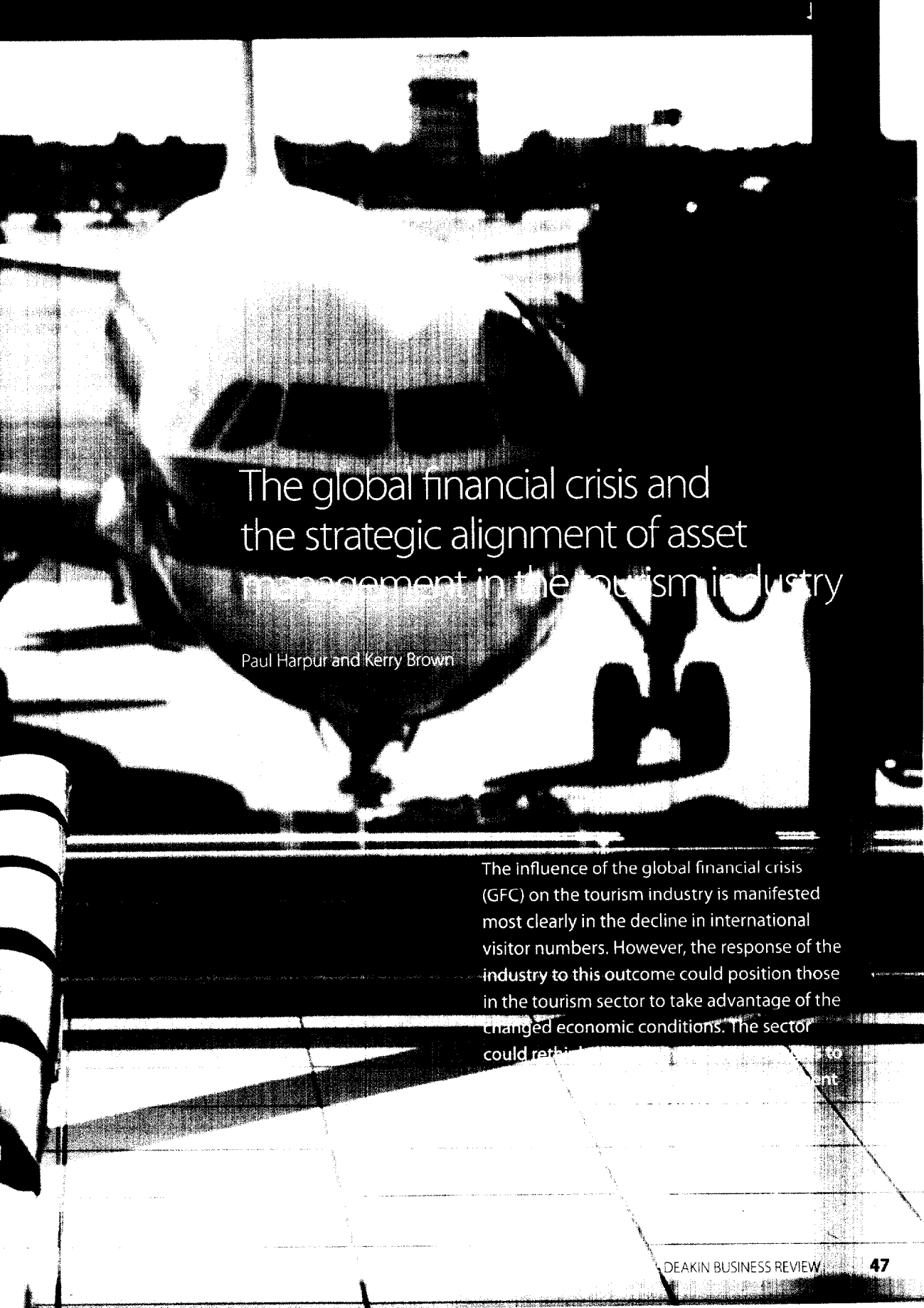

The global financial crisis and the strategic alignment of asset management in the tourism industry

