Internationalization of service-oriented companies: Case study research into a hospitality group

Internacionalização de empresas de serviços: Um estudo de caso aplicado a um grupo hoteleiro

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Abstract

The service sector has grown in importance in recent years mainly because it contributes towards economic growth and job creation in many countries. As yet, the services sector has been the subject of little research and few empirical studies, especially within the field of innovation. Moreover, the specific features of services make it difficult to study their internationalization, notably in tourism companies. The purpose of this study is twofold. Firstly, to present a literature review of internationalization in services and hospitality companies in particular. Secondly, to discuss a case study focusing on the largest Portuguese hospitality group (Pestana Group). This allows us to formulate hypotheses that support empirical study and make some important observations regarding service-oriented companies.

Keywords: internationalization, hospitality companies, services, strategy.

Resumo

O setor dos serviços ganhou um peso significativo nos últimos anos e contribuiu para o crescimento económico e criação de emprego em muitos países. Contudo, ainda que nos últimos anos os estudos sobre o setor serviços tenham vindo a aumentar, este setor carece ainda de investigação, principalmente de estudos empíricos aplicados ao estudo da inovação e da internacionalização. Para além disso as características dos serviços, em particular no caso da hotelaria dificultam o estudo da internacionalização. Este artigo tem dois objetivos. Por um lado, apresenta uma revisão de literatura sobre internacionalização de serviços, com ênfase no caso da hotelaria. E, por outro lado, pretende discutir um estudo de caso aplicado ao maior grupo hoteleiro português (Grupo Pestana). Esta investigação permitiu a formulação de hipóteses que suportam o estudo empírico e apontou um conjunto de pistas relevantes sobre este assunto no caso das empresas hoteleiras.

Palavras-chave: Estratégia, hotelaria, internacionalização, serviços.

1. Literature Review

1.1. Internationalization of services: Some frameworks

The internationalization of companies to new markets often creates opportunities for value creation and growth (Lu & Beamish, 2001). Therefore, internationalization is considered a means of improving performance and some companies move rapidly to global expansion and is rapidly conducted in a few cases, for instance when they start on a global scale (Oviatt & McDougall, 1994; Knight & Cavusgil, 1996; Rialp et al, 2005).

Studies on internationalization strategies in the service sector are divided into two distinct groups. Whereas the first claims there are differences between the internationalization of products and services (Root, 1987; Bradley, 1991), the second argues that the specificities of services are a minor factor and that internationalization theory used to study industry can also be applied to services (Boddewyn et al, 1986) (Erramilli, 1990). Many services e.g. information services and accounting, can be produced by decoupling production and consumption so that they are exportable and become 'hard services'; on the other hand, separation is not possible in another set of services such as hotels and hospitals, namely 'soft services', (Vandermerwe & Chadwick, 1989; Erramilli, 1991).

1.2. Theories of internationalization in services

The eclectic paradigm or OLI theory (Ownership, Location, Internalization) was the pioneering theory that helps us to understand the internationalization process in services companies (Dunning & Norman, 1983, 1987; Dunning, 2001). Dicken (2003) say these firms decide to internationalize if they have some competitive advantages in terms of OLI assets and competencies over those in the host country. Bryson et al (2004) argue that the ownership advantage (referred to as company's specific advantage) is based on the company's reputation and knowledge of its human resources. The location advantage refers to the importance of knowledge about specific aspects of the local market and of providing customer service (face-to-face) in the host country.

The advantages of internalizing are determined by the firm's ability to preserve specific knowledge without the risk of loss or sharing, as well as its ability to use knowledge of customer needs and profile in the provision of services and the possibility of controlling the quality of service provided. All these advantages could be better exploited if the company moved to these markets (rather than exporting or licensing) and took total control of the internationalization process. Table 1 presents the advantages of OLI in services companies.

