel Group. Because CFROC is a government organisation, in other words, not a profit-driven partner and still much more influenced by the bureaucratic socialism. Since GD got involved in the operation, the contract did not allow CFROC to have the same strong influence on human resource, recruitment, marketing and other hotel operations as before. To a certain extent, it can be argued that this meant a reduction in CFROC's political power that could not be accepted.

Thus, CFROC came up with the idea to renegotiate with GD regarding the share stock to 50/50, which was rejected by the group. The disagreement resulted in the refusal of CFROC to obtain the new operating license for the hotel, and other measures to hinder the hotel's operation. Conflicts led to very unpleasant relations between the two parties. Facing all these difficulties, GD decided not to take CFROC to court, because the group feared that in the future they would undoubtedly meet more difficulties regardless whether they won in court or not. This co-operative journey could not go any further. GD Hotel Group therefore accepted CFROC's alternative offer that withdrew its management team and investment in October 1996 and since then CFROC came back in power.

Table 6.9 demonstrates the operational performance of 1996 and shows that the GOP had decreased 29.5% by the end of the previous year. It is clear and can be predicated that Chinese government officials still take great interest in the political considerations, that is against the philosophy of economic reform, and will eventually cause the healthy business to suffer.

In fact, the GD Hotel Group has an advantageous strategic position in doing business in the China, which stems from its international business experience and expertise, the knowledge about the Chinese market and its intermediate role. These factors allow the firm to play *different cards with different competitors: they play a* 'foreign' card with the domestic firms and a 'domestic card' with other foreign investors. However, the reality shows that the organisation can compete effectively in Hong Kong but is inefficient in China's market where they seem to have more competitive advantages.

Regarding the case in Beijing, the major cause of failure was that the GD Hotel Group is a provincial enterprise from one of the SEZs, Guangdong and is registered in Hong Kong. This organisation, to a certain extent, has accepted the business values, norms and practices of a market economy. It was concerned about how to enhance its own economic interests, and tended to ignore administrative directions.

This is not in accordance with the political intentions of the CFROC's leaders. Moreover, in comparison, CFROC has a stronger direct relationship with the central government officials, which can be regarded as an indispensable competitive asset for CFROC over GD Hotel Group. This case demonstrates the role that central government's political bureaucracy had in the project, state intervention in corporate operations remains significant.

GD Hotel Group's other unsuccessful project in the interior regions was Guangdong Regency Hot Spring Hotel, Zhengzhou. Zhengzhou, the capital of Henan Province, is located in the southern part of the Yellow River's lower middle area. It is one of China's most historical and cultural centres with a population of 6 million. The city is a key communication hub linking the country's air traffic, highways and railways. The hotel is located in the commercial centre. It is an European- style 5-star hotel, finely decorated and completed with all the facilities.

In 1998, the GD Hotel Group signed a management contract with the owner of the hotel – a private body, a friend of GD's managing director – to manage this hotel. Interestingly, after one year, GD quit the business because the owner did not have the financial ability to pay the management fee. Furthermore, GD found out that the owner had a high level of bank debt, there was no initial plan to co-operate with GD Hotel Group to run the hotel, but instead the purpose appeared to be to get loans from the bank by using GD's name.

This was an outcome of *guanxi* involved investment. It is interesting that although GD has been operating in a market economy, its management style is still largely shaped by the bureaucratic system that can be reflected in its centralised decision-making behaviour and its in favour of *guanxi* in the decision making. As noted in chapter 4 *guanxi* is determining sources of information on which decisions are based and actual choice made. In this sense, a systematic and objective approach to the decision has been undermined (Porter, 1996). Therefore, It can be argued that GD is still in its early stage of development with regard to the application of modern management style and techniques. This is due to fact that the government appointed managers in GD still play a major role which is a specific feature of Chinese state owned enterprises. However, both development failures in the interior regions revealed that GD's future development requires a new management style which is more market orientated and driven by economic goals. It can be predicted that the early adoption of a new management style will facilitate GD's growth and ultimately lead GD to be more successful and competitive.

### 6.3.3 Overseas Investments

At the initial stages of opening to the outside world, enterprises in China which were eligible to have foreign affiliates were limited to the international economic and technological co-operation companies of individual provinces and cities and to import and export corporations, which were permitted to engage in foreign trade. In 1985, the Ministry of Foreign Economic Relations and Trade decided to allow an increase in the number of enterprises with investments abroad (Gang, 1992).

GD Hotel Group started its overseas investment as early as 1988, with the Chinagora Hotel in Paris by signing a joint venture contract with an overseas Chinese business man. Chinagora Hotel is located inside the cultural and touristic Chinese complex of Chinagora, with pagoda rooftops adorned with some 400,000 varnished tiles specially brought from China. Apart from 181 guest rooms, it has a Chinese department store, two Chinese restaurants, Karaoke, a Tea house and a traditional Chinese garden. The architecture of this hotel is Chinese.

Table 6.10 shows the operational performance of Chinagora Hotel in Paris. It can be seen that the average room rate is low in comparison to other GD Hotels. In 1998, the average room rate was HK$ 247,32 which was a 38% decrease over the previous year, but the average occupancy rate was only 49.44%. In comparison to other GD Hotels, the Chinagora Hotel has made the least economic contribution to the group. Although, the GD Hotel Group has changed its partner and later became the sole owner of the hotel, the performance of this hotel has still decreased and there are no signs of improving. The reasons behind this poor business performance will be presented in detail in the next chapter.

**Table 6.10: Operational Performance of Chinagora Hotel in Paris (HK$)**

| 1995 | | 1996 | |
|---|---|---|---|
| Turn over | 17,014,329 | Turn over | 17,417,307 |
| Gross Operating Profit | 838,601 | Gross Operating Profit | 881,643 |
| Average Room Occupancy | 65.92% | Average Room Occupancy | 67.29% |
| Average Room Rate | 426,42 | Average Room Rate | 374,85 |
| **1997** | | **1998** | |
| Turn over | 12,938,241 | Turn over | 8,373,545 |
| Gross Operating Profit | 695,526 | Gross Operating Profit | 660.085 |
| Average Room Occupancy | 46.42% | Average Room Occupancy | 49.44% |
| Average Room Rate | 403,20 | Average Room Rate | 247,32 |

Source: Internal Company Documentation

In 1991, GD Hotel Group made its second overseas investment – the Regina Hotel in Bangkok. The hotel is located in Thailand's premier business and entertainment district, which is also known as the "City of Angels". The hotel is of three-star ranking, has 315 guest rooms, all fully equipped with mini bar, cable and movie selection. As mentioned before, in accordance with the liberalised China outbound tourism policy, the Chinese government included more destinations such as Thailand, Macau, Singapore, Malaysia, Republic of Korea, Australia, Japan and New Zealand on the list of destinations Chinese citizens could visit (The Year Book of China Tourism *Statistics*, 1999). Table 6.10 shows that the Regina Hotel's major source market is Mainland China, accounting for an average 79% of total occupancy. The domestic Thailand market ranked second. The hotel's other major markets are based on South - East Asia.

**Table 6.11: Major Market Areas of Regina Hotel, Bangkok**

| Major Markets | 1996 | 1997 | 1998 |
|---|---|---|---|
| | % | % | % |
| Mainland China | 77.0 | 76.0 | 84.48 |
| Thailand | 11.6 | 9.6 | 14.71 |
| Malaysia | 9.8 | 12.78 | 0.2 |
| Japan | 4.1 | 0.42 | 0.19 |
| Singapore | 0.42 | 0.08 | 0.12 |
| Hong Kong | 0.42 | 0.45 | 0.08 |
| Taiwan | 0.11 | 0.41 | 0.04 |
| Others | 0.07 | 0.10 | 0.05 |

Source: Internal Company Documentation

In the study of the internationalisation process, the creators of the Uppsala Internationalisation Model assume that a firm first develops in its domestic market and then gradually develops its operations abroad. At the core of the internationalisation process is a lack of knowledge and subsequently uncertainty about markets abroad due to lack of market information (Johanson and Vahlne, 1977). The accumulation of experiential knowledge about foreign markets is assumed to be the main source and key driver in the internationalisation process (Johanson and Vahlne, 1990), as it reduces uncertainty and the related perceived risk. Firms are also said to target neighbouring, psychically close countries, and subsequently enter foreign markets with successively larger psychic distance (Ibeh, 2000).

However, this internationalisation process was not pursued by the GD Hotel Group. GD started its business in 1986, undertook its first overseas investment in 1988 and the target market was in Europe that is far away from its Hong Kong base and with a totally different culture, language, political system and market environment. It raises an interesting question what is the rationale behind this international expansion? The answer and more empirical insights relating to GD's internationalisation will be presented in chapter 7.

## 6.5 Concluding Remarks

This chapter provides empirical information on the development of the case study organisation. The development of the GD Hotel Group is unique and illustrates the impact of China's economic reform and open-door policy upon a state-owned firm. The growth of this hotel group to a great extent depends on the liberalised policies of China outbound travel and the favourable policy treatment (as foreign investors) when they invested in China.

In order to gain more knowledge in relation to a state owned service firm's internationalisation, and to address the research objective (a) and (b), namely to investigate the GD's internationalisation specifics and to analyse the role of the government in its internationalisation, 13 semi-structured interviews were conducted with key informants in the case study organisation, and 2 interviews with major hotel consulting companies involved in Chinese hotel projects. Empirical findings and analysis from these interviews will be presented in the following chapter.

# Chapter 7: Internationalisation of the GD Hotel Group – Empirical Evidence and Discussion

## Introduction

As stated in chapter 5, the internationalisation specifics of state owned hotel companies from a developing country in transition from a centrally-planned economy to a market economy have not been empirically investigated. This study addresses this gap by investigating the internationalisation specifics of a state owned Chinese hotel chain, the GD Hotel Group.

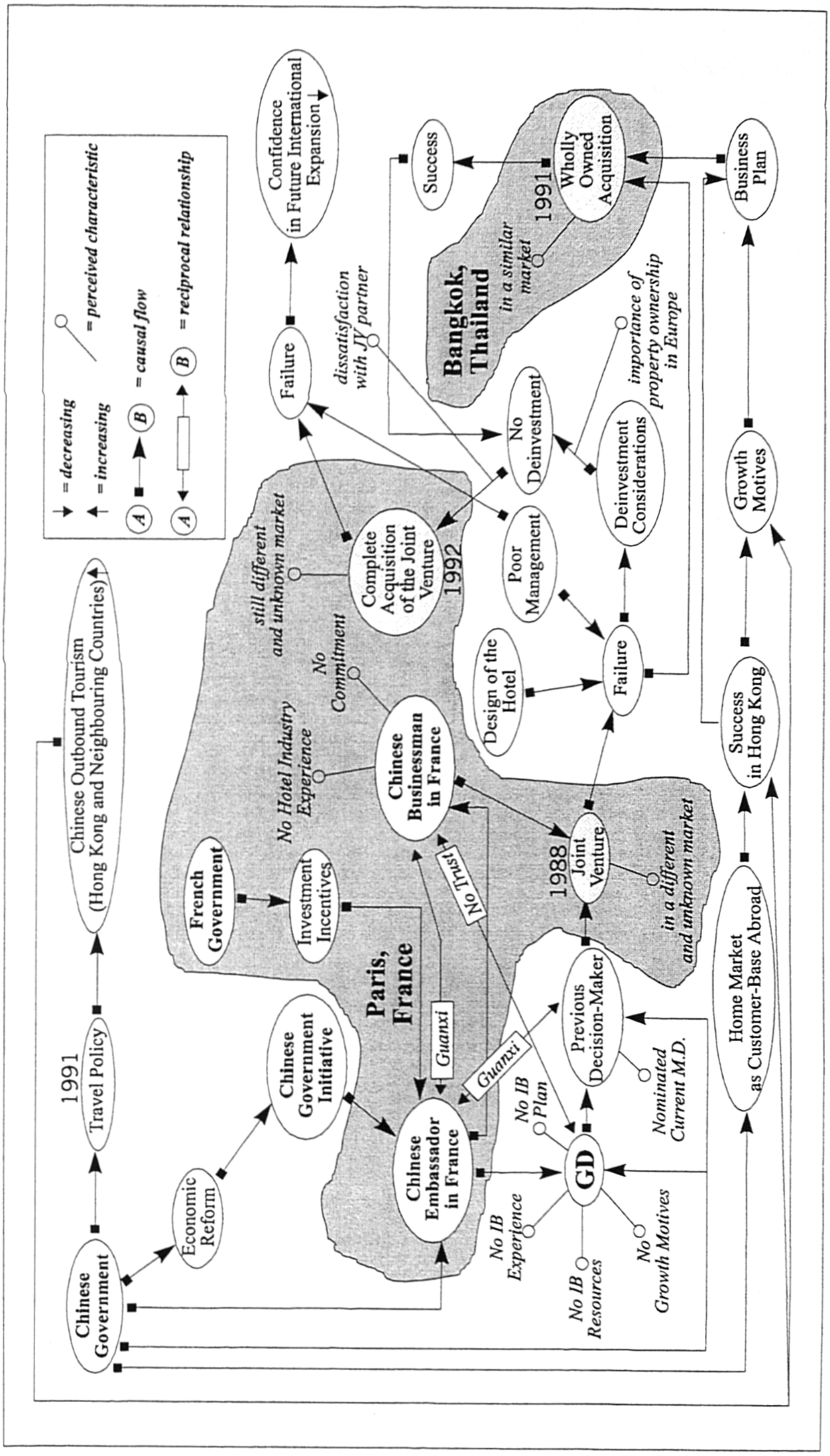
Following the analytical procedures as outlined in chapter 5, this chapter will present the empirical findings relating to research objectives (a) and (b), namely the investigation of the GD Hotel Group's internationalisation specifics and the assessment of the role of the government in its internationalisation. It is worth noting that as a state owned enterprise registered in Hong Kong, GD only regards its investments outside China and Hong Kong as their internationalisation activities. The following sections will therefore only address the internationalisation specifics outside China and Hong Kong.

This chapter will be structured accordingly. The first three sections will address the specifics of research objective (a), that is precisely the reasons for GD's internationalisation, the competitive advantage of GD and the problems associated with GD's internationalisation. This will be followed by an analysis of the role of the government in GD's internationalisation, research objective (b).