Paul Harpur and Kerry Brown

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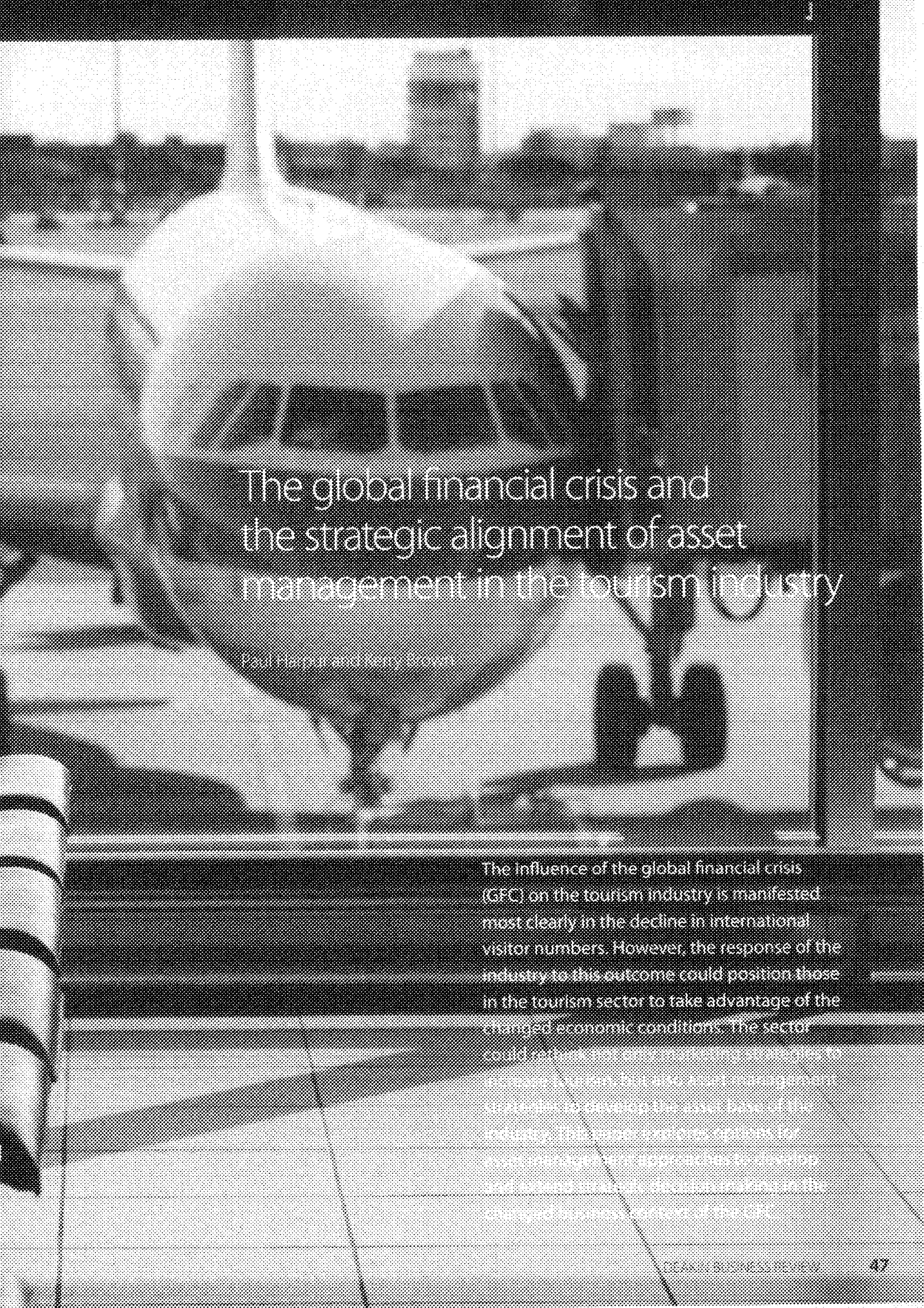

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Introduction

The worst global financial crisis (GFC) since the Great Depression has realigned expectations about the structural determinants of financial markets. The prior certainties of more consumer spending and better lifestyles built on market-based calculations of supply and demand and consequently greater access to goods and services are no longer viable. In this economic climate, more people are unemployed and those who have jobs are generally spending less. The reduction in spending is especially problematic in industries that offer customers non-essential or luxury goods.