Table 1 - Advantages of ownership, location and internalization in services

Ownership advantage	Location advantage	Internalization advantage	Type of activity
Capital; Specialist knowledge; International reputation; Access to markets; Managerial skills.	Skilled Labor; Size of local market; Need to protect market; Information.	Protection and exploitation of knowledge (labor supply) and business contacts (demand); High information costs; Quality; Buyer uncertainty.	Reinsurance; Executive Search; Accountancy; Management and engineering consultancy; Branch banking; Investment banking; Insurance Design.

Source: Dunning and Norman, 1983: 679 adapted by Faulconbridge et al, 2008

With regard to the internationalization of hospitality companies, the mode of entry into the hospitality sector implies a high level of control in the internationalization process. An assessment is made of four types of control: a) management and quality control b) physical assets c) organizational routines and tacit knowledge d) codified strategic assets (e.g. brand and

booking system). Depending on the entry strategy used, responsibility for the control of this area by international hotel company or hotel of host country varies (Contractor & Kundu, 1997).

In this context, the different options are divided into three groups: a) Direct investment with total control (acquisition and creation of new subsidiaries); b) Direct investment involving shared control; c) Forms that do not involve capital such as management contracts and franchising (Buckley, 1995). In the case of direct investment with total control, the company has exclusive control over the four areas mentioned above; on the other hand, direct investment in cooperation (joint ventures) is only full control over codified assets while other areas are usually shared with the partner. In the case of management contracts, hotel chains are responsible for operations, implementing systems, procedures and brand, recruitment of hotel directors, human resources policies and quality. The hotel is managed as a property of the hotel chain.

Finally, in franchising contracts the hotel chain gives its brand to the hotel and includes marketing and quality control. In this case, the chain does not manage the hotel; the hotel has daily control of operations and its physical assets. The chain only controls the codified assets, while the tacit control of assets is shared with the hotel.

Table 2. Entry modes and types of control exercised by hospitality companies

Entry modes				
Types of control	FDI (total ownership)	FDI (shared ownership)	Management contracts	Franchising
Strong control	a, b, c, d	d	d	d
Weak control	-	a,b,c	a,c	c
Without control	-	-	b	a, b

a. Daily control of the hotel
b. Control over physical assets
c. Control over organizational routines / tacit elements of the company
d. Control over codified assets encoded

Source: Contractor & Kundu, 1997

Factors that determine internationalization and the selection of country for internationalization may include trading conditions (country risk, cultural distance and market potential) and other factors related with organizational skills (size, international experience, intangible assets and skills).

1.3.1. Factors related with trading conditions

i) Country risk

Companies operating in international environments face a set of circumstances determined by the economic and political situation of the destination country (political instability, currency risk, etc.). When risks are high, companies seek to ensure a position that makes it easier for them to abandon the country without substantial losses (Kim & Hwang, 1992). In these circumstances, firms prefer licensing or joint ventures rather than investments that involve total ownership. Moreover, it is important to note that the more risky and volatile markets make internalized activities less attractive (Buckley & Casson, 1976).

ii) Cultural distance

A perceived cultural distance between the country of origin and destination is one of the most studied variables (Johanson & Vahlne, 1977, 1990). Some authors argue that cultural differences may be lead to the need for new methods of ownership in order to deal with the difficulties of training local resources and the transfer of the firm's know-how (Gatignon & Anderson, 1988). This is particularly relevant in the case of service firm (Erramilli & Rao, 1990). Internalizing foreign operations through entry modes involves a high level of control so as to ensure that the service is provided according to the standards imposed by the mother company.

iii) Market potential

Theorists of internalizing (Buckley & Casson, 1976) and studies related to life cycles (Vernon, 1966) have associated market size with entry modes that involve a high degree of involvement and control. The possibility of adjusting the sales volume in the growth phase evidently allows faster amortization of the fixed costs.

2.3.2. Factors related with organizational skills

i) Dimension

International activities consume a great deal of resources with the result that large companies often have a greater capacity to internationalize. Some studies confirm that smaller firms face certain constraints in accessing financial resources and management (Kogut & Singh, 1988, Agarwal & Ramaswami, 1992).

ii) International experience

Standard literature on the subject suggests a positive relationship between international experience and the adoption of entry modes with a high level of control.