## 7.1 Reasons for Internationalisation

Analysing the reasons for GD's internationalisation is the first step in understanding the overall internationalisation process of the GD Hotel Group. Transforming the within-case displays (a display of all themes and sub-themes derived from one single interview) and cross-case displays (a display of all themes and sub-themes across all interviews) into cognitive maps revealed a relatively consistent cognitive pattern of reasons and influences of GD's internationalisation across interviewees. Therefore, the individual cognitive maps were grouped across all respondents following the analytical procedures outlined in chapter 5 (see Eden, 1993; Scheper and Faber, 1994; Swan, 1997). Figure 7.1 presents this grouped cognitive map. It visualises the various factors and their relationships in relation to GD's internationalisation process as perceived by GD's top management. This section describes and analyses this process. In order to enrich the understanding of this process, complementary quotes from the interviews will be used throughout this section. As noted in chapter 5, the quotes will not identify the specific names or positions of respondents from GD as a commitment to confidentiality was given at the interviews. Instead, interviewees are categorised into three groups according to their positions which are Senior Corporate Member (SCM), Senior Functional Member (SFM) and General Managers (GM). Due to the fact that the hotel consultants who were interviewed, were not directly involved in GD's internationalisation activities, as outsiders they could not provide further insights.

**Figure 7.1: Perceived Factors in GD's Internationalisation**



There are three key themes that emerge from the grouped cognitive maps in relation to reasons for the GD's internationalisation (see Figure 7.1). The overall important role of the Chinese government; the internationalisation process and outcome of GD's international expansion into France; and the internationalisation process and outcome of GD's international expansion into Thailand. Since the specific role of the government will be described and analysed in section 7.4 addressing research objective (b), the following two sections will focus on the specific reasons and their relationships regarding the internationalisation into France and Thailand.

### 7.1.1 The First Overseas Investment

Figure 7.1 visualises the chain of causal events that led to this first international expansion. It shows that the Chinese government was the initiating cause in GD's first international expansion. This finding reflects the broader view of the interviewed consultants who said that Chinese enterprises' initial overseas investments in general were determined and controlled by the Chinese government. As already noted in chapter 4, until as recently as 1997, the Party Congress announced a separation of the roles of government and enterprises. Since then, the Chinese government is no longer directly involved in Chinese enterprises' foreign investments (Young *et al* 1999). However, at the initial stage of Chinese enterprises' overseas investments – from 1985 until 1997 – this was not the case. Since GD's initial international expansion fell into that time period – it undertook this investment in 1988 – thus, it is not surprising that a government initiative was the triggering factor (see Figure 7.1).

Figure 7.1 shows, the political influence in relation to GD's internationalisation in Paris did not stop there. According to the interviewees, the Chinese ambassador in France introduced the project to GD, the land was cheap and both the French and Chinese governments supported the idea, especially the French government which offered GD investment incentives. In addition to the introduction of the project, Figure 7.1 also shows that the Chinese ambassador suggested the market entry strategy which was the formation of a joint venture. Interestingly, GD's business partner, an overseas Chinese businessman in France, was also introduced by the Chinese ambassador. This highlights the second important factor in GD's first internationalisation, the influential role of close personal relationships.

These close personal relationships in traditional Chinese culture are referred to as *guanxi*. The term *guanxi* refers to special relationships or having connections with important or influential people for a continual exchange of favours (Chen, 1995). Figure 7.1 clearly demonstrates the practice of *guanxi* in GD's first internationalisation. The close personal relationship between the Chinese ambassador and GD's previous decision-maker as well as the close relationship between the Chinese ambassador and the overseas Chinese businessman was a key feature in GD's first international expansion. Interestingly, despite the observation that *guanxi* was of influential importance, there was no *guanxi* between the two parties who were actually operating and managing the joint venture. This is an important observation which will be discussed later.

In summary, GD's first foreign investment was characterised by political influence of the home and host countries' governments, as well as close personal relationships between the decision-making parties involved (*guanxi*). In stark contrast to initiating factors that are usually suggested in the literature (see chapter 2), economic factors played virtually no role in GD's first international expansion. Neither reactive economic factors like unsolicited customer inquiries nor proactive economic factors like market demand based internationalisation played a role in GD's first venture abroad. But as Figure 7.1 reveals, there were additional factors of importance.

As stated by the interviewees, GD was inexperienced, it had no international business resources in place, it had no explicit growth motive and it had no international business plan. The potential for successful management of the hotel was therefore hindered from the start. But two additional factors further aggravated this. First, GD's operation in a foreign and unknown market and second the adopted mode of entry.

In line with arguments put forward by Johanson and Vahlne (1977; 1990 see also chapter 2), GD's managers perceived operating in France as "distant" from their home market. France was, in essence, seen as a different and unknown market. GD's unprepared approach did further worsen this. However, as the managers also revealed, they hoped that the overseas Chinese businessman who was living in France and holding a French passport – would somehow reduce this distance. However, as one interviewee (SFM) said: "... *we could hardly rely on our partner. He did not have the experience of running hotels, he did not have connections with* *related industries such as travel agents, he did not have the foreign market information and had limited knowledge about local market environment....*" Rather than reducing distance and positively effecting GD's first international venture, the adopted mode turned out to be another source of conflict and problems, because it added the additional managerial problem of partner management, a non-committed partner to be more precise.

As Root (1994) notes (see also chapter 3), once a company has decided on a joint venture method for a target market, its managers must initiate a search / evaluation process which is very much like that of acquiring a foreign company. The process involves drawing up a joint venture profile that specifies the desired features of a candidate; identifying / screening candidates and negotiating the joint venture agreement. Decision-makers also need to know the objectives and strategy of the prospective local partner. Clearly, this rational and planned approach to forming a joint venture was not what happened in GD's case. As noted above, there was no close relationship between the two partners and the important formation of trust in joint ventures did not develop. Both parties relied on the external advice of the Chinese ambassador with whom both parties had close relationships. Therefore, it is not surprisingly that only after the joint venture was formed, GD found out that its joint venture partner was not really committed to the joint venture. The partner's experience that might help to reduce the noted perceived distance, a common reason behind pursuing joint ventures, was not fulfilled, and the failure was therefore not surprising.

Figure 7.1 also shows that the design of the hotel was another factor which caused the failure. As one interviewee (SFM) highlighted: "*... that was a failure in the sense that huge space was used to build traditional Chinese gardens which were intended to attract Western customers. From a financial point of view, that was a waste because it cannot generate revenues*". But what was not seen by the interviewees is that, as illustrated in Figure 7.1, they did not even know whether such a hotel design would attract Western customers because they did not conduct market research prior to the investment.

Facing an unsatisfactory relationship with the partner and poor financial performance, the GD Hotel Group faced the decision of what to do with this investment. As Figure 7.1 shows, although GD initially thought to deinvest, it actually deepened its commitment to Paris by completely acquiring the hotel. There were reasons behind this move as illustrated in Figure 7.1. First, the success of GD's second international investment in Bangkok (to be discussed below) was regarded as an important factor, because it gave GD's management confidence that they could manage properties abroad. Second, the unsatisfactory joint venture experience caused a change in GD's entry mode. GD's management hoped that the acquisition would eliminate the problems associated with its partner and with shared decision making. Third and finally, the GD Hotel Group recognised the importance of owning a property in Europe. As one of the senior corporate managers remarked: "*It would not be a smart decision if the top management gave up the hotel in Paris. We saw the value it has especially for our long-term development because we committed to become an international player...*"

However, the operational performance was still not satisfactory. Figure 7.1 shows that the acquisition did not change the underlining problem. Although GD stopped the joint venture contract, it still faced the problem of poor management due to lack of experience, resources and a clear business plan. Moreover, the hotel still operates in a different and unknown market with no secured customer base in comparison to other GD's properties (see also GD's second internationalisation move). The continuing failure has greatly reduced the confidence of the firm in making further international expansion, this can been seen in Table 6.1. Table 6.1 shows that GD has not been involved in the international expansion since 1991, it preferred to enlarge its foothold by penetrating new markets in places (domestic markets) which are considered safe (see Table 6.1).

### 7.1.2 International Expansion into Thailand

Figure 7.1 shows that the initiating factor of GD's investment in Bangkok, Thailand was again the Chinese government. But this time the role of the government was more indirect. As mentioned in chapter 6, in 1991, the Chinese government changed the travel policy by which Chinese citizens were allowed to travel to neighbouring countries for leisure purposes. Thus, the government created a supportive environment that GD could capitalise from (Chinese outbound tourism), but the government did not directly get involved in GD's investment in Bangkok.

In contrast to GD's first overseas international expansion, which was characterised by political influence of the home and host countries' governments, as well as close personal relationships between the decision-making parties (*guanxi*), GD's second investment was characterised by economic factors. Based on success in Hong Kong, GD followed its customer base into a similar market with a well-developed expansion plan. As one interviewee (SCM) said:

*"The project in Thailand was undertaking under the condition of the changed tourism policy towards outbound tourism. Chinese outbound travellers would like to visit more destinations on their trip to Hong Kong. It was the opportunity for us to expand by following them. We had the clear idea about who would be our target market - the guaranteed growing Chinese visitors... Thailand is an approved destination for Chinese tourists. By following and targeting them we intended to promote GD in the Asia Pacific region".*

This view was enriched further by another interviewee (SFM): "*...we learned the lesson from Paris, we were aware that the lack of well thought out project through feasibility study can spell eventual disaster, therefore we did a proper preparation prior to the investment*".

The entry mode choice of the investment in Bangkok was wholly owned. Figure 7.1 shows that the failed joint venture in Paris was an influential factor in this choice. Overall, the investment in Bangkok was successful, an outcome in contrast to the one in Paris.

The success of GD's second international expansion suggests some tentative implications for theory. The findings show that the suggested importance of psychic distance (Johanson and Vahlne, 1977) also applies in the context of the internationalisation of location-bound service firms from developing countries in transition from a centrally-planned economy to a market economy. The applicability in a different cultural setting strengthened the validity of the psychic distance theory. When GD invested into a distant market, they were not successful compared to their investment in a close market.

The findings also suggest support for the theory of client following (Erramilli and Rao, 1990). As Porter (1990) argues, the internationalisation of domestic demand is particularly important in many services. Home consumers that travel to other nations provide a formidable advantage to the nation's service firms. Opportunities to establish overseas locations are quickly apparent and firms enjoy a base of home consumers abroad. GD's first investment was not following Chinese outbound tourism but its second investment was. The former was not successful and the latter was. This has an important implication for addressing the research aim (see chapter 8).

Furthermore, the findings give some support to the importance of experiential knowledge (Johanson and Vahlne 1977, 1990). In its initial international expansion, GD was not experienced and the venture was not successful. In relation to its second investment, GD was more experienced, it learned from its first investment and the venture was successful.

Besides the importance of government non-direct involvement as suggested by Porter (1990) must be noted and will be further discussed in section 7.4. There is also an interesting lesson for theories on international entry modes. This study's findings show that in contrast to the rational and analytical focus to foreign market entry in the literature (see for example Root, 1994), the history of a firm's internationalisation matters. Had GD not had the bad experience with the foreign entry mode of joint venture it might not have favoured the wholly owned entry mode in Bangkok. The findings suggest that models of choices of foreign market entry need to embrace more explicitly the history dependent nature of a firm's internationalisation.

## 7.2 Competitive Advantage

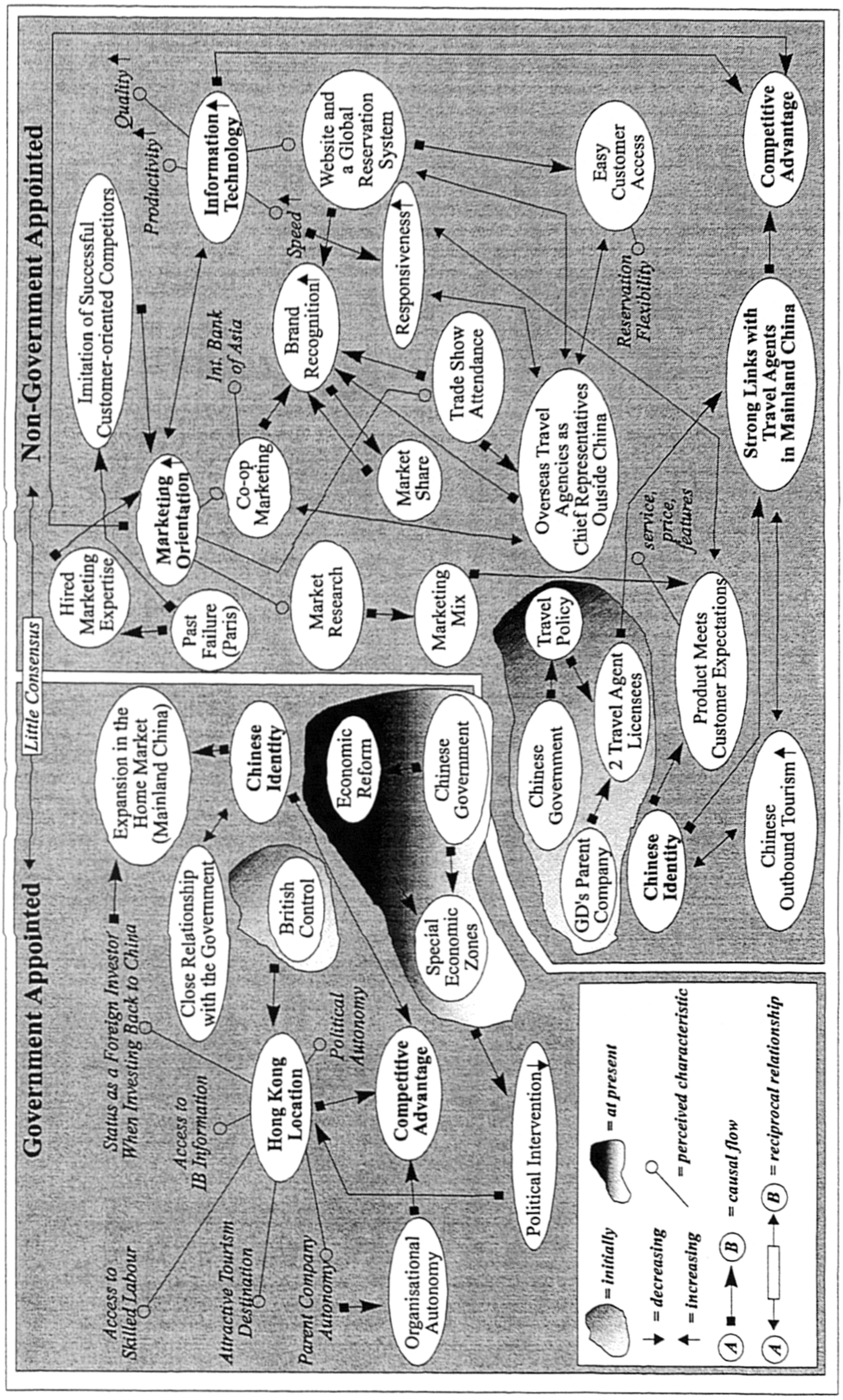
Following discussion of the reasons for GD's internationalisation, this section addresses the second specific aspect of research objective (a) that is the competitive advantage of the GD Hotel Group. Figure 7.2 shows the grouped cognitive maps of the interviewees in relation to the issue of competitive advantage. In contrast to the revealed cognitive pattern of GD's reasons for internationalisation, the transformation of the within displays and cross case displays into cognitive maps revealed cognitive dissimilarities between top managers who were appointed by the government and those who were not.