The tourism industry has been hit hard by the GFC. As customers elect to forego holidays, travel less or spend less on their holiday, the tourism industry is faced with a dual problem of declining tourist numbers together with a major difficulty in continuing to maintain its fixed assets. The Jackson Report (2009, p. 16) on tourism highlighted the need for strategic action and the requirement 'to do more than capitalise on Australia's appeal' or face the consequences of losing 3.6 million international arrivals by 2030.

In 2007–2008, tourism contributed more than $40 billion to annual GDP and is Australia's largest services export industry (Jackson 2009). It was reported that short-term international visitor arrivals to Australia declined in June, down 4.7 per cent (year-on-year) to 364, 800 arrivals. Further, arrivals from most of Australia's top ten markets were lower in June, with Japan (down 44.5 per cent) and China (down 20.9 per cent) recording the largest declines. In June 2009, it was reported that holiday travel fell 8.5 per cent and, at the same time, business arrivals continued to decline, down 12.6 per cent, although travel for education increased by 12.8 per cent (DRET 2009).

In a speech to the Tourism Transport Forum Parliamentary Summit, Federal Minister for Resources, Energy and Tourism, Martin Ferguson announced a *National Long-Term Tourism Strategy* that would focus on:

- increasing productivity and competitiveness in the tourism industry
- reforming the regulatory system
- targeting investment
- developing and improving labour and skills, and infrastructure provision
- providing better access to aviation (Ferguson 2009).

The *Strategy* has an underpinning framework of industry development that seeks to revitalise tourism infrastructure, building skills and instilling a culture of innovation. The difficulty in large-scope policy initiatives is to build models that may operationalise the policy agenda.

In the light of this, the strategic asset management plans for tourist operations could focus on reducing costs, but also ensure that the assets are available and in good condition for the future. This paper analyses the transaction cost economics asset specificity model for guiding decisions on asset management, particularly about a cost reduction approach of outsourcing asset management. It further develops this model to offer a framework to determine whether outsourcing models of asset management can achieve greater alignment with an organisation's strategic direction as a way of revitalising the industry in the wake of the GFC.

Developing a practical model to guide asset management decision making

The strategic determination of physical assets within the tourism sector is an area that could offer new insights, not only for individual firms, but also for the way in which tourism is integrated into the economy. In an early attempt to define the components of tourism, Jafari (1974) focused on the importance of infrastructure in developing a strategic approach to tourism. Later, Smith (1994) identified physical plant, service, hospitality, freedom of choice and involvement as the constituent elements of tourism and contended that this constellation of resources and characteristics confirmed tourism as an industry sector. In this way, tourism infrastructure is a critical element that forms the underpinning architecture of tourism. Further, Tsang et al. (2009) contend the supply chains of tourism operations are important elements of business advancement and that decision dynamics of enterprises should be studied at the strategic, operational and tactical levels. This paper begins to establish this conceptual framework for decision making.

A central consideration of this paper concerns the ownership and operation of a firm's assets and who should own, operate and maintain the assets of the organisation. Related questions include:

- Should the ownership be undertaken within the firm?
- Should the tasks and assets be outsourced to a third party, such as an outside contractor, or should labour hire companies be used?