In this context, the investor's inexperience and lack of knowledge may be a major obstacle to the development of operations (Johanson & Vahlne, 1977). This means that an inexperienced investor can make bad decisions on the location, adaptation of products and services to the local market, human resource management and contact with suppliers and banks. As a result, many investors prefer to enter international markets using methods that involve less commitment (Eriksson et al, 1997). Companies with more international experience show greater independence in the control of risk, and profit from international operations.

iii) Intangible assets and competences

Some studies argue that when the development of foreign operations involves a high component of intangibility and specific skills, the company tends to choose entry modes that involve high levels of control (Buckley & Casson, 1976, Hill et al, 1990). In hospitality companies, this variable is very important as a competitive advantage of hotel chains and involves specific skills related to tacit knowledge; control prevents the risk of competitive advantage resulting from indirect control and ensures that operations are conducted according to the quality standards of the mother company.

3. Empirical study

3.1. Methodology, problems and propositions

This section presents the case study of the internationalization of the Pestana Group. This is currently the largest Portuguese group working in the sector and began implementing its internationalization strategy in several countries some years ago.

Our empirical research was carried out by applying case study methodology which, according to Yin (1989), investigates a contemporary phenomenon within a real-life context when the boundaries between the phenomenon and context are not clearly evident and where multiple sources of evidence could be used. Comparing case study methodology with other methodologies, Yin (1989) states that issues raised by the research must be analyzed in order to define which the method to use. More specifically, this method is suitable for answering explanatory 'how' and 'why' questions and deals with operational facts that occur over time rather than frequencies or incidence. To achieve a better understanding of internationalization strategies particularly in the service sector, the main aim of our research was to address the question: How are services with "soft" features such as hotels internationalized? Based on the literature review presented in the above sections, the following propositions were formulated:

P1: Entry modes that involve a high degree of control are positively associated with the increase of cultural distance

Proposition 1 endeavors to answer one of the issues raised by this research, namely to understand if cultural distance involves greater control over the activities of the hotel.

P2: Entry modes that involve a high degree of control are positively associated with the market potential

Proposition 2 aims to understand the extent to which the degree of control is associated with size and market potential.

P3: Entry modes that involve a high degree of control are positively associated with company size

Proposition 3 aims to determine whether company size influences the entry mode in international markets.

P4: The type of control depends on international experience

Proposition 4 analyzes whether the type of control in internationalization process is determined by international experience, which is the focus of much of the literature on the subject.

P5: Entry modes that involve a high degree of control are positively associated with a high degree of intangibility and specificity of the service provided by the company

Proposition 5 allows us to test if the intangibility of services, i.e. the inclusion of 'soft' services, influences the modes of internationalization.

The unit of analysis is the organization, i.e., the Pestana Group. The choice of this case followed criteria that guaranteed reliability. As mentioned in the first part of this study, innovation and internationalization in services are understudied and still in their infancy in the case of hotels. This led to the application of case study research. According to Yin (1989), any research is typified as a case study when there is a desire to understand a complex social phenomenon, and its investigation retains the holistic and meaningful characteristics of real-life events. Both these aspects fit this case perfectly and we consulted secondary information about the Pestana Group to assess this information.

Data were collected by means of multiple lines of evidence as Yin suggested (1989). The main methods and sources of data collection were: (1) the internet, which provided historical data and some of the company's recent results, (2) documental analysis, especially institutional publications with information about the company profile and history as well as other documents provided by the company, and (3) interviews.