As mentioned in chapter 4, in China's state owned enterprises some key positions are occupied by government appointed people and this phenomenon also applied to GD. The first part of the interview questions (see Appendix 1) was related to the personal information, the empirical evidence revealed that those senior corporate members in GD were government appointees aged over 40 which supports Wong and Macher's (1997) view. Senior functional members such as financial controller, marketing director and general managers came to their positions via qualifications and their nationalities diversified. Interestingly, Wong and Macher (1997) argue that the generation aged 40 to 50 that grew up during the Cultural Revolution without adequate training but in favour of Confucianism and bureaucratic socialism, they have occupied the most important positions in Chinese state owned enterprises which caused the problem of poor management.

It is worth noting that government appointed managers in GD said that they had varied levels of hotel background before taking their current positions, but non-government appointed managers questioned these claims. Due to the specific features of GD's top management, two grouped cognitive maps were therefore developed, reflecting the specifics of each group of managers with regards to GD's competitive advantage and problems associated with GD's internationalisation. Figure 7.2 presents the map of perceived competitive advantage.

In contrast to the previous research objective, the interviewed consultants provided valuable outside perspectives with regards to Chinese hotel companies' competitive advantage. Their views will be presented in conjunction with the analysis of the cognitive maps of GD's top managers. As mentioned in chapter 5, this procedure will substantiate and validate the findings from the case study organisation.

**Figure 7.2: GD' s Perceived Competitive Advantage**



### 7.2.1 Government Appointed Managers' Perception of GD's Competitive Advantage

Figure 7.2 clearly shows the theme which was perceived by the Government appointed managers as GD Hotel Group's key competitive advantage, its Hong Kong location.

As mentioned before, the Chinese government started implementing reform and an open door policy at the end of the 1970s. This led to the establishment of special economic zones and the open coastal cities as windows for developing foreign economic activities. Clearly government appointed managers viewed this economic reform, paired with the initial British development and control of the Hong Kong territory, as the key reasons of its locational advantage. Figure 7.2 shows the key characteristics of the perceived locational advantage of Hong Kong.

First and foremost, less political intervention was regarded as a key determinant of the perceived locational advantage of Hong Kong, leading to higher degrees of management autonomy. This perception was despite the fact that GD's first internationalisation was heavily affected by the government, as discussed in section 7.1.1. As one interviewee (SCM) said: *"Despite the government involvement in our first overseas investment, in comparison to other Chinese hotel chains, we have enjoyed more management autonomy and lower administrative constraints."*

The managerial autonomy as perceived by the interviewees also relates to organisational autonomy from the parent company. As mentioned in chapter 6, the parent company was established in Hong Kong 1981. Due to its early exposure to a market economy, the parent company not only enjoyed and experienced the effectiveness of non-government influenced, autonomous decision-making, but it also saw the fruitfulness of granting the GD Hotel Group similar organisational autonomy. As one interviewee (SCM) said: "... *the hotel division was very independent of the parent company in terms of the right to make investment decisions. Unlike many other Chinese multinational firms, the choice of markets, entry modes and partners were not centralised to advance the parent company's interest. Although the expansion always involves substantial capital, the parent company did not pressurise us by setting out the payback time. Because of the trust, in my opinion, that stimulated the pace of growth, and also resulted in a good working relationship between the parent company and us.*"

Besides political and organisational autonomy, the government appointed interviewees also perceived a set of unique locational factors as contributing to GD's competitive advantage (see Figure 7.2). Hong Kong as an attractive tourism destination was regarded as one of the locational advantages that benefited the GD Hotel Group's development. This view reflects empirical data by Go and Pine (1995), stating that tourism in Hong Kong is the second most important industry. This factor can be further enriched by the following statement by one of the interviewees (SCM): "... *Hong Kong is the leading financial, trade and tourist centre. This location guarantees the size and the growth rate of tourism, which* *ultimately has been creating room demand and bringing business to us...".* This statement reflects related views in the literature stressing that hotel services are very location sensitive due to inseparability of supply and consumption (see chapter 2).

In addition to Hong Kong being an attractive tourism destination, government appointed managers also perceived access to important resources as an additional determinant of Hong Kong's locational advantage (see figure 7.2). In particular, access to skilled labour and access to international business information was seen as crucial elements. While the latter merely supports internationalisation theory (Johanson and Vahlne, 1977, 1990), the former factor emerged later on as important in relation to GD's problems in internationalisation. As will be highlighted below, human resources related factors are among the key problems in GD's internationalisation. It is therefore interesting to note the cognitive inconsistency among government appointed managers, because access to skilled labour should allow them to address this problem. This interesting finding will be discussed later, together with the discussion of the internationalisation problems of GD (see section 7.3).

A final factor referred to by the government appointed managers who were interviewed in relation to the locational advantage of Hong Kong are the benefits the GD Hotel Group derives from its status as a foreign investor when investing back into China, further positively influenced by GD's Chinese identity. As one interviewee (SCM) said: *"When we invested in China, we received favourable policy treatment (tax benefits) which was only given to foreign firms. That is a specific* *advantage over domestic hotel companies"*. As mentioned in chapter 4, in order to cope with the oversupply of luxury hotels in China, since 1988 the China National Tourism Administration came up with a policy which does not permit foreign investments in high standard hotels. However, as a foreign investor, the GD Hotel Group invested in a 5-star hotel, the Guangdong Regency, Zhuhai in 1991. Indeed, similar to findings by Lin (1996), the revealed close links between GD and the Chinese administrative bodies in mainland China were seen as an indispensable competitive advantage over other foreign firms when investing back to China.

### 7.2.2 Non-Government Appointed Managers' Perception of GD's Competitive Advantage

The first striking finding with regards to the competitive advantage perceived by non-government appointed managers is the limited consensus between them and the government appointed managers. Indeed, only the Chinese identity of GD was a shared perceived source of competitive advantage. However, in contrast to the government appointed managers, the implications of GD's Chinese identity differed. As Figure 7.2 shows the non-government appointed managers stressed rather the market and customer implications of this identity. Not only did they perceive the Chinese identity as supportive in capitalising on increasing Chinese outbound tourism as well as supportive in meeting customer expectations, but they also perceived it as enabling GD to foster and maintain strong links with travel agents in Mainland China, a perceived competitive advantage in its own right. According to the non-government appointed managers, these strong links were initially established due to a travel policy initiative of the government which led to Guandong (Hong

Kong) Tours Ltd becoming one of the only two licensed travel agents handling Chinese outbound tourism (see Figure 7.2). The importance of this historical event was already discussed in the previous section as well as in chapter 6.

The non-government appointed managers perceived two additional competitive advantages that GD enjoyed, advantages which were not mentioned by the government appointed managers. First the marketing orientation of the firm and second the advanced use of information technology. Each aspect will be discussed below.

**7.2.2.1 Marketing Orientation of the GD Hotel Group**

According to the interviewee (SFM): "*Marketing is not a concept but a function in our firm and it has become part of our organisational culture. We place heavy emphasis on understanding and appreciation of customers' expectations, and our development is based on translating customers needs into products and services. In order to compete in today's market, we have to create value-satisfying products and services*". Other managers shared this view and its cognitive structure is manifested in Figure 7.2, visualising the characteristic importance of market research, which resulted in marketing mix adaptations and the meeting perceived of customer expectations.

However, Figure 7.2 illustrates that this is rather a recent phenomenon. This is because GD learned the lesson from the failure in Paris which led to the acquisition of outside managerial marketing expertise. That was an important contributing factor to its current marketing orientation. This failure also led to the imitation of successful marketing practice from customer orientated competitors. Assistant marketing *manager gave the following example. He said* that Hilton surveyed its customers about what kind of breakfast they like. And then Hilton came up with a breakfast just a little bit above its customers' expectations, leading to higher levels of customer satisfaction. This piece of information was obtained from one of the Hotel magazines. Subsequently, this led to a survey which was conducted by GD among its business travellers in relation to the facilities provided in their deluxe rooms, the outcome of which strengthened GD's service offering. In addition it also increased its overall marketing expertise, which in turn positively affected GD's marketing orientation.

In addition to market research, co-operative marketing activities were seen as the second key characteristic component of GD's marketing orientation. As stated by one of the managers, the key goal of these co-operative marketing activities is to increase GD's brand recognition thereby potentially increasing its overall market share. One example of GD's co-operative marketing effort was the co-operation with the International Bank of Asia. As the interviewee (SFM) explained: "*In May 1997, the GD Hotel Group together with International Bank of Asia Limited issued The Guangdong (Int'l) Hotel Management Ltd. Visa Card. Besides the current 10,000 GD Hotel Group VIP Card members, people who apply for this Visa Card will enjoy discounts at any GD Hotels. When they book holidays or use any service of Guangdong (Hong Kong) Tours Company, the Visa card holder will get discount as well. At the end of May, we joined the Hong Kong International Travel Exhibition.*

*The promotion of the new Visa card was successful there with great response from clients and visitors. It helped the firm rise to a new level.*"

However this quote and related statements made by other managers also reveals the characteristic importance of trade show attendance. Not only did it lead to perceived increased brand recognition ("The idea is to promote our products and create international marketing recognition of GD Hotels."), but more importantly it led to overseas representation of the firm. This is a rather important effect, because until 1997, the GD Hotel Group was not engaged with any overseas travel agents to promote GD Hotels. Only after attending international trade shows such as the International Tourism Bureau in Berlin, the Hong Kong International Travel Exhibition and the Taipei International Travel Fair was GD in a position to establish representative links with overseas travel agents. As one manager (SFM) remarked: "*Since 1997, 19 well established travel agents in 17 countries have signed contracts being the chief representatives of the GD Hotel Group. These representatives have been engaged in promotion of the GD Hotel Group overseas, which will ultimately enhance the image and brand awareness of the group.*" Incorporating the overseas travel agents into GD's co-op marketing activities was seen as further contributing to increasing brand recognition.

#### 7.2.2.2 Information technology

Apart from viewing GD's marketing orientation as competitive advantage, the non-government appointed managers viewed the use of information technology as another competitive advantage. They viewed it as increasing productivity, as increasing the quality of their services offered and as increasing their organisational responsiveness. Most importantly however, they viewed their global reservation system, incorporated into their web site, as the key competitive advantage caused by their investment into information technology. As one interviewee (GM) enthusiastically said: *"By setting up our global reservation network we allowed consumers greater access to available rooms and more flexibility in making reservations. Also, the travel agents and our overseas representatives can make bookings electronically. It reduces human error and it is faster. The continuous appliance of information technology will stimulate our internationlisation process"*

According to the interviewees, the computerised hotel reservation network has made great strides towards perfecting automated reservation links between guests and travel agents on one side and individual hotels on the other. This was further illustrated by the following quote: "*By launching our web site www.gdihml.com.hk, the most important advancement is the ability of each hotel to list all of its different room types, descriptions, rate categories and special packages and offers in the network. The information is then available to hundreds of thousands of travel agents world-wide, as well as to individual consumers.*"(SFM)

Now however, the question arises to what extent the perceived competitive advantages – perceived by both the government appointed and non-government appointed managers – do in actual fact constitute competitive advantage. The next section will address this issue by critically comparing the perceived competitive advantages with sources of international competitiveness (Porter, 1990) and sources of sustained competitive advantage as suggested in the literature (see for example Barney, 1991)

#### 7.2.2.3 Perceived Competitive Advantage, Sources and Sustainability

Using Porter's diamond (1990) as an explanatory framework for the creation of competitive advantage (see chapter 2), it becomes apparent that mainly factor and demand conditions explain some of GD's perceived competitive advantage. In particular, the perceived factor conditions (access to skilled labour and access to international business information) and the perceived demand conditions (Hong Kong as an attractive tourism destination and increasing China outbound tourism) support Porter's view that a firm's nationality and home base can be one of the key sources of the firm's competitiveness, especially for service firms. In addition, the importance of strong links with related and supporting industries, most notably the travel agents in Mainland China and overseas, also emerged as an important source of GD's competitive advantage.

Notably absent is however the factor of the firm's strategy, structure and rivalry in domestic market. On the one hand this finding is not surprising because the GD Hotel Group is a state owned enterprise from a country in transition from a centrally-planned to a market economy (see chapter 4). On the other hand however, GD was initially founded in Hong Kong, at that time clearly a market driven economy. But as Figure 7.2 shows, due to GD's Chinese identity, GD's parent company's initial license as one of only two outbound travel agents and its close relationship with the government, GD was effectively isolated from the hotel industry rivalry in Hong

Kong. GD more or less enjoyed a secure supply of customers (China's outbound tourism). It is therefore not surprising, as will be discussed later, that GD is now facing various problems in expanding further into competitive international markets (section 7.3).

While utilising Porter's framework helped to understand the sources of the GD Hotel Group's perceived competitive advantage, the question whether these perceived advantages do actually constitute competitive advantages and to what extent they are sustainable still remains unaddressed. Barney (1991) offers a framework for assessing the sustainability of a firm's competitive advantage.

According to Barney, there are four attributes that a firm's resource must hold to have the potential of sustained competitive advantage. First, a firm's strategic enabling resource must be valuable, valuable in the sense that it allows exploiting opportunities and / or it allows minimising threats in a firm's environment. Second, a firm's strategy enabling resource must be rare among a firm's present and future competitors. Third, a firm's strategy enabling resource must be imperfectly imitable. This condition holds if either the ability of the firm to obtain this strategy enabling resource is dependent upon unique historical conditions, or if the causal link between the strategy enabling resource possessed by a firm and the firm's sustained competitive advantage is causally ambiguous, or if this strategy enabling resource, generating a firm's advantage, is socially complex. Fourth and finally, there cannot exist strategically equivalent substitutes for this strategy enabling resource that are valuable but neither rare nor imperfectly imitable.

Barney (1991) viewed these factors as empirical indicators on how useful resources are for generating sustained competitive advantages. Applying this framework to the empirical evidence gathered from the case study organisation reveals the rather surprising insights into the nature of the perceived competitive advantages. Hong Kong location was regarded as one of GD's competitive advantages. Applying Barney's framework shows that only one of the four attributes hold. Neither rareness, nor imperfect imitability, nor substitutability holds in relation to the perceived competitive advantage of Hong Kong location. Only the value attribute could apply. Therefore, this perceived competitive advantage is not a sustainable competitive advantage.

In relation to the other two perceived competitive advantages (marketing orientation and information technology), it shows that they are valuable but not substitutable, and that the rareness feature and imperfect imitability also do not apply. Again, they are not sustainable competitive advantages. Indeed, only the strong links with travel agents in Mainland China, imperfectly imitable due to historical events and social complexity (Chinese identity), constitute a valuable and a rare and a non-substitutable competitive advantage. This advantage is however of a purely domestic nature.