Assets include all the tangible and intangible assets of value to the business. This paper focuses on the management of the fixed and mobile physical assets such as buildings, vehicles and computers as one key strategy to overcome the effects of the GFC in the tourism industry. The supply-side aspects relating to managing tourism assets in the face of downturn are investigated. The best way to manage these assets is through a total asset management approach that regards management from an organisational perspective. Moreover, Brint et al. (2009) recommend that asset management processes focus on promoting organisational activities and, at the same time, ensuring that these activities result in excellent customer service.

Corporations that strategically outsource non-core aspects of their operations can substantially reduce costs while maintaining operational capacity (Jenkins et al. 2002; Lajili and Mahoney 2006; Merino and Rodríguez 2007). Robertson's thesis (2006) hypothesised that the integration of supply-chain logistics processes, the application of supply-chain management principals and the application of human social principals/approaches positively influence supply chain and business performance. He found conditional support for this hypothesis. While supply chains can be profitable it is crucial to correctly manage the contractual relationships and business needs effectively (Furneau et al. 2008; Furneaux et al. 2008; Parmigiani 2007).

The financial benefits of outsourcing have led to studies into how tourist operations can effectively outsource (Lam and Han 2005). To determine if a business should outsource part of its operations, it is advisable to apply a transaction cost economics (TCE) model. TCE assists in explaining how a business can structure its operations to achieve profit maximisation through cost minimisation (Williamson 1979, 1985, 1996). The TCE model can be divided into three components—asset specificity, asset uncertainty and asset frequency. All of these components should be considered whenever a business is deciding to outsource or insource asset management. Asset specificity focuses on the value of the asset to the particular transaction. An asset has high specificity where it has high value for a particular transaction, but has lower value outside that particular transaction. Asset uncertainty focuses on the degree of uncertainty about the factors that will influence the transaction. For example, if a business purchased a new vehicle with a warranty that included a loan vehicle, then the probability of the business being without that asset would be low and, therefore, the asset uncertainty about that vehicle would be low. However, if the vehicle was a second-hand vehicle without a warranty, then the degree of asset uncertainty would be higher. Asset frequency focuses upon the number of times that asset is used. For example, if a business required a special device to clean the air conditioning towers once every six months, then the asset frequency would be low. However, if it was required every week, then the asset frequency would be high.

Asset specificity can be divided into six dimensions—human, physical, site, dedicated, brand capital and temporal asset specificity (Lamminmaki 2005, 2007; Williamson 1985). Lamminmaki (2007) argues that the two asset specificity dimensions most relevant for hotels are brand capital and temporal asset specificity. The brand capital dimension is high where the management of the asset is crucial for the business's reputation. For example, the brand capital dimension is high in relation to the quality of the food at the hotel restaurant, as this is a factor in hotels' star rating. In contrast, the brand capital influence of the manager's office furniture is low since the public do not see this part of the hotel. Temporal asset specificity is high where the timing and coordination of the asset's management is important; that is, for activities such as shuttling customers to airports where any delays in coordination can be extremely damaging to the business. However, temporal asset specificity is low for activities, such as cleaning the outsides of windows, where the precise timing and coordination of such activities is less important.

Generally, authors claim that the higher the asset specificity, the more likely that management of the asset will be performed in-house (Lamminmaki 2007; Lohtia et al. 1994). The main reason for in-house asset management with high asset specificity is due to the control the business can have over the asset's management. The presumption is that where asset management is outsourced the business has less control, and where the asset is managed in-house the business is presumed to have greater control. The control a business

has over the performance of a task is more complicated than assuming that outsourced activities equate to low control and that activities performed in-house by an employee equate to high control.

The ability to control another person is supported by a range of factors the controlling agent demonstrates, including the legitimacy to lead, the ability to reward, superior expertise, the capacity to demand respect, and the ability to coerce a person for non-compliance (Raven and French 1958). The extent to which the sources of power exist in every relationship will depend upon subjective factors and not solely on the status of the parties as either employer/employee or principal/contractor. Accordingly, the assumption that a manager has more control over an employee on all these factors than a principal has over a contractor is not sustainable.