2. 2. Case Study: Internationalization of the Pestana group

2.2.1. Description of the company

The Pestana Group[1] is Portugal's largest international tourism and leisure group and one of the largest in Europe, where it ranks 25th. There are eight business divisions operating under the Pestana brand that include; Hotels & Resorts, *Pousadas de Portugal*, Holiday Ownership, Gaming, Travel, Golf and Residence, Industry and the International Business Centre of Madeira. Starting with a 300-bedroom hotel in Madeira in 1972, the family-owned Pestana Group has grown steadily and its portfolio currently includes almost 90 four and five star hotels worldwide divided into two brands: Pestana Hotels & Resorts and Pousadas de Portugal. In 1985 the Pestana Group began an expansion drive in mainland Portugal, which has then continued in Africa and South America. The Group opened its first hotel in a European capital outside Portugal, the Pestana Chelsea Bridge Hotel & Spa in London n 2010, and in May the following year, it opened the Pestana Berlin Tiergarten. It has continued with its ongoing global diversification process that has taken Pestana hotels to ten countries in three continents of the world: Argentina, Brazil, Venezuela, Portugal, Germany, England, Cape Verde, Mozambique, São Tomé and Principe and South Africa. In the leisure area, the Group now owns and runs 44 hotels (9 in Madeira, 9 in the Algarve, 1 in Lisbon, 2 in Cascais and Sintra, 1 in Porto, 1 in England, 1 in Germany, 9 in Brazil, 3 in Mozambique, 1 in South Africa, 1 in Cape Verde, 2 in Argentina, 1 in Venezuela and 3 in São Tomé and Príncipe) as well as 37 Pousadas de Portugal, 15 Holiday Ownership units, 6 golf courses, 3 real estate ventures, two casinos (in Madeira and São Tomé and Príncipe), an air charter company and a tour operator. In 2003, the group was awarded the international tender to manage the *Pousadas de Portugal* chain, which added 44 unique properties to its portfolio that are located in converted monuments, palaces, convents and castles spread throughout Portugal. According to information provided by the Pestana Group, it will continue to grow and open the following projects between 2012 and 2013: USA: Pestana South Beach Art Deco Hotel in Miami; Uruguay: Pestana Montevideo, Montevideo; Argentina: Pestana Buenos Aires Golf & Residences (their 3rd investment in Argentina); Morocco: Pestana Casablanca, Anfa Place Beach Resort, Casablanca; Angola: Pestana Luanda Bay, Luanda; Portugal: Pestana Tróia Eco-Resort, Tróia; Pousada de Cascais, Cascais; Pousada da Serra da Estrela, Covilhã; 1 Hotel in Lisbon – name to be defined; 1 Pousada in Lisbon– name to be defined.

The Group is constantly looking into ownership and management proposals, particularly in South American and European capitals, and expects to have reached its 100th property by the end of 2012, the year in which it celebrates its 40th anniversary in the hotel industry. In 2010, the Group's revenue came to 500 million Euros (EBITDA 100 million Euros). The Pestana Group currently has a workforce of 7,000 people worldwide.

2.2.3. Development strategies of the Pestana Group

The strategies adopted by the Pestana Group are based on three vectors:

[1] All information was provided by the Pestana Group and is available at www.pestana.com

1 - Horizontal integration: After having secured a solid base in their home market in the autonomous region of Madeira, the Pestana Group set out to increase its 'core business' (hospitality). The growth initially remained in Portugal - the Algarve, Cascais, Sintra and Porto - and later grew through internationalization; this started out in countries that shared affinities with Portuguese culture, such as Mozambique, Brazil and Cape Verde. Reaching out to the rest of the world in 2010, it opened the Pestana Chelsea Bridge in London, thereby taking its first step outside Portuguese speaking countries but still in Europe. In 2011, the group opened the Pestana Berlin. In 2012-2013, there are plans to open new hotels in the USA, Uruguay, Argentina, Portugal (Cascais, Troia, Serra da Estrela) Morocco and Angola.

2 - Vertical integration: Growth in other sub-sectors of tourism in Portugal including gambling, golf, real estate, leisure air travel via charter flights and tourist operations abroad (with special focus on the United Kingdom).