This observation also reflects the views of the consultants interviewed who believed that Chinese hotel companies do not have sustained competitive advantage to compete at a global level because the leading hotel companies have already established their strong brand names and market share when Chinese hotel companies entered the industry. The problems that Chinese hotel companies possess such as poor management, lack of resources, low brand awareness and political influence, contributed to this fact.

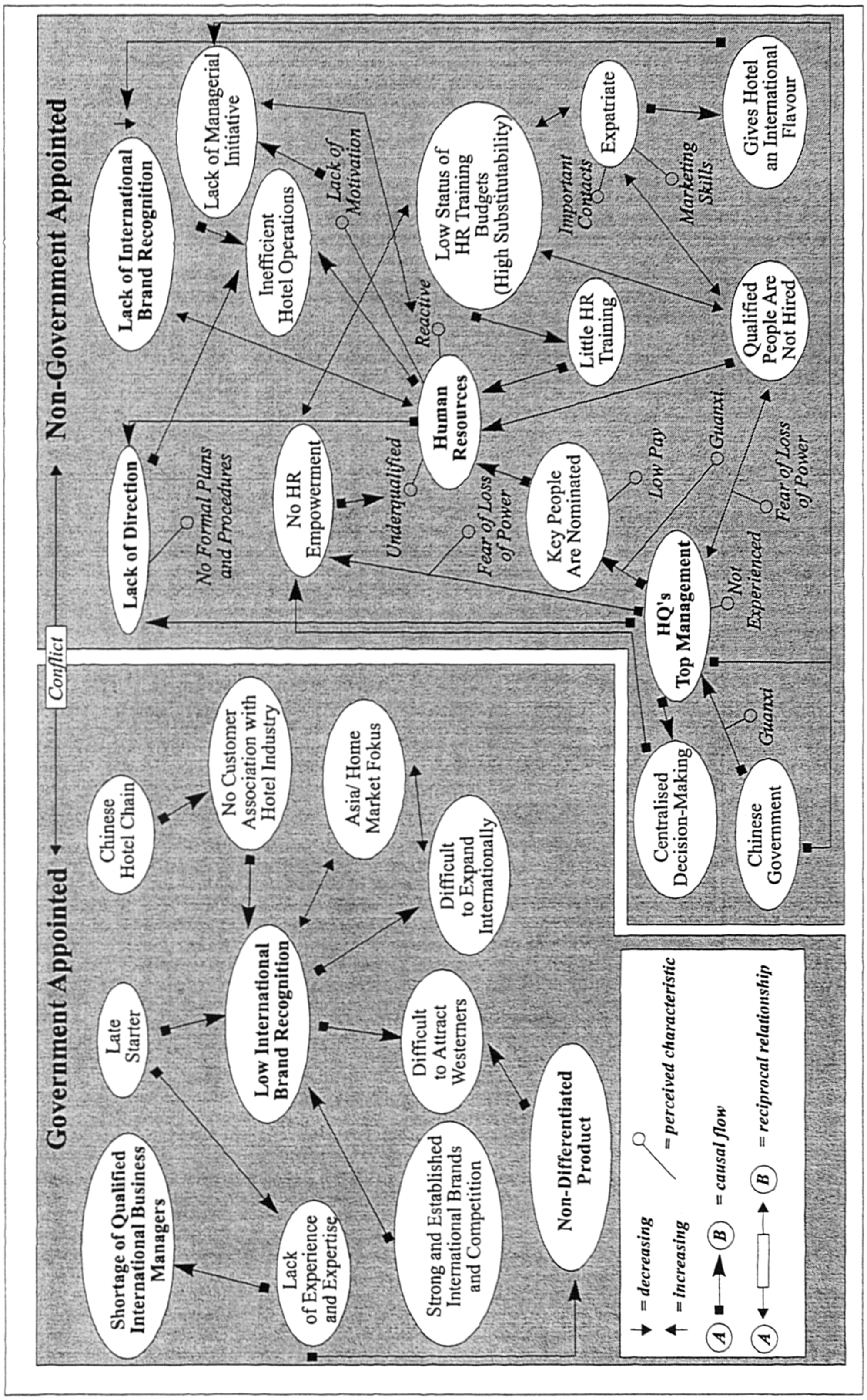
In order to enrich the understanding these problems, the next section will address the last aspect of research objective (a), that is the perceived problems in the GD Hotel Group's internationalisation.

## 7.3 Problems in the GD Hotel Group's Internationalisation

Similar to the previously discussed and analysed perceived competitive advantage of the GD Hotel Group, the perceptual pattern of problems differed between government and non-government appointed managers. Therefore, grouped cognitive maps for both groups were developed, based on their individual maps and derived from the within and across case displays. Figure, 7.3 presents the outcome of this analytical procedure.

Similar to the previous research objective, the interviewed consultants could again provide valuable outside perspectives with regards to problems in the international development of Chinese hotel companies. Their views will be presented in conjunction with the analysis of the cognitive maps of GD's top managers. As mentioned in chapter 5, this procedure will substantiate and validate the findings from the case study organisation.

**Figure 7.3: Perceived Problems in GD's Internationalisation**



### 7.3.1 Government Appointed Managers' Perceptions of Problems of GD's internationlisation

There were three interrelated factors identified by the government appointed managers, namely: shortage of qualified international hotel managers, low international brand recognition and non-differentiated products. These aspects will be discussed below.

#### 7.3.1.1 Shortage of qualified international hotel managers

A perceived shortage of qualified international hotel managers was the first problem raised by the government appointed managers. As one interviewee (SCM) remarked: " *We cannot deny the fact that we have not developed a sophisticated management team and that limits our development*". This view not only reflects similar views in the literature (Harvey, 1996), but it was also supported by one of the interviewed consultants. The Managing Director from Lintel Hospitality Consultants stressed that unqualified management is one of major problems that hinder Chinese hotel companies' internationalisation:

*"Some of the top management personnel came from non-relevant background. Imagine a GM with a medical doctor qualification, how can you expect him to run a successful hotel business. You do not need to be surprised, it is an existing phenomenon especially in state owned organisations. Some key people were appointed by the government although they have no hospitality background and experience".*

Although the latter aspect was not mentioned by the government appointed managers (in stark contrast to non-government appoint managers, see section below), they also perceived lack of experience and expertise as a problem. A problem that is aggravated by the perceived shortage of qualified personnel. However, when linking this perceptual pattern back to the cognitive maps of government appointed managers in relation to GD's competitive advantage, an interesting cognitive consistence emerged. Although the government appointed managers viewed access to skilled labour as one of the contributing factors to Hong Kong's locational advantage, they did not seem to take advantage of this factor. Mapped views by the non-government appointed managers identified the reasons for this cognitive inconsistency. As will be discussed below (see section 7.3.2), fear of loss of power – the nominated government appointed managers fear that better qualified managers might challenge their position – is a key reason for this inconsistency.

#### 7.3.1.2 Low international brand recognition and a non-differentiated product

The perceived shortage of qualified international hotel managers and its aggravating effect on perceived lack of experience and expertise was also seen as contributing to the second key problem that emerged, the problem of low international brand recognition.

According to the government appointed managers several factors contribute to this problem. First of all, they viewed their identity as a Chinese hotel chain as a contributing factor to the low international brand recognition. According to them there is no customer association with the industry. Being a late starter in the hotel industry was seen as a key contributing factors to this status quo. Strong and established international hotel brands (see chapter 3) and competition further fuelled GD's low international brand recognition. And this low international brand recognition was ultimately regarded as the key problem contributing to the difficulty of attracting Westerners and expanding internationally.

Offering a non differentiated product, perceived as being caused by GD's lack of experience and expertise, further contributed to the difficulty of attracting Westerners and expanding internationally. A resulting Asian and home market focus reinforced this overall problem, because focusing on the Asian and home market limits the extent to which international expansion will be pursued by GD. This issue was enriched further by one of the consultants who remarked that the problems of low brand recognition and non-differentiated product were caused by an unsophisticated management. He said: *"poor management directly lead to low potential of product innovation and development...lack of experience and expertise of management lead to the difficulty of creating brand recognition. Therefore, qualified people are a major source in creating the competitive advantage of Chinese hotel chains"*.

As already suggested above, the problems perceived by the government appointed managers only gave a limited account of GD's overall problems in their internationalisation. The perceptual pattern of non-government appointed managers revealed further problems.

### 7.3.2 Non-Government Appointed Managers' Perceptions of Problems of GD's internationlisation

As can be seen in Figure 7.3, the non-government appointed managers shared the view with government appointed managers that the human resources and the lack of international brand recognition (note the use of the word "lack" with the non government appointed managers and the use of the word "low" with government appointed managers) constitute the key problems in GD's internationalisation.

However, the non-government appointed managers provided causal explanations for these two shared problems, causal explanations that also explained the cognitive inconsistency of government appointed managers. Following the causal flow of problems viewed by the non-government appointed managers (see Figure 7.3) identifies GD's headquarters top management as the core cause of the perceived problems. The government appointed top managers were not only seen as inexperienced, but also as causing the human resources problem by not empowering their employees and by providing little human resources training. As one interviewee (GM) said: *"... when we have to cut down our expenses, first to go is training expenses, which is not right..."* Interestingly, the key reason for this behaviour relates to a fear of losing power. One non-government appointed manager (SFM) said: *"...if there are many more qualified top managers in the headquarters, some managers might feel insecure"*. This led to the fact that the possible solution to this human resources problem, such as hiring of foreign expatriates or accessing skilled labour in the Hong Kong market, were not pursued (see Figure 7.3).

This problem was also seen as further aggravating a classical human resource problem in non-market economies, the problem of a lack of managerial initiative. The non-government managers viewed GD's managerial staff as rather reactive. And although research has shown that such typical employee behaviour is the outcome of socialisation processes determined over time by a country's political and economic system (Frese *et al*, 1996) – therefore unlikely to be completely different without the observed management style of the government appointed managers – the management style of the government appointed managers nevertheless slows down, or even halts, a process towards more personal managerial initiative at work.

According to non-government appointed managers, consequently, there is not an effective strategy to tackle GD's key problems. Moreover, the cognitive map of non-government appointed managers reveals another inconsistency in relation to government appointed managers. Although the government appointed managers stated that organisational and political autonomy are valuable characteristics of the Hong Kong locational advantage, they themselves did not implement such a management style in the organisation. As one non-government appointed manager (GM) said: "*... due to the previous unpleasant experience, now I do not say anything more than they expected. The decision making in this firm is still highly centralised...*" This point was further enriched by another respondent (SFM): "*...we rarely perform a proactive role in relation to our international expansion although we have committed to it. Usually one or two people make important decisions in GD, although we are entitled to take part but never invited...*" Figure 7.3 shows that this behavioural inconsistency further aggravated GD's problems.

Overall it becomes apparent that there is a hidden organisational problem within GD. The apparent conflict between government appointed and non-government appointed managers' views clearly hinders consensus building and decision making at the managerial level. In studies of management issues in China, many researchers have provided insights into this phenomenon (see for examples Child and Lu, 1996 Sergeant and Frenkel; Porter 1996; Wong and Maher, 1997). Child and Lu (1996) note that Chinese managers were generally political appointees and their decisions were largely shaped under the pre-reform centrally planned economy. In comparison, the managers from the market economy emphasise competence for the job, devolved strategy-formulation, formalised organisational procedures and financial performance criteria. This observation by Child and Lu (1996) helps to provide further understanding of the conflict between government appointed managers and non-government appointed managers and their perceptions of problems in GD's internationalisation.

Overall, the analysis of GD's internationalisation revealed that government related factors were of explicit or implicit influence throughout GD's internationalisation. Governmental factors formed and influenced GD's business location (Hong Kong), its first internationalisation, its strong links with travel agents in Mainland China and its headquarters' top management composition. The cognitive differences between government appointed and non-government appointed managers further highlighted this influence. A further analysis of the role of the government is therefore needed. The next section will address that (research objective b).

## 7.4 The Role of the Government

Each of the cognitive maps presented in the previous sections clearly visualised the influence of the government. There was therefore no need to develop a set of additional cognitive maps relating specifically to the role of the government.

Addressing research objective (a) revealed that, as expected, the role of the government was crucial not only in GD's internationalisation but also in its organisational and managerial structure and operations. This finding not only reflects related findings in the literature (Jenkins and Henry, 1982; Porter 1996; Zhang and Bulcke, 1996; Esichaikul and Baum 1998; and Zhang, 1999), but the influential role of the government was also not surprising for both government appointed and non-government appointed managers. All respondents did acknowledge the very positive role of the government in creating an environment that enabled and supported tourism development. The Chinese government initiatives of economic reform, the establishment of special economic zones, the introduction of liberating travel policies and the encouragement of the internationalisation processes in state-owned firms were all important and influential conditions which allowed the establishment and development of GD (see Figure 7.1 and Figure 7.2).

However, both groups of managers explicitly stated that they would like to see a reduction of government involvement. As one of the government appointed managers (SCM) observed: *"As a state owned firm, we were granted the right from* *the government to internationalise, but it would be unwise if overseas expansion decisions have to be determined and controlled by the government ... We made our own decision regarding the investment in Bangkok and it has met very good financial outcome, this case somehow can indicate that we are able to make international expansion without government intervention".*

This point was shared by the non-government appointed managers. As one respondent (SFM) remarked: "*Overseas investments involve big sums of capital, thus, the government tended to control it by helping the firm to choose and decide where to invest and how to invest. However, the results have not been pleasant and have not matched the government's initial goal – facilitating economic reform. It is necessary that Chinese multinationals enjoy more autonomy, and the decision on multinational development should be left to the firms themselves as long as they are financially profitable. The government should play a backstage role, which is to design and implement policies that can support Chinese multinational firms competing in the international markets if economic reform is to be successful".*

Taking the findings of the previous research objective into consideration, it becomes clear that the motivation for seeking less government influence differed between government and non-government appointed managers. While the government appointed managers regarded the government involvement as such as negative, the non-government appointed managers focused more on the negative effects of government involvement. These effects manifested themselves in the appointment of inexperienced managers with inappropriate centralised decision-making styles, leading to an inefficient management of GD.

The motive behind government appointed managers in seeking less government involvement seemed to be rather driven by considerations of power (see Figure 7.3 and the related 'fear of loss of power' observation) than driven by considerations of increased efficiency. In contrast to the motives behind the government appointed managers' views, the non-government appointed managers were more concerned with the centralised government management style that was adopted by the government appointed managers in conjunction with direct governmental interference. This observation reflects what Zhang and Bulcke (1996) have termed the importance of a real entrepreneurial logic among Chinese state-owned firms in general. The role of the government can therefore be synthesised to be both positive and negative, as well as direct and indirect (see figure 7.4).

