CHAPTER 4

Industry critical success factors and their importance in strategy

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In kitchens, Chefs have the same pots and knives. However, some keep them cleaner and sharper than others. In the end, some dishes taste and look better than others.

Franco Fontebasso, Chef and Owner

Introduction

The fundamental tenet in strategy states that, in order to perform well, a firm must achieve a certain degree of alignment between environmentally driven imperatives and its competencies and capabilities. At a micro level, such alignment is achieved by matching the firm strengths to the critical success factors (CSFs) specific to the existing structure of the industry and segment it is competing in.

Early literature on CSFs focuses on reporting systems and data gathering, and is essentially driven by executives' needs for more relevant information. In this initial attempt to prioritize business issues, scholars and practitioners delved into those few areas in which results need to be satisfactory for the organization to ensure successful competitive performance. What emerged from these inquiries are lists of CSFs, organized by industries or functions.

Other works, more interested by the economic nature of CSFs, shed some light on the relationships between industry factors and firm-specific resources and capabilities. These efforts highlighted the dynamic relationships between organizations' strategic choices and the character of CSFs, which, in turn, influenced the performance potential and overall attractiveness of the industry.

While these efforts all stressed the importance of CSFs in strategy, the questions of what those CSFs are in the hospitality industry, and how they relate to the environment and firm performance remain unanswered. This manuscript provides an overview of past and current thinking about CSFs, their relationships to environmental forces and firm performance. In an attempt to synthesize the literature on the subject, both from the general management literature and, more specifically from the hospitality field of study, it offers a conceptual definition of CSFs, and, through industry examples, illustrates their importance to strategic management as applied to hospitality firms. Finally, a practical framework for the identification and management of CSFs is proposed.

Critical success factors and information needs

Strategic decision-making centres around two fundamental questions pertaining to domain definitional and navigational

issues. At the corporate level, top-management teams are faced with the daunting task of domain selection and definition which determines in which industry the firm is to be in. Such undertaking aims at aligning the corporation with the major remote environmental forces driving change. The second issue, usually referred to as business strategy, is narrower in its scope as it is primarily concerned with the task environment. At this level, the navigational concerns call on managers to align their business units or firms to the forces shaping the task environment. In both cases, understanding the forces driving change requires managers to scan their environment and to cope with massive information flows.

Several frameworks have been provided by strategy management scholars and consultants to assist managers in their scanning duties. At the task level, Rockart (1979) suggested that companies could more effectively scan their environment by concentrating their information needs on those "limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization" (p. 85). These key areas in which success is necessary are industry-wide CSFs. Together, they characterize the structure of the industry and how firms compete in it and respond to environmental forces. Rockart (1979) provided examples of CSFs for varying industries. For instance, styling, quality dealer system, cost control and meeting energy standards are typical CSFs shared by all automobile manufacturers. Rockart (1979) also posited that CSFs evolve over time and shape the boundaries of the industry.

Other authors have emphasized the importance of defining those areas that are critical to the long-term success of firms. Freund (1988) stressed the importance of monitoring CSFs to avoid business failure rather than to gain competitive advantage. To him, CSFs need to be defined for the overall organization, as well as for each business unit and function. Freund (1988) also pointed out that CSFs need to be generic enough to include means required to achieve strategic goals as opposed to specific and related only to performance indicators. He suggested that firms should identify CSFs using a top-down approach that would ensure the alignment of business units with the overall goals and objectives of the corporation. Freund (1988) proposed a 5-step approach to CSFs:

1. Identify the success factors necessary to the attainment of the overall corporate objectives;
2. Determine the related CSFs for each business unit's functional area. Only five to ten CSFs should be retained at each level;

3. Develop strategies that leverage strength and prevail over weaknesses in each CSF;
4. Develop lists of key performance indicators to monitor the performance on each CSF; and
5. Establish processes and procedures to monitor performance and provide timely feedback.

The use of CSFs as control or monitoring systems has been advocated by several other authors (Green and Welsh, 1988). This control approach suggests that CSFs are not only important areas to supervise during the strategy implementation phase, but also that they are detached from the strategy development stage and used primarily to manage exceptions or to detect early signs of failure. Other research however has shown that the CSFs approach is used more proactively by managers too. Simons (1991) for instance discussed the potential advantages of using CSFs in the strategy-making process. While the author recognized that CSFs do not necessarily help managers reduce the uncertainties pertaining to the future changes that can occur in their environment, he argued that they could be used as signalling tools providing information about how changes actually affect their firms. Accordingly, he suggested that top managers should use subset of control systems interactively while keeping the rest for diagnosis purposes. In his study of 16 large corporations, Simons (1991) found that executives using some control systems and CSFs interactively had a much clearer vision and sense of direction than those not doing so.