3 - Their tourism and leisure industry is diverse and tailored to each of the areas where they operate, adapting its business to the specific characteristics of each region, i.e., it never relies on standardized models.

3. Analysis of results and concluding remarks

This case study research followed the pattern-matching techniques (Yin, 1989), which is one of the recommended methods for such an analysis. This method allows empirically-based or observed patterns to be compared with expected patterns. If patterns match, the results help increase the internal validity of the case study. The proposition resulted from the literature and the studies identified as relevant to the research.

The results will be analyzed using table 3, which presents the findings on the validation of the formulated propositions.

Table 3 - Data analysis and validation of the propositions

Propositions	Validation	Case study
Factors related to the conditions of transaction		
P1: Entry modes that involve a high degree of control are positively associated with the increase of cultural distance	Not confirmed	The Pestana Group began its internationalization in countries that are culturally close to Portugal, for instance Latin America (Brazil) and Africa, focusing on FDI with total control.
P2: Entry modes that involve a high degree of control are positively associated with the market potential	Confirmed	The Group held FDI in high potential markets in South America. According to the Group, South Americas markets represent an important slice of the total gross operating income.
Factors related to organizational skills		
P3: Entry modes that involve a high degree of control are positively associated with company size	-	The data collected do not allow P3 to be objectively validated. However, information provided demonstrates that entry modes involving high degree of control are associated with the size of the company, i.e. they increase as company size increases.
P4: The type of control depends on the international experience	-	The data collected do not allow P4 to be validated. In this case, the company wants to maintain control over large international operations, even in the early stage of the internationalization process.
P5: Entry modes that involve a high degree of control are positively associated with the high degree of intangibility and specificity of the service provided by the company	Confirmed	The company considers that the provision of services requires total control over the international operations in order to maintain high standards of quality.

The results indicate that in terms of horizontal strategy, the company embarked on an internationalization strategy in markets with there was more cultural proximity (Mozambique, Brazil and Cape Verde). It was only after they had acquired further international experience that they decided to enter other markets, such as Venezuela and Argentina. The Pestana Group recently opened hotels in two European countries (UK and Germany), both of which are more distant from a cultural viewpoint. According to the Group, their growth strategy was decided upon after examining expansion into defined geographic areas in order to achieve economies of scale and synergies. At the same time, they decided on a strategy of vertical growth in other subsectors of tourism activity, such as golf, recreational real estate, leisure air travel and tourism operations. This concerted strategy aims to avoid dependence on major international operators and increases the attractiveness of the product in their core business.

According to Table 1 in the literature review and the results suggested by the propositions in the study, the Pestana Group is following a strategy of internationalization that falls within the OLI paradigm. The Pestana Group recognizes the value of owning property for reasons related to capital; moreover, it has always been a family business and intends to foster the association of reputation and brand with its quality image. It is

an advantage to expand to larger markets, thereby removing size limitations associated with the Portuguese market. Finally, their internationalization strategies allow them to protect internalized knowledge (in the case of hospitality, tacit knowledge seems to be very important but difficult to transfer) and it facilitates quality control (an extremely important factor in hotel chains) given the internationalization to African and South American markets where there is uncertainty and risks. This strategy allows the process to be internalized and ensures greater control over market uncertainty.

In conclusion, the results indicate that the characteristics of internationalization in the service sector, particularly in the case of hospitality companies, are different from those in the manufacturing sector. The findings of a similar study made of the Pestana Group in 2008 are comparable (Carvalho & Sarkar, 2008). This case study suggests that the Group decided on FDI with total ownership as a way of controlling the standards and quality associated with their brand, as well as international operations. On the other hand, this family-run business has grown from a small nucleus in Madeira which could have influenced the choice of ownership and control in the internationalization process. The increased size of the company may or may not determine a change in that trend, even assuming that the characteristics of intangibility of the service are a limitation. Further studies could apply the same methodology to other groups and companies in the hospitality sector in order to compare internationalization strategies and validate the influence of variables such as dimension and the importance of the internal market in the internationalization process.

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