**Figure 7.4: The Influence of the Government**

| | Positive Influence | Negative Influence |
|---|---|---|
| Direct Influence | - travel policy<br>- international business incentives | - influence in decision-making (interference from outside) |
| Indirect Influence | - economic reform<br>- special economic zones | - influence in management style (influence from within) |

The positive influence of the government was both of a direct and indirect nature. Economic reforms and the introduction and development of special economic zones had a positive effect for the whole Chinese economy, therefore a rather indirect - that is not specifically directed at GD's operations - influence on GD. Besides these more general and therefore indirect positive impacts, the Chinese government also directly influenced GD's operations in a positive way. The implementation of a liberalised travel policy for Chinese tourists and promoting firms' internationalisation had a direct and positive impact on GD's development. Figures 7.1 and 7.2 visualised that quite clearly.

However, despite these positive influences, direct interference into GD's operations was seen as rather negative. This is a view that reflects a similar argument made by Porter (1990), when he calls for a government role that is partial, non-interfering in the firm and encouragement of a competitive environment. Porter actually stresses (p.619) that: "governments have been notably unsuccessful in managing firms and in responding to the fluid market changes that characterise international competition."

The findings of this study clearly support this argument in the previously unaddressed context of location-bound service firms' internationalisation from developing nations in transition from a centrally planned to a market driven economy. In his study of internationalisation of Chinese manufacturing enterprises, Huang (1993) concludes similarly that less government involvement and intervention into state owned enterprises and more market competition will result in operational efficiency and profitability.

However, this study's findings enrich this view of the observed indirect negative role of the government. Even though the direct involvement of the government might at present be less than in the past (see Figure 7.2, political autonomy as perceived by the government-appointed managers), there exists a "hidden" legacy problem due to the appointment of inappropriate managers close to the government. These managers, in essence, project, either consciously or subconsciously, government style management - management that was characterised as centralised, lacking of directions and clear plans and procedures, reactive rather than proactive and with no personnel empowerment (see Figure 7.2) – into GD's operations. The cognitive and behavioural inconsistencies of the government-appointed managers that were revealed in this chapter that underline this problem quite clearly.

This finding substantiates and supports the argument by Zhang and Bulcke (1996). They argue that the differences amongst Chinese multinational firms are to a large extent determined by two key factors: influence of the governmental bureaucratic system and the development of a real entrepreneurial logic. But the problem from the perspective of the firm is that these two factors are often interrelated, as was shown above.

Even if the government itself is less involved in the operations of a firm, the development of real entrepreneurial logic is nevertheless clearly hindered if market forces do not ensure that the best managers are in charge of a firm like GD. That is not to say that government appointed managers are per se not good managers, but the evidence provided in this study suggests that they are less likely to have the experience and expertise that is needed. This finding can help in understanding the argument of a consultant who remarked: *"...the Chinese hotel companies that can successful compete in international markets in the future will be owned by the private sector because their corporate strategies of development are driven by the profit maximisation principle and not political concerns..."*.

Finally, the above argument for letting market forces rule the management appointment process also relates to GD's overall past development. As was analysed above (see section 7.2), GD enjoys little sustainable competitive advantage over its competitors. GD is actually thriving on a nearly secure market of increasing Chinese outbound tourism. GD's exposure to "real" competition, according to Porter (1990) one of the key factors in the diamond that prepare and infuse a company with a competitive outlook, is limited. Only their venture into the French market can be seen as a move into a competitive, contestable marketplace. However, this move was not initiated by GD's economic considerations, it was initiated and even implemented by strong governmental preferences. Failure was nearly inevitable.

The role of the government should therefore move beyond the positive direct and indirect influences that were mentioned by the interviewees (see Figure 7.4). The government should start encouraging domestic competition. In the long-run this would not only lead to a reduction in the appointment of inappropriate managers, but it would certainly also help to create an entrepreneurial, proactive and innovative spirit that could ultimately strengthen the competitive position of the GD Hotel Group and other Chinese state owned firms.

## Conclusion

This chapter presents grouped cognitive maps drawn from the case study organisation and visualising important themes associated with GD's internationalisation. It also analysed the role of the government in GD's operations. Findings derived from these maps are linked to the literature, as well as linked to findings from interviews with consultants in the hotel industry with experience in Chinese hotel chains, such as GD. This procedure helps to analyse and synthesise the findings, thereby addressing the first two research objectives of this thesis.

With regards to the first research objective it was found that the development of the GD Hotel Group as a multinational company seems to have been determined more by changes in Chinese government policies than by gradual developments of its corporate strategies and its resource endowments. Consequently, a gradual internationalisation process of organisational learning which was developed by Johanson and Vahlne (1977) cannot be confirmed for the GD Hotel Group.

The evidence also demonstrated that GD enjoys little sustainable competitive advantage over its competitors. Its development was actually thriving on a nearly secure market of increasing Chinese outbound tourism. GD's exposure to "real" competition was limited. Furthermore, GD suffers from poor management because of a deficient bureaucratic system, unprofessional managerial personnel and low motivation. This fact clearly reflects that the application of modern management techniques and styles are still at an early stage of development.

With regards to the second research objective it was found that the role of the government was crucial in GD's internationalisation. The government influence can be synthesised to be positive and negative, as well as direct and indirect. Despite positive influences, direct interference into GD's operations was seen as rather negative. Even though the direct involvement of the government might at present be less than in the past, there exists a "hidden" legacy problem due to the appointment of inappropriate managers close to the government.

These findings are instrumental for addressing the research aim of this study. The next chapter presents the outcome of the research aim, a theoretical framework of internationalisation of Chinese hotel companies. The empirical evidence of this chapter and theories will guide the analytical steps that are presented there.

# Chapter 8: Conclusion – Key Findings Synthesis, Internationalisation Framework, Implications, Limitations and Directions for Future Research

## Introduction

Based on the literature review and the empirical evidence drawn from the case study organisation, addressing research objective (a) and (b), this chapter is going to address the overall research aim of this study. The goal of this research aim is to develop a theoretical framework of the internationalisation of hotel companies from developing countries in transition from a centrally-planned economy to a market economy. The basis for the development of this theoretical framework is the analysis of the empirical evidence addressing the internationalisation specifics of GD (research objective (a)) and the role of the government in its internationalisation (research objective (b)). This chapter also discusses the implications of this study's findings for research and theory, policy makers and practitioners. The discussion of its limitations and direction for future research will conclude this chapter, and this thesis.

## 8.1 Synthesis of the Key Findings

The empirical findings of this thesis have shown that several important and interrelated factors contributed to GD's internationalisation. In synthesis, these factors mainly relate to the role of the government, the role of resources and the role of competitive advantage and strategy.

The government emerged as the fundamental driving force to initiate the internationalisation. The government, to a certain extent, controlled the resources or at least directly or indirectly influenced companies' resources. These resources were in turn important in the internationalisation process of the firm. Furthermore, these resources also affected the firm's competitive advantage and strategy and, finally, the internationalisation outcome. The following sections will discuss each of these aspects in detail.

### 8.1.1 The Role of the Government

Traditionally, researchers have argued that the government should not be involved in the operations of firms (see Porter, 1990). Huang's (1993) study about Chinese manufacturing enterprises' internationalisation also strongly suggests the separation of the government involvement in firms' developments. This study found support for these arguments in the non-manufacturing, location-bound service context of the hotel industry.

The empirical investigation revealed that the government was crucial in GD's internationalisation. It was not only the initiating force but it also influenced GD's organisational and managerial structure as well as operations. The study found that the role of the government was both positive and negative and direct and indirect. The evidence showed that when the government was directly interfering in GD's operations (GD's first investment), the internationalisation outcome was not satisfactory. Conversely, when the government was not directly interfering in GD's operations, when the government was directly or indirectly shaping the competitive environment, GD's internationalisation was successful. However, the evidence also suggest that, although government involvement decreased over time (see GD's second investment), its influence is still observable, but in a more implicit manner.

The analysis of the cognitive maps reveals cognitive and behavioural inconsistencies among the government appointed managers. This finding points to a hidden governmental legacy problem. The government-appointed managers, although enjoying less government intervention, still followed and implemented governmental managerial styles of centralised decision making, little employee autonomy and empowerment. According to the non-government appointed managers this was the key problem that hindered GD's efficient internationalisation, and the development of an entrepreneurial logic (Zhang and Bulcke, 1996).

Moreover, it was found that GD enjoyed limited sustainable competitive advantages. This was in part due to the government not encouraging domestic competition. This relationship, in conjunction with the previous link between the government and the management style of the government appointed managers, shows the revealed influential interrelationship between the government and GD's resources.

### 8.1.2 The Role of Resources

The influential interrelationship between the government and GD's resources was shown to be important, because the empirical evidence clearly demonstrated the importance of resources in GD's internationalisation. The study shows that in GD's first internationalisation, GD was suffering from a lack of resources. As the cognitive map reveals, lack of international business experience, lack of knowledge about the foreign market and lack of international business resources such as management expertise were some of the contributing factors that led to the subsequent failure of its first overseas investment. By contrast, GD's second internationalisation was characterised by a stronger resource-base. The empirical findings show that GD did not only gain experiential knowledge from its first venture abroad, but their success in Hong Kong also infused GD with additional financial resources. Besides other things, the stronger resource-base was one of the contributing factors led to the success of the second investment.

However, despite the stronger resource-base in their second overseas expansion, this study also discovered several problems in relation to GD's resources. In synthesis these problems related to GD's human resources and its product offering. In relation to the former, it is particularly interesting to note that although GD suffered from a perceived human resources problem, they did not address the problem. This behavioural inconsistency manifested itself in not hiring qualified people and in not providing sufficient training to its staff. The reason behind this behavioural inconsistency was fear of losing power, as perceived by the decision-making, less qualified government-appointed managers in GD's headquarters. This finding highlights the interrelationship between the role of the government and GD's resources.

The human resources problem also affected GD's product offering problem. This problem relates to GD's non-differentiated product and GD's lack of international brand recognition, which ultimately led to the difficulty of GD's further expansion and competing with other international hotel companies. These resources related factors have important bearings on GD's competitive advantage and strategy.

### 8.1.3 The Role of Competitive Advantage and Strategy

The weakness in GD's resource-base directly links to its competitive advantage in operating internationally. Although GD managers perceived several sources of competitive advantage, the in-depth analysis in chapter 7 revealed only one sustainable competitive advantage. This advantage, the close link with Mainland China travel agents, was however of a purely domestic nature. It was therefore not surprising that GD's first venture abroad, when GD was exposed to established international competition, was not successful.

However, in GD's second overseas investment, despite a weak competitive position albeit with a stronger resource-base, its competitive disadvantage was not as problematic. As was shown, this was due to an explicit change in strategy, or to be more precise due to a strategic approach as opposed to a reactive political approach. In contrast to its first venture abroad, GD's second overseas investment was characterised by an explicit strategy of following Chinese outbound tourism abroad. This strategy helped GD to reduce its resource-base weakness and its competitive disadvantage. The success of this strategy in terms of the financial performance of the hotel supported the fruitfulness of this approach.

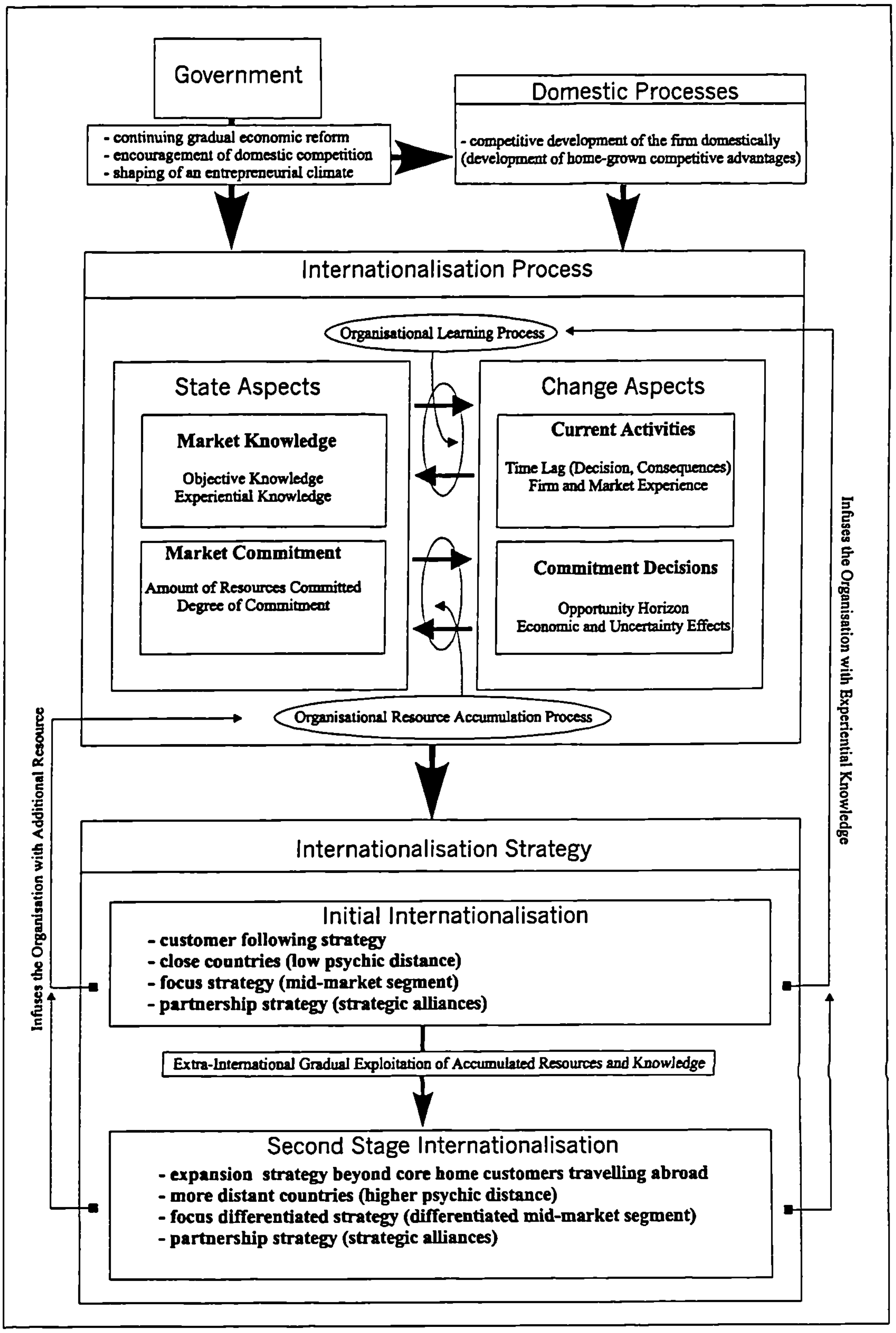
In summary, the synthesis of the key findings presented in chapter 7, identifies three sets of interrelated factors – the role of the government, the role of resources, the role of competitive advantage and strategy – that shaped and explained GD's overall internationalisation. Based on these insights, the following section will develop a theoretical framework of the internationalisation of Chinese hotel companies, a framework which can be used as a normative guideline to successful internationalisation of Chinese hotel firms.