Collins (1990) analysed in detail the operation of legal liability and power relationships in contractual relationships. Consequently, he argued that principals often have a high degree of control over contractors but can often reduce their liabilities through using corporate structures. Nossar et al. (2004) and Harpur (2007, 2008) have analysed the power relationships in the principal outworker relationship. Principals often have substantial control over outworkers' flow of work, remunerations and possibilities for future work and often exercise considerable legitimate and referent authority. Nossar et al. (2004) labelled the principal contractor in this relationship the 'effective business controller' due to the considerable control the principal has over the contractor.

To demonstrate how control can operate, two hypothetical situations concerning the management of the gardens around a hotel's pool and courtyard are offered. In one situation, the business manages these assets in-house by employing a semi-retired self-funded retiree. The employee regards the job as a hobby as he previously enjoyed tending the garden in his own hotel, which he sold for a substantial profit on retirement. In this situation, the employee has no financial dependency upon the business and has high job mobility. As a consequence, the business has limited capacity to use rewards or coercion to control the employee. In the other hypothetical situation, the business elects to outsource the gardening operations to a small contractor who manages the gardens of three hotels. The contractor has a contractual arrangement with each hotel that she will not manage more than three hotels at once, and the contract details the types of plants and the state in which they must be maintained. If the contractor breaches the contract, the principal can terminate the contract. The contractor has invested heavily in the business and relies on the continual income stream from the hotels to remain solvent. In this case, the principal has substantial reward authority and coercive power. In these two examples, the legal status of the parties as either employer/employee or principal/contractor has very little influence on the actual control the hotels have over their asset management.

In relation to coercive power, legal regulation has influenced the ability of employers to regulate their employees' contracts. Chapter 2, Part 2 of the *Fair Work Act 2009* details the standards under which employees must be employed including:

- maximum weekly hours (Division 3)
- requests for flexible working arrangements (Division 4)
- a range of leave entitlements (Divisions 6, 7, 8 and 9)
- notice of termination and redundancy pay (Division 11).

Without analysing this process in detail, it is sufficient here to observe that the Australian industrial relations system heavily regulates the employment relationship.

However, the terms on which principals can contract with contractors have much less regulation. *The Independent Contractors Act 2006 (Cth)* state unfair contract provisions can provide contractors some regulatory protection (see, for example, section 106 of the *Industrial Relations Act 1996 (NSW)* or section 276 of the *Industrial Relations Act 1999 (Qld)*). These regulatory protections will override any contractual agreement between the principal and the contractor and prevent certain forms of exploitation. Despite this limited protection, the law operates on the presumption that the principal/contractor relationship is a commercial relationship and thus requires less regulation (Stewart 2009). The assumption that contractors are corporations and not employees results in contractors being prohibited from acting collectively. The anti-competitive conduct provisions in Part IV of the *Trade Practices Act 1974 (Cth)* prohibit corporate entities from acting collectively to negotiate terms and conditions of contracts (McCrystal 2007). This means that independent contractors cannot form trade unions or act collectively to improve wages or working conditions. The limited

regulatory protection afforded to independent contractors or small businesses means that in some cases these parties will have less power than employees to resist their employers' use of reward or coercive power.

This paper proposes that the decision to outsource or insource asset management under the TCE approach should adopt a more complex method to determining the control relationships. The asset-specificity model should be regarded as a two-stage process. The first stage involves applying the six dimensions of asset specificity to the business. This process will indicate the degree of control and coordination the business requires over the management of the asset. So, if the contractor's business is dependent on the business, then that business will have great reward and coercive control over the management of that asset. The degree of control a business can exercise over employees and contractors will always depend on the individuals involved, the economic situation and relevant laws. In the second stage, the business should assess if this level of control can be achieved more effectively in the particular businesses' employment and contracting circumstances.