## 8.2 Towards a Theoretical Framework for the Internationalisation of Chinese Hotel Companies

The main aim of this research is to develop a theoretical framework of the internationalisation of Chinese hotel companies. The assessment of research objectives (a) and (b) prepared the ground for this framework. This research used a case study approach analysing the internationalisation specifics of the GD Hotel Group. By adopting this research technique, themes, lessons and strategies emerged which can be related to theory. The following sections will relate the key findings to theory in order to develop a theoretical framework which can be adapted by other Chinese hotel companies.

Figure 8.1 presents the framework and the following sections will discuss its key constituent parts in detail.

**Figure 8.1: Framework for the Internationalisation of Chinese Hotel Companies**



### 8.2.1 The Government and the Domestic Market

Traditionally, in developed economies, it has been argued that the government should only play a partial role in the economy (see for example Porter, 1990). However, in most developing countries, due to a scarcity of resources, a lack of expertise and limited involvement of the private sector, the government often plays a central role in changing social and economic structure of the society. Researchers argue that a higher degree of government involvement is required in developing countries in the initial stage of their economic development (see for example Jenkins, 1994; Esichaikul and Baum, 1998). The argument is that the government should decrease its involvement only gradually. The non-gradual movement from a centralised planning and operational system to one of complete privatisation has dangers (Jenkins, 1994). The current chaos in the states of former Soviet Union illustrated the perils of a rapid structural transformation.

As this research has shown that in the context of the hotel industry, the government has played a major role in the development of the Chinese hotel industry in general and the internationalisation process of a Chinese hotel chain in particular. A major difference to the international hotel companies that were reviewed in this study. However, as the empirical evidence showed, government involvement was only positive at the level of the economy, government involvement at the firm level was not. The implications of this finding are reflected in the framework (see Figure 8.1).

In contrast to the Uppsala Internationalisation Process Model, this framework incorporates the government, because it is an enabling and facilitating force in

Chinese hotel companies' internationalisation. This reflects the more general views of Jenkins and Henry (1982), Jenkins (1994) and Esichaikul and Baum (1998). More importantly, it reflects the situation that the private sector in China is still embryonic and in certain parts of the economy, it may not be represented at all. However it is not an argument for continuing centralisation, rather it is an argument for continuing gradual economic reform, encouraging domestic competition and shaping of an entrepreneurial climate. These factors are important for strengthening the competitiveness of Chinese hotel companies home-base, which in turn should strengthen the internationalisation process of Chinese hotel companies (see Figure 8.1).

#### 8.2.1.1 The home-base as a precondition for developing competitive advantage

As this study revealed, GD enjoys limited sustainable competitive advantage compared to the international competitors such as Mandarin Oriental, Shangri-La, Holiday Inn and Accor. It is highly unlikely that this situation is different for the other, non-international Chinese hotel companies. It was shown that when GD entered a competitive market (Paris) without a secured market source (in comparison to Bangkok), it could not compete successfully.

According to both Dunning (2000) and Porter (1990, 1998), the home location matters. It is the source of what Dunning's eclectic paradigm (see chapter 3) refers to as an ownership advantage. This advantage is usually developed to a large degree in a firm's home market (Porter, 1990, 1998), the development experience of American hotel companies clearly demonstrate this fact. This assumption is also implicit in the

Uppsala Internationalisation Model which assumes that firms first develop domestically before they start their internationalisation. The empirical evidence shows that this was not the case in GD's development. It did not develop a viable competitive posture domestically before it started its internationalisation. This was in stark contrast to the development of the American and other leading hotel firms (see Chapter 3).

As Figure 8.1 highlights, it is therefore important that the Chinese government upgrades the domestic economy (Porter's diamond) in the suggested way to enable the competitive development of the firms domestically. This process should allow the development of home-grown competitive advantages, which can be subsequently – or if needed in parallel – exploited internationally. The contributing positive effects of GD's stronger resource-base, in parts accumulated from its home-base success in Hong Kong, in its second internationalisation clearly give supportive evidence for this suggestion. This approach in the specific context of this study's focus on the hotel industry is potentially particularly fruitful. As discussed in chapter 4, domestic tourism in China is growing rapidly and there is a situation of undersupply in relation to the mid-market hotel segment. This unaddressed expansion opportunity could therefore constitute a significant source for developing a competitive resource-base for future internationalisation expansion. However, as also incorporated into the framework, the shaping of an entrepreneurial climate is an essential element in the overall upgrade of China's domestic economy.

#### 8.2.1.2 An entrepreneurial climate as a precondition for developing competitive advantage

Apart from the internal conflicts between government-appointed and non-government appointed managers – a problem that will probably resolve itself automatically as a new generation of managers (non-government appointed) will take over their positions in the future – a key problem is the attitudinal predisposition of the Chinese workforce. The international hotel companies that were reviewed in this study share some similarities in terms of they proactively seek international expansion opportunities and very innovative and aggressive in international competition with the aim to gain competitive advantage (e.g. Mandarin Oriental, Accor). However, as the cognitive maps revealed, there is a lack of an entrepreneurial climate in GD, a climate which is characterised by autonomy, innovativeness, risk taking, proactiveness and competitive aggressiveness (Lumpkin and Dess, 1996).

An empirical investigation into the unique historical situation of East and West Germany made it quite clear how different political and economic systems can shape people's behavioural pattern (Frese *et al* 1996). The study found a significantly lower personal initiative at work in East Germany and the results supported the theory of socialisation. Clearly, the findings of this study reflected, at least indirectly, that similar socialisation forces are at work in China. The employees, particularly older, government-appointed mangers in this case study, were largely shaped by the pre-reform centrally-planned economy. This was reflected by their low economic motivation and initiative, as well as the projection of government-style management practices into GD's operations (centralised decision-making, no personnel empowerment, little commitment to personnel training). It can be argued that this specific feature is a major contributing factor that hinder the development of GD's competitive advantage.

Therefore, it is important for the government to initiate the development of an entrepreneurial climate. According to Jenkins (1994) this can most effectively be achieved by gradually increasing the role of the private sector driven by competitive forces. This should strengthen the personnel intensive hotel industry and it should therefore strengthen their competitiveness when venturing abroad. The lessons drawn from the failure of GD's first internationalisation stress the importance of this point. But it is worth noting that the issue of developing an entrepreneurial climate should include a specific element of developing an international entrepreneurial outlook, often argued to be a pre-condition in firms' internationalisation in general (Dichtl *et al* 1990).

### 8.2.2 The Internationalisation Process: Organisational Learning and Resource Accumulation

The second key element in the internationalisation framework (see Figure 8.1) is the actual internationalisation process itself. As discussed above, in comparison to the international hotel companies which are private owned and / or from market economies, the internationalisation process of GD was influenced by the Chinese government. This study revealed that the government enabled and facilitated the initiation of this process and, if it encourages domestic competition it supports this on-going process. However, although obviously based on the Uppsala Internationalisation Model (UIM) and supporting parts of its suggested process forces, it incorporates additional peculiarities of GD's internationalisation, peculiarities that can be considered relatable to other non-international Chinese hotel companies that have not yet ventured abroad.

#### 8.2.2.1 Incrementalism and internationalisation as an organisational learning process

As synthesised in chapter 2, the Uppsala Internationalisation Model (UIM) essentially views the internationalisation process as an organisational learning process of accumulating experiential knowledge. This process was also found in GD's internationalisation. Its initial internationalisation served as an experiential learning source for its second internationalisation.

Furthermore, the normative notion of incrementalism was supported. Although GD's initial internationalisation defied the conventional notion of incrementalism – GD invested in a distant country with no international experience – its subsequent failure supported the normative value of the concept. This support was further validated by the later success of GD in its second internationalisation, an internationalisation that followed a more incremental path (investment incrementally followed its first investment).

However, besides the supportive evidence, strengthening the theory's underlying logic and its applicability to other cultural contexts, this study also identified two factors that differed and are likely to differ for other Chinese Hotel companies as well. First, there was no support for the network extension of Johanson and Vahlne (1990) and second, a parallel process – a process not explicitly considered in Johanson and Vahlne's framework – was operating in GD's internationalisation: the process of accumulating and exploiting supportive organisational resources (see Figure 8.1). Each aspect will be further discussed below.

**8.2.2.2 Internationalisation as an organisational process of accumulating resources**

The case study evidence showed that GD's second internationalisation was not only characterised by experiential learning effect, but it was also characterised by the exploitation of supportive resources accumulated from its first internationalisation and, mainly so, from its successful operation in Hong Kong. Supporting emerging empirical evidence in other contexts shows that the internationalisation process is also a process of resource development and exploitation (see for example Petersen and Pedersen, 1998). This study shows that this process was also at work in GD's internationalisation. Thus, it needs to be added to the internationalisation process model (see Figure 8.1).

Although UIM is grounded in Penrose's theory of the growth of the firm (Johanson and Vahlne, 1977, 1990) with its focus on a firm's resources and excess managerial capacity, resource related factors like the development of the resource-base of a firm and its subsequent transformation into organisational capabilities is not explicitly addressed (Andersen, 1997). The model focuses on experience that transforms into knowledge as the key resource in the internationalisation process. However, if a firm does not have the resources to support its internationalisation, although it is knowledgeable about international markets, internationalisation will either not take place at all, or it will lead to lower levels of performance. The case study evidence supports such an interpretation. This is further validated by the empirical findings of Petersen and Pedersen (1998) showing that the resource-base of a firm shows a stronger statistical relationship with internationalisation than knowledge accumulation. Thereby supporting the importance, as well as complementarity of organisational resources other than knowledge. The framework (see Figure 8.1) incorporates this extension.

The incorporated organisational *resource accumulation process* can also be seen as a potential theoretical bridge incorporating Dunning's eclectic paradigm (Dunning, 2000). His paradigm, although rather more static than process oriented (see Chapter 3), postulates the importance of an ownership advantage in explaining the existence and form of multi-national enterprises. This part of his framework is clearly reflected in the incorporation of the resource accumulation process. However, rather than seeing it as a static prerequisite prior to a firm's internationalisation, it is seen as both a supportive (although not necessary) prerequisite and an integral part of the internationalisation process itself. Internationalisation does not only imply the exploitation of domestically accumulated resources internationally, but it also implies that the internationalisation process itself infuses the firm with additional resources (Bell *et al*, 1998; see also the link between the internationalisation process and the internationalisation strategy in Figure 8.1).

#### 8.2.2.3 Internationalisation as an isolated organisational process: the unimportance of networks

As noted in chapter 2, Johanson and Vahlne extended their original process model in 1990 to incorporate the important influence of business networks on a firm's internationalisation. The important influence of a firm's external relationships, its network, was found to be of particular influence in industrial markets, although the relationship view of a firm's operations has also recently gained in importance in consumer markets (Morgan and Hunt, 1994). Surprisingly, despite arguments in the literature that the network, relationship view is particularly fruitful in service industries (Berry, 1983; Grönroos, 1994), this study's findings do not support the view in the context of the internationalisation of Chinese hotel firms.

The in-depth case study analysis of GD's internationalisation reveals little network influence, apart from the discussed domestic political dimension, and its potential influence is therefore not reflected in Figure 8.1. Its network of external relationships did not directly influence both of GD's analysed internationalisation phases, apart from the discussed domestic political forces. The first internationalisation was influenced by political forces – the only source of network influence that is incorporated in the framework – and the second internationalisation was influenced by customer following motives, not by existing network relationships with economic actors in Thailand (a very good contrast to Shangri-La's expansion into China).

In retrospect, this finding is not surprising, because network effects on a firm's internationalisation are often argued to be contingent upon a firm's network embeddedness (Brock, 2000). Due to China's well-known history of being isolated from the 'rest' of the world, it is not surprising that GD's internationalisation was also characterised by comparatively high degrees of isolation from the global hotel industry and its associated business networks. However, besides the low degree of network embeddedness, another crucial contributing factors needs to be addressed: the reluctance of GD's managers to develop international networks.

As was revealed in chapter 7, *Guanxi* plays a key role in GD's internationalisation, as well as its general operations. This strong home-based network prevented GD from developing an international network. Not only did GD's managers lack an international orientation which prevented them from actively developing and expanding an international network, but they also wanted to keep GD's Chinese atmosphere by not hiring expatriates (see Chapter 7). This behavioural pattern, arguably a unique feature of GD's top management, can be explained by China history as briefly noted above, as well as the fear of losing power (see chapter 7).

Overall, it is therefore unlikely that Chinese hotel firms' internationalisation in general, at least in the short and mid term, is heavily influenced by an international business network. It should however be mentioned that recent developments in communication and information technology, most notably the Internet (see also the role of GD's web site as discussed in chapter 7), could in the future dramatically increase the importance of network influences on Chinese hotel firms' internationalisation. This is because a global, location insensitive medium like the Internet can de-encapsulate a firm from its location sensitive, often purely domestic network of business contacts. Emerging empirical studies find support for this argument (Bennett, 1997; El Louadi, 1998).

It can therefore be argued that although currently there seems to be no direct evidence for network influences on the internationalisation of Chinese hotel firms, in the future these influences are likely to come into play and, over time, increase in importance.

### 8.2.3 Internationalisation Strategy: Initial and Second Stage Internationalisation

The Uppsala Internationalisation Model (UIM) was, among other things, criticised for its lack of a strategic dimension (Melin, 1992). However, as the study of GD has shown, strategy matters. The proposed framework of the internationalisation of Chinese hotel companies does therefore incorporate a strategic dimension (see figure 8.1)

Due to the various organisational and environmental problems that GD faced in its internationalisation, factors most likely to be similar for other Chinese hotel firms, a two-stage internationalisation approach is proposed here. An initial internationalisation strategy of addressing comparatively little contested foreign markets in a resource developmental rather than exploitative way and a second stage internationalisation strategy characterised by extra-international exploitation of accumulated resources and a more sophisticated internationalisation strategy. The following sections will discuss each aspect in more detail.

#### 8.2.3.1 Initial internationalisation strategy

It has become apparent that GD's internationalisation, particularly its first internationalisation, was characterised by a non-strategic, unprepared approach with little supportive resources. The unsuccessful outcome of its first international venture has important lessons for other Chinese hotel firms and its implications are incorporated into the proposed framework (see Figure 8.1).

The overall message is that strategy, whether formalised or emerging matters. Simply internationalising without any clear direction, without any supportive resources and without any economic motive does not work. The contrast between GD's first and second internationalisation showed this quite clearly. Therefore, Chinese hotel companies should develop a strategic posture towards their internationalisation and, taking their organisational and environmental specifics (see chapter 7 and discussions above), as well as the findings regarding GD's internationalisation into consideration, the following strategies for their initial internationalisation are suggested.

**Customer Following Strategy**

Since Chinese hotel firms are characterised by resource poverty, compared to international hotel companies, and little competitive advantage due to lack of domestic competition and an entrepreneurial climate, initial internationalisation activities should follow a low risk expansion into markets that are not highly contested by internationally established competitors. Therefore, and in line with the insights of GD's success in Thailand, Chinese hotel firms should follow a customer following strategy. Not only is this type of strategy often suggested for other service firms in general (Erramilli and Rao, 1990; Porter, 1990), but the literature review has also shown that this type of strategy led to the successful internationalisation of American hotel chains.

As GD's second internationalisation has shown, when a service firm follows its customers abroad it follows a relatively secure source of business, unless it has a negative reputation in its home market. Because the travelling customers are faced with an uncertain, new environment especially so for the inexperienced Chinese tourist, they would rather like to avoid high search costs involved in finding a hotel that they do not know. This problem is further aggravated by the fact that hotel services are experience goods (see chapter 2) and not search goods.

Following such a strategy is particularly fruitful for Chinese hotel companies, because Chinese outbound tourism is going to increase in the near future (see table 8.2) and because China is a country with a huge population of over 1.2 billion people. The combination of these two factors constitutes an important potential source of revenue for hotel companies following this stream of outbound tourists. It is therefore not surprising that the W.T.O. predicts that China is likely to become the fourth biggest outbound country among the top ten countries by the year 2020 (WTO, 1997).

**Table 8.2: Comparison of Population in China and Total Outbound Travel 1985-1998**

| Year | Population (Millions) | Total China outbound | Total Outbound to Total Population % |
|---|---|---|---|
| 1985 | 105,851 | 308,978 | 0.29 |
| 1986 | 107,507 | 363,479 | 0.38 |
| 1987 | 109,300 | 484,592 | 0.43 |
| 1988 | 111,026 | 683,604 | 0.62 |
| 1989 | 112,704 | 730,408 | 0.65 |
| 1990 | 114,333 | 754,376 | 0.65 |
| 1991 | 115,823 | 875,062 | 0.75 |
| 1992 | 117,171 | 1,149,002 | 0.98 |
| 1993 | 118,517 | 1,732,978 | 1.46 |
| 1994 | 119,850 | 1,943,678 | 1.46 |
| 1995 | 121,121 | 2,243,245 | 1.85 |
| 1996 | 122,389 | 2,311,184 | 1.89 |
| 1997 | 123,626 | 2,297,128 | 1.86 |
| 1998 | 124,810 | 2,597,442 | 2.08 |

Source: A Statistical Review of Tourism 1993-1999, HKTA.
Statistical Yearbook of China, 1997.

Besides an increasing number of Chinese tourists travelling abroad, Chinese tourists are also becoming richer. As China's GDP per capita increases, Chinese tourists will have more money that they can spend when travelling abroad. Table 8.3 shows this development.

**Table 8.3: Gross Domestic Product (GDP) in China 1985-1998**

| Year | GDP (100 Million Yuan*) | Per Capita GDP (Yuan*) |
|---|---|---|
| 1985 | 8964.4 | 853.0 |
| 1986 | 10202.2 | 948.0 |
| 1987 | 11962.5 | 1104.0 |
| 1988 | 14928.3 | 1355.0 |
| 1989 | 16909.2 | 1512.0 |
| 1990 | 18547.9 | 1634.0 |
| 1991 | 21617.8 | 1879.0 |
| 1992 | 26638.1 | 2287.0 |
| 1993 | 34634.4 | 2939.0 |
| 1994 | 46759.4 | 3923.0 |
| 1995 | 58478.1 | 4854.0 |
| 1996 | 68593.8 | 5634.0 |
| 1997 | 74772.4 | 6048.0 |
| 1998 | 79552.8 | 6374.0 |

Source: Statistical Yearbook of China, 1997.
A Statistical Survey of China, 1999.
* 1 Yuan = 0.1208 US$ (2000 rates)

The average living standard of Chinese citizens has improved, especially for the residents of the Special Economic Zones, coastal cities, and cities like Shanghai, Beijing and Tianjing. Therefore, people living in these areas are most likely to represent the bulk of the potential market for outbound travel. Although a majority of the Chinese population in general remains predominantly rural, the total size of this urban market is impressive (Zhang, 1999). China outbound travellers globally will play a critical role in influencing world tourism. As W.T.O.(1997) suggests, the

Chinese market will mushroom in size over the next twenty years. The growing outbound Mainland Chinese market comprising of relatively inexperienced international travellers, seeking to experience new environments but within the protective shell of a familiar company. This provides a perfect opportunity for Chinese hotel companies to enlarge its foothold in international markets.

**Target Markets: Close Countries (Low Psychic Distance)**

A second and related aspect of the initial internationalisation strategy relates to targeting close countries. As argued in the Uppsala Internationalisation Model, due to differences between the home and host country in relation to factors such as language, culture and economics, targeting close countries can facilitate the internationalisation process by lowering barriers that a firm might encounter. Targeting close markets can constitute a locational advantage (Dunning, 2000), this is because other international competitors might face higher costs due to less familiarity with the market. GD's success in its second internationalisation clearly showed that such a strategy could work.

Chinese hotel companies are therefore advised to target close international markets, ideally markets such as Thailand, Malaysia, Singapore, Korea and Japan that are considered in China's outbound tourism policy. Thereby, they in essence combine the benefits of both customer following and targeting close countries.

**Focus Strategy (Mid-Market Segment)**

Besides addressing the strategic question of whom to target (customer following strategy) and where to target (close countries), it is also important to consider the strategic question of how to target. In relation to Porter's generic strategy framework (Porter, 1980), this question mainly relates to differentiation versus cost leadership strategies and focus strategies.

Since Chinese hotel companies are likely to initiate their internationalisation with a comparatively weak resource-base and therefore with a comparatively weak competitive advantage in comparison to its international competitors (e.g. Shangri-La, Mandarin Oriental, Accor). Thus, a focus strategy, focusing uni-dimensionally on the customer requirements of its Chinese outbound tourists, is therefore recommended.

As noted in chapter 6, expectations of Chinese tourists are congruent with the mid-market sector. On the one hand Chinese tourists are not willing to and not able to pay for luxury hotel offerings, and on the other hand Chinese tourists do not want to completely sacrifice on quality. This preferential customer pattern, known as "extremeness aversion" in other contexts (Shapiro and Varian, 1998), should guide the initial internationalisation strategies of Chinese hotel companies. Focusing on the mid-market sector has the additional advantage of addressing an uncrowded market segment – no single international hotel company purely focuses on this segment – as revealed in the strategic group analysis (see Chapter 3).

However, Chinese hotel companies should be aware of the potential "stuck in the middle" problem of this strategy (Porter, 1980), because a mid-market focus strategy is vulnerable to both the budget market competition and the up-market competition. Chinese hotel companies are therefore advised to constantly monitor their competition in order to offer a viable balanced proposition between the two extreme market propositions.

**Partnership Strategy (Strategic Alliances)**

Shundich (1997) argues that geographical expansion needs partnership, apart from pursuing equity participation entry strategies, the strategic question that needs to be considered is with whom to pursue the internationalisation. As became evident in the analysis of the case study organisation, internationalisation processes in the hotel industry are rarely processes of isolation. Although it was shown that direct network influences were absent in GD's internationalisation due to a low international network embeddedness and an unwillingness to expand business networks internationally, its operations were nevertheless dependent on support from related business partners. Particularly, GD's second internationalisation benefited from co-marketing activities, especially from its close links with domestic travel agents. However, Chinese hotel firms should try to benefit more from such co-operative business strategies because strategic alliances can help Chinese hotel companies to overcome their resource disadvantages, accelerate the pace of entry into new markets and improve their competitive positions (Varadarajan and Cunningham, 1995; Vyas et al 1995).

Although there has been little systematic analyses of the benefits and risks of strategic alliances in the hotel industry (Dev and Klein, 1993), strategic alliances are argued to increase across all industries due to, among other things, increases in the level of global interrelatedness of economic actors (see for example Vyas et al, 1995; Anonymous, 1995; Dunning, 1998). However, despite offering the potential benefit of mutual gain (Hamel *et al,* 1989) with less resource exposure (Dev and Klein, 1993), strategic alliances are difficult to manage. Partner selection and the subsequent development of commitment and trust is of paramount importance. The international nature of the proposed strategic alliances further aggravates these issues (Cullen *et al*, 2000).

Entering into strategic alliances with Air China and/or strategic alliances with home market travel agents and/or tour operators could therefore facilitate Chinese hotel companies' internationalisation. Not only would it expand their operational reach with additional resources, but the cultural closeness would also facilitate the operational side of such an alliance. The importance of trust and commitment might therefore be facilitated. However, foreign partners should also be considered because Chinese tourists are more likely to travel to major tourist destinations and the hotel construction sites in prime locations are dear (Go and Pine, 1995) and the strategy of acquisition is very costly as well (Tse and West 1992). In this respect, one likely option for Chinese hotel companies is to integrate marketing and / or operational management functions through more or less formalised strategic alliances with foreign hotel companies.

Alliances raise the possibility of conflict between partners (Dev and Klein, 1993), and the failure rate is high (Hergert and Morris, 1988). It might be more problematic to pursue such a strategy between Chinese enterprises and foreign firms because the Chinese approach to management is different to the approach to management which has developed in the market economy (see Chapter 4). It was one of the contributing factors that caused the high rates of joint venture failure (Beamish and Speiss, 1992). Therefore, it can be argued that successful alliances with foreign partners, to a great extent, depend on the appearance of younger generation of energetic, career-driven, hard-working, profit-driven and well-educated Chinese managers who are willing to adapt to new challenges. They are the people that may facilitate Chinese hotel companies internationalisation.

#### 8.2.3.2 Second stage internationalisation strategy

As indicated in Figure 8.1, the initial internationalisation strategy should infuse the Chinese hotel companies with additional resources and experiential knowledge. Paired with the domestically accumulated resources (see the importance of the government-domestic market link above), this initial internationalisation strategy should enable Chinese hotel companies to move beyond its initial international expansion, facilitating its second stage internationalisation (see Figure 8.1). While the initial internationalisation strategy was characterised by a least resistance path to international expansion, the second stage internationalisation strategy is characterised by an extra-international gradual exploitation of previously accumulated resources and knowledge. Each of its specific dimensions will be discussed in further detail below.

**Expansion Strategy Beyond Core Home Customers Travelling Abroad**

The answer to the strategic question of whom to target in the second stage internationalisation strategy is clearly determined by the customer following strategy that was pursued in the initial internationalisation strategy. In a way, this normative chronological order is the direct opposite of GD's internationalisation. GD started to internationally expand beyond its core home customers and failed and only subsequently pursued a customer following strategy which was successful.

The pursuit of the initial internationalisation strategy, together with its competitive domestic development should have endowed the expanding Chinese hotel company with a competitive resource-base to enable and facilitate an expansion beyond its core customer base. This essentially implies targeting and attracting non-Chinese customers. However, as noted in Chapter 3, leading hotel companies have already established their strong market positions and brand equities. Together with the analysis of GD's initial internationalisation it was shown that this is not an easy task, even if following the above prescribed initial internationalisation strategy. This is, among other things, mainly due to a non-existing customer association of Chinese firms with the hotel sector, the non-differentiated nature of their product offering paired with a lack of a positive international brand recognition and poor management. Branding to create customer awareness is therefore essential, paired with a more differentiated product offering (see below for more details).

While this might have been an impossible task at an early stage of international development, at a subsequent stage success is more likely. It should however be noted that this success clearly depends on the success in the initial phase, the development of the domestic competitive context and the development of a sophisticated management team. The timing of shifting from the initial internationalisation strategy to the second stage internationalisation is therefore dependent on the outcome of the previous phases and highly likely to be firm specific.

**Target Markets: More Distant Countries**

Following the above outlined expansion strategy of targeting customers beyond the core home customer travelling abroad implies targeting more distant countries. As the analysis of GD's initial internationalisation has shown and in-line with the normative propositions of internationalisation theory (Johanson and Vahlne, 1977, 1990) targeting more distant markets is difficult. It is difficult because of the various differences in language, culture, economics and politics that constitute the psychic distance, and it raises the costs for a foreign firm to enter a foreign market due to higher levels of uncertainty. Therefore, a well-planned and structured manner (Douglas and Craig, 1989) is required when Chinese hotel companies entering the second stage internationalisation strategy to target more distant countries. Market research, feasibility studies and potential partnerships with partners who know local markets are therefore advisable.

Moreover, in relation to GD's observed human resource problem, it is advisable to hire managers and employees with the industry background and personal knowledge of the market. Simply implanting Chinese managers via *guanxi* into some newly established hotel operation abroad is unlikely to work (Huang 1993; Zhang and Bulcke, 1996; Lin, 1996). A combination of local and headquarters expertise is needed in order to reduce distance and to lower costs in adapting to local tastes.

**Differentiated Focus Strategy (Differentiated Mid-Market Segment)**

As noted above, the second stage internationalisation strategy is characterised by targeting customer beyond Chinese hotel firms' initial Chinese tourists travelling abroad. As the in-depth analysis of GD's internationalisation has revealed, such an expansion is difficult because of different customer expectations. Particularly Western tourists do have higher expectations and the perceived switch costs. The successful expansion strategy of Mandarin Oriental and Shangri-La illustrate a new dimension in the development of luxury products in the hotel industry. Therefore, it is likely that a more differentiated focus strategy, still targeting the mid-market segment but in a less standardised way, might be more suitable.

As reviewed in Chapter 3, the international hotel industry was characterised and dominated by a single, standardised, luxury or upmarket product offered by

American hotel companies (e.g. Hilton, Sheraton). This was challenged by non-American hotel companies' international expansion strategy, the strategy which did not only seek moving into new regions and locations but also sought to enter new market segments (e.g. Accor). The success of the so-called multi-tier branding strategy in the hotel industry led many hotel companies to follow such a growth route seeking to increase market share by covering a wider range of product offerings (e.g. Holiday Inn, Forte).

Therefore, as the strategic groups analysis has revealed, multinational hotel companies either follow the tradition of emphasising on up-market products – differentiated product offering (e.g. Mandarin Oriental, Shangri-La) and standardised in orientation (e.g. Hilton) – or they pursue a multi-tier branding strategy trying to cover a whole range. Therefore, it can be argued that there is less competition in this mid-market segment and in addition a more differentiated product offering is more difficult to be imitated by potential competitors and new entrants. Ideally, to avoid imitation and ensure sustainability (see discussion about the nature of sustainable competitive advantage in Chapter 7), Chinese hotel companies are advised to incorporate a positive Chinese cultural element in their product offering. If perceived as positive by the Western customers, imitation is difficult for the established Western hotel due to the social complexity (see Barney, 1990) of creating a Chinese atmosphere.