Applying a two-stage approach to asset specificity

To demonstrate how the two-stage approach to asset specificity can be applied, we will now apply this approach to the management of a pool facility through analysing the management of a swimming pool using the six elements of asset specificity. This particular asset was selected as it is common to a large number of hotels.

1. Human-asset specificity

Are there any unique skills associated with the management of the facility that are particular to the operation? Pools involve specialised skills, but these skills are easily transferable to any operation in this industry. Consequently, managing this asset has low human-asset specificity and any employee or contractor is relatively easy to be replaced.

2. Physical-asset specificity

Is the investment in assets particular to the business or are they easily transferable? Pools are often installed with landscaping that is not transferable. However, the pumps associated with the pools are transferable to some extent, but would still have low physical-asset specificity. The pool cleaning equipment, which is used to maintain the facilities, would be easily transferred to other operations and so would have high-physical asset specificity.

3. Site specificity

Site specificity concerns the proximity of the asset to the customer base. As hotels generally own their own pool facilities, this dimension is often immaterial. However, for example, if a hotel sold a lease over the pool facilities and permitted the contractor to allow members of the public to pay while the hotel customers can use the facilities without charge, then the contractor would have high site specificity.

4. Dedicated-asset specificity

Dedicated-asset specificity exists where a business purchases assets as part of a long-term relationship with a client. This is not relevant for pool facilities generally.

5. Brand-capital specificity

Pool facilities have extremely high brand-capital specificity. If these facilities are poorly managed, the hotel may drop in rating and lose customers. As a consequence, it is crucial for a hotel to ensure the pool asset is maintained at a high standard.

6. Temporal-asset specificity

A pool asset would have low temporal-asset specificity. A pool usually requires general maintenance such as daily administering of chemicals, daily cleaning and irregular machine maintenance. As there is no fixed time at which these activities must be completed, there is arguably moderately low temporal-asset specificity. For example, there is generally a large window of time in which the pool can be cleaned to work around maximum usage times.

Using the six dimensions of asset specificity, the question is: should hotels insource or outsource the management of their pool facilities?

The extremely high brand-specificity means the hotel must have high control over how the pool is managed. Using a standard TCE asset-specificity analysis would most likely result in the pool management being performed by an employee. However, a more holistic

approach to considering the degree of control required may demonstrate that a contractor may achieve greater results for the hotel.

While the physical asset specificity for the pump is moderate, it is high for the pool-cleaning equipment. If the equipment is not maintained, the pumps will be hardest to replace, as these are large, expensive assets that require specialist professional attention. As contracting out the pump creates greater challenges, the potential of outsourcing the pump will be analysed. When deciding whether the pool pump should be managed internally or outsourced, the hotel needs to consider factors such as:

- Is it more expensive to hire an employee with the necessary skills to manage the pool, or is it cheaper to outsource this to a specialist pool-maintenance contractor with greater economies of scale?
- Does the hotel have a person who can effectively supervise the pool-cleaning employee or contractor to identify if they are failing to perform technical aspects of maintenance?
- If the hotel does not have effective supervisory capacity, should the hotel lease a pump from a contractor and contractually require them to maintain it?
- If the hotel leases the pump, what would be the implications if the contractor winds up? For example, are there other contractors who can readily take over maintenance or will the pump be repossessed?
- The hotel needs the pumps to be functional every day. Can this requirement easily be distilled into a contract to enable a contractor's performance to be objectively judged?
- Could the hotel use contracts to reduce their legal liabilities through hold harmless clauses (Harpur 2008)?

The conceptual framework introduced in this paper offers a way forward for developing a critical decision-making approach to better managing assets in the tourism industry.

Conclusion

Resolving these issues has resonance and application for many different physical assets within the tourism industry. It is suggested that not only strategies to increase tourist numbers but also strategies to assist with better decision making relating to the assets within the sector will contribute to the recovery from the GFC.

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