Although this proposition might be in direct contrast to the previously attested lack of a customer association of China with the hotel industry, the success of hotel companies like Mandarin Oriental and Shangri-La gives an indication of a potential perceived customer value. Chinese hotel firms targeting the mid-market segment with a differentiated product offering might try to project this positive luxury image into their offerings, stressing more the association with Asia than with China. Positioning their offering as affordable Asian luxury accommodation might be a possible marketing route to follow. Again, branding, this time paired with product development is essential to successfully pursue such a more sophisticated strategy.

However, as stressed above, careful marketing research should evaluate the feasibility of such an approach. Moreover, as noted in the previous section, such an approach is in need of a more qualified staff. This again shows that the various strategic aspects of the second stage internationalisation are highly interconnected.

**Partnership Strategy**

It should have become clear from the discussion of the various aspects of the second stage internationalisation that this strategy is more costly and complex than the initial internationalisation strategy. Hence the need for resource accumulation and gaining experiential knowledge via the discussed domestic processes and the initial internationalisation strategy. Nevertheless, it is unlikely that the successful implementation of this strategy does not require business partners (Shundich, 1997). Congruent with the discussion of pursuing a partnership strategy in the initial internationalisation strategy, co-operation is also essential in the second stage internationalisation phase apart from acquisition and greenfield investment.

However, due to the potentially stronger resource-base, including a stronger market position and brand recognition, it is possible that the partnership strategy at this stage offers more options for Chinese hotel firms.

An alliance with partners based on different countries allows each individual partner a new logic for management action (Go and Pine, 1995). However, as noted above, managing strategic alliances is difficult, particularly when the business partners come from different cultures. The important development of trust and commitment might, therefore, be hindered (Cullen *et al*, 2000). But the experience and resources gained during the first internationalisation phase should have infused the Chinese hotel firm with enough supportive resources as well as market power to enter into a strategic alliance with a foreign partner at an equal level. It was shown in the past that alliances between strong and weak partners rarely work (Bleeke and Ernst, 1991). It is therefore important to find partners with compatible objectives and styles (Dev and Klein, 1993).

## 8.3 The Implications of This Research

The experience of the GD Hotel Group's development has implications for policy makers and other Chinese hotel companies.

### 8.3.1 Implications for Policy Makers

In a developing country where resources are scarce and there is an absence of a strong and experienced private sector, the level of government involvement is likely to be greater than that in countries that have a predominantly free-enterprise philosophy. Government has to undertake an entrepreneurial role to ensure that pioneer activities are initiated. The development of the GD Hotel Group (from its inception) has clearly demonstrated how this philosophy works in China. However, the empirical evidence that emerged from this research indicates that less government involvement and intervention into the firm's internationalisation and more market competition will result in operational efficiency and profitability.

If the Chinese government intends to further facilitate its economic reform and succeed in reforming Chinese state-owned enterprises (SOEs), it is important to take into the account the perspective of the firms as regards their management autonomy, corporate business strategies and their motivations for outward investment. It is necessary that Chinese multinationals enjoy more autonomy, and the decision on international development should be left to the firms themselves as long as they are financially profitable. The government should play a backstage role, which is to formulate and implement policies that can support and improve Chinese multinational firms' competitiveness. The directions of international expansion which are affected by initiatives and preferences of the government (for the personal benefits of a few top managers and government officials) is not recommended and outward investment should be for the benefit of the firm.

Furthermore, China's economic reform is associated with the reform of its SOEs. It is worth noting that small and medium sized firms (SMEs) also need government attention in relation to their internationalisation. Dealing with SOEs might be the priority of the government at present, but the potential contributions from SMEs to China's economic growth needs to be considered. Together with the increasing number of privatised SOEs, the next wave of Chinese outward foreign investment which will match the economic performance of the economy in the millennium, will most likely be private-sector driven. For the development of China's socialist market economy, especially for the development of China's modern enterprise system, the Chinese government needs to reconsider the nature and the extent of its role.

### 8.3.2 Implications for Practitioners

The experience of the GD Hotel Group is also illuminating to other Chinese hotel companies. For an individual Chinese hotel company that aspires to become MNE, it has to improve its management by promoting more global oriented managers and to undertake international expansions. Without the former, it is impossible for the firm to create sufficient competitive advantages to ensure the success of the later. It is clear that preliminary resources and capabilities are needed before the firm can undertake internationalisation beneficially. These include the firm's financial, managerial, technological competence and its capability to market its products both in domestic and international markets.

People influence the extent to which an organisation can expand. Few Chinese hotel companies have sufficient international experience and expertise to ensure the success of overseas investments. Therefore, more effort should be devoted to training qualified staff and developing a sophisticated management team. With the growing importance of being an international player, Chinese hotel companies need effective planning in human resources development to ensure their long-term growth.

However, in entering the international hotel marketplace, Chinese hotel companies face a very competitive environment in which most of the major players have already achieved a strong market position. Thus, it is more important for the firm to have a clear understanding of what its corporate objectives and strategies are. To successfully expand in international markets, the firm has to closely monitor its environment for opportunities and threats and make critical decisions about the direction of expansion. From the experience of the GD Hotel Group, it can suggest that the direction of expansion must be in accordance with the economic benefits for the firm and not personal benefits. Market research and a feasibility study must be carried out before the investment. The type of hotel product must be driven by demand led forces not availability of funding, or government good will.

In their process of internationalisation, it seems advisable to take advantage of being a Chinese hotel company to provide service to the growing outbound Chinese market which consists of relatively inexperienced international travellers. Due to language barriers, culture differences and food preferences etc., they tend to stay in familiar Chinese hotels, and this market will mushroom in size over the next twenty years. The rapid transition of the Chinese economy from a centrally-planned economy to a market system presents Chinese enterprises with certain opportunities and threats with regard to their investment overseas. The differences amongst Chinese enterprises investing abroad are to a large extent determined by two key factors:

influence of the government bureaucratic system and the development of a real entrepreneurial logic (Zhang and Bulcke, 1996). Chinese hotel companies should be aware that enterprises which can develop an early link between these two factors, are likely to be more successful and competitive than those that have based their international business strategy only on the privileged position which they received from the government.

## 8.4 Limitations of the Study

Just like any scientific inquiry has its limitations, the present exploratory research has limitations due to its applied methodology and its limited empirical base. Limitations of the study were already addressed in detail in Chapter 5, therefore, only the methodological limitations are presented here in order to point out directions for future research.

From a methodological perspective, the major limitation associated with the present study is the generalisability of the empirical evidence from the single case study. This research adopts a case study approach. From a positivistic standpoint the research cannot be regarded as representative and the methodology is incapable of generating findings which can be validly generalised to wider instances of the phenomenon in the population at large. There is a recognition of the difficulties of generalising on the basis of case study approach (see Bryman, 1988, Clark, *et al* 1998), because a case study lacks scientific weight and general applicability. This lack of statistical validity makes generalisation difficult.

Manson (1996) addresses an important question as to what the qualitative researcher can claim on the basis of the results from their research. In other words, to what extent the findings of the research are representative and can be generalised to the wider sector. Indeed, with quantitative research, in general, sample sizes should be greater than other approaches and controlled in such a way as to be representative of the population from which they are drawn. This allows greater confidence in accepting the reliability or generalisability of the findings which qualitative research cannot compete with.

However, as Brotherton (1999) argues, the selection of a particular case for inclusion in a study is normally purposive rather than random in nature. Thus, the basis for selection is not usually governed by the concerns of statistical probability but by theoretically informed judgement. In case study research, it is considered more appropriate to treat representativeness in terms of a qualitative logic for the selection of cases for study, rather than a quantitative logic of sampling from a population.

This exploratory study attempts to expand and generalise theories and not to enumerate frequencies by investigating a Chinese hotel chain's internationlisation. The research seeks to establish aspects of behaviour in the process of the only multinational Chinese hotel chain's internationlisation; lessons and experiences from this case can be learned by other Chinese hotel chains. Furthermore, the key ideas of the theoretical framework of internationalisation which is developed by this research can be transferred to other Chinese hotel chains through a process which Rose (1993) called 'Lesson-drawing'. As Bassey (1981 p.85-86, cited in Brotherton 1999) points out 'The relatability of a case study is more important than its generalisability... if they are relatable, and if by publication of the findings they extend the boundaries of existing knowledge, then they are valid'.

Indeed, by adopting the case study approach, the research does not have the strengths of providing wide coverage of the range of situations and probably being fast and economic in comparison to quantitative research. By using a single case study, it does not allow a strategic comparison. Thus the evidence and theories drawn from the case are less powerful compared to a multi-case approach. However, as mentioned before, each research strategy has its own strengths and weaknesses, the appropriateness of a research approach derives from the nature of the social phenomenon to be explored (Morgan and Smircich, 1980). The nature of this research has determined that the case study approach is the most appropriate.

## 8.5 Future Research

In light of the above-discussed limitations, a number of further research areas have emerged.

1) Comparative studies: Future research can be conducted in a wider context by using multi-case approach due to the fact more and more Chinese hotel companies will undertake internationalisation. The proposed internationalisation process framework for Chinese hotel companies needs extensive empirical testing, more research into this phenomenon could help to test and explore the model. More cross-

country and comparative studies are needed to address different aspects of behaviour associated with internationalisation between Chinese hotel companies and others.

2) Strategic expansion and organisational issues: Future research can focus on exploring expansion strategies such as acquisition and strategic alliances and to analyse how Chinese hotel companies may make effective use of these strategies. It is a very important managerial issue. Additional work could also examine the role of the technology in the process of internationalisation. The effects of specific internal (human resource, marketing and decision making) and external factors (home country government agenda, host country environment, competitors, and the change of global tourism pattern) that influence firms' internationalisation also need further clarification. Future research can also be undertaken to investigate how organisational structure has changed in response to its strategic changes and degree of internationalisation.

3) Other emerging markets: Dynamic changes in a country's economic development and MNEs' expansion there are not unique to China. Similar events are also happening in other emerging markets such as India, South America, South Africa and Eastern Europe. These countries share similarities to China in terms of strong government control, changing government policy, reforming their economies, no deep roots of market economy and the danger of political instability. Therefore, the internationalisation process framework proposed in this study can be used as a framework for future research to test whether it is valid in these emerging markets

where the government is the key body for changing the social and economic structures of the society.

4) Longitudinal and Processual Studies: This study's cross-sectional nature did not allow for an assessment of developments over time or for an examination of processes *per se*. Therefore there exists a clear need for longitudinal and processual studies (Pettigrew, 1997), particularly taking into consideration their scarcity in past research in general (Kinnear and Taylor, 1991). An analysis of up to four developments and processes can be thought of reflecting on this study's findings. First, the government-policy-domestic-development process (for example impacts of implemented policies unfolding over time and their relationships), second the Chinese hotel firms' development process (for example assessing the relationship between its domestic and its international development), third the resource-knowledge-accumulation development process (for example analysing their relationship and their link to the internationalisation process) and the initial-internationalisation-second stage-internationalisation process (for example the relationship of the customer following strategy with the subsequent targeting of Western tourists). An examination of these developments and processes might however only be possible if the researcher adopts a more emic perspective (Morey and Luthans, 1984).

5) Studies at Different Analytical Levels: Finally, future studies could employ a different analytical focus. This study mainly focused on the firm and management level. Future research could be conducted at different levels.

Future research could, for example, be conducted by focusing on the technology/ product/ services level. This study showed that different strategic groups with different product offerings exist in the international hotel industry. Future research could expand on these insights by focusing on technology/ product/ service specifics like standardisation versus differentiation and its effects on the internationalisation of Chinese hotels.

Given the significant economic growth and the remarkable tourism development in China, the need to grow domestic hotel companies is really no surprise. The continuity of the open door policy, changing travel patterns among outbound Chinese tourists as well as increasing competition on the domestic front as a result of liberalisation, provides the necessity and opportunity for the international expansion of Mainland Chinese hotel companies. Although, at the present, the GD Hotel Group has the advantage over its domestic rivals since it is multinational in nature, this phenomenon will not last long. Future research into the phenomenon of Chinese hotel companies international expansion will help us gain a comprehensive understanding of the creation and evolution of these hotel companies towards internationalisation. The changes in their corporate strategies and internationalisation experience will present other interesting topics in order for academics to examine the impact of Chinese hotel players on the international hotel industry.

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# Appendix

## Appendix A: Interview Guide for the Case Study Organisation

**Personal background**

Could you please give me a brief overview of your professional career prior to joining GD?

Why did you come to work for GD?

How long have you been working for GD?

What is your position and functional role in this firm?

**Internationalisation Specifics**

In what circumstances did GD start to look at overseas markets? Why did you undertake overseas expansion? Did you have an initial strategic plan for your firm's internationalisation?

When did GD first invest abroad? What was the place? How and why had this market been selected?

What was the selected market entry choice (e.g. Wholly-owned, acquisition, management contract, franchising, joint venture)? Why?

When you first invested abroad, what kind of preparation works have you done prior to entry?

What factors/ motives led to GD's second international expansion (e.g. political, governmental, personal, social-cultural and economic)?

How and why did GD select that market? What kind of preparation works have you done prior to entry?

How does GD make investment decisions (e.g. procedures, who are involved, etc.)?

Entry and expansion of a multinational enterprise in the global market is often a gradual process of learning, reaction, and adaptation to the external environment by timely deployment of effective strategies (Craig & Douglas, 1996). Do you agree with that? Could you please compare and contrast this statement to GD's expansion?

What is your firm's current strategic plan regarding internationalisation? (e.g. target markets, products to offer, market entry modes, etc.)

Did your parent company support GD's expansion? If so, how?

GD is a socialist firm operating in a capitalist society. To what extent does this affect the internationalisation process? What advantages and constraints are created due to this fact?

How do you see GD in the market place?

Do you think your company has competitive advantages in relation to international expansion? What are they? How did your company create these competitive advantages?

Could you please tell me the major problems which hinder the internationalisation of GD? What strategies have been pursued to cope with these problems?

Does GD suffer from a shortage of qualified international managers?

Does GD have a human resources development policy for its employees? If yes, to what extent has the policy been implemented?

Regarding the overseas operations, what is the percentage of the local managers?

What do you require from a Chinese manager before sending him / her abroad?

Please tell me how important is hiring expatriate managers for GD's internationalisation?

From your point of view, could you please tell me the potential of GD's future international expansion?

**The Role of the Government**

What was the role of the government in your firm's expansion?

How much autonomy does your company enjoy from the government?

What kind of role do you expect the government to play? Why?

# Appendix B: Interview Guide for the Hotel Consultants and Analysts

| |
|---|
| Date: |
| Company: |
| Company Address / Telephone: |
| Interviewee / Current Position: |
| Could you please tell me what kind of hotel projects you have been involved? |
| With regards to the Chinese hotel chains' internationalisation, could you please give me your views on their key internal (organisational) strengths and weaknesses? As well as their external (environmental) opportunities and threats? |
| Taking your analysis into consideration, how do you evaluate the future potential of Chinese hotel chains' development? |
| From your point of view, what are the best ways for the Chinese hotel chains to become the international players? Why? |