Critical success factors and industry structure

While information and control-system scholars looked as CSFs as being things executives need to pay attention to, other streams of research in strategy have looked at them from an industry structure perspective. The idea that industry structure is crucial to the enduring success of firms has been central to the development of the industrial organization's (IO) view of strategy. As suggested by Porter (1980), the attractiveness of an industry depends on its relationships with the external forces present in the task environment. Firms' strategic actions are responses to environmental changes with the aim of increasing their bargaining power over suppliers and buyers, or raising entry barriers to prevent potential new competitors to enter the industry. The concepts of entry barriers and bargaining power are powerful to explain what CSFs can be and why they are important to strategy. Table 4.1 provides examples of Porter's (1980) generic strategies. Principally conceptual and prescriptive, these generic

Table 4.1 Porter's Generic Strategies

Generic Strategy	Strategic Actions (Content)	Strategic Consequences
Overall low-cost leadership	Aggressive construction of efficient-scale facilities Cost reduction from experience (experience curve) Tight cost and overhead control Avoidance of marginal customer accounts Cost minimization in areas like R&D, service, sales force, etc.	Defend the firm against intense rivalry as still can earn returns after its competitors have competed away their profit. Decrease the bargaining power of buyers as they cannot drive down prices more than at the level of the next most efficient firm. Buffer the firm from actions taken by powerful suppliers as it provides flexibility to cope with cost increases. Reduce threat of new entrants as the position requires factors that raise entry barriers. Reduce threats from substitutes due to the relative advantage gained over the competitors.
Differentiation	Create a unique design or brand image Create a unique technology Create unique features Create unique customer service Create unique dealer network	Insulate the firm against rivalry through brand loyalty and lower price sensitivity from the buyers. Provides higher margins that mitigate the power of suppliers. Decrease the threats posed by potential new entrants and substitutes through customer loyalty.
Focus	Concentrate all efforts on a particular buyer group Serve the narrow strategic market more effectively and efficiently than competitors	Achieve the same advantages than low cost and differentiation strategies *vis-à-vis* its narrow target market, but not from the perspective of the market as a whole.

Source: Porter (1980).

strategies still suggest several propositions related to the relationships between structural factors of the industry, strategic choices made by firms and their strategic consequences.

For instance, firms following a differentiation strategy would attempt to develop their businesses by focusing on unique areas which would be difficult to imitate and thus raise entry barriers. Likewise, differentiators would prevent customers from selecting other alternatives by increasing their switching costs. In both cases, the actions taken by these firms to establish their position would alter the structure of the industry. These areas in which the differentiator creates its uniqueness then become CSFs. For example, a restaurant franchisor could try to differentiate itself by developing superior site selection capabilities. If successful, the strategic action would likely become a benchmark in the industry and change the way franchisors compete. The superior site selection capabilities would ultimately become industry-wide CSFs and need constant attention from management.

The concepts of bargaining power and entry barriers are to be understood in the context of the five forces shaping the task environment of firms (Porter, 1980). In the five forces framework, the relative bargaining power of the industry *vis-à-vis* its external forces, as well as the relative heights of the entry barriers, define the degree of rivalry among industry competitors. As industries and task environments evolve, different dynamics become apparent, and different CSFs emerge. These interactions have been described extensively from the perspective of the industry or market life cycle. For example, Wasson (1974) suggested that strategic focus changes depending on the stage of the life cycle. He argued that product development, pricing strategy, distribution policy, and intelligence focus varied depending on the type of competition at each stage of the cycle. For instance, at the market development stage, the distribution policy should concentrate on selected distributors and provide them with high margin so that they could heavily advertise. In contrast, at the maturity stage, distribution policy should include as many dealers as possible, and provide them with a well supplied but low-cost inventory.

Synthesizing the literature on strategy and industry life cycle, Hofer (1975) presented a list of organizational, environmental, and resource variables that were deemed as strategically significant at different stages of the cycle. While based on manufacturing industries, these variables are interesting as they illustrate the evolutionary nature of CSFs.

Table 4.2 presents some of the variables of Hofer (1975) that are closely related to CSFs. The evolutionary nature mentioned above is exemplified by the importance of the rate of

Table 4.2 Strategically Significant Variables at Different Stages of the Life Cycle

Life Cycle Stages	Industry Structure Variables	Organizational Characteristics and Resources
Introduction	Uniqueness of the product Rate of technological change in product design	Quality of products
Growth	Type of product Rate of technological change in product design No. of equal products Barriers to entry	Market share Quality of products Marketing intensity
Maturity	Type of product Rate of technological change in process design Degree of product differentiation No. of equal products Transportation and distribution costs Barriers to entry	Market share Quality of products Value added Degree of customer concentration Marketing intensity Discretionary cash flow/gross capital investment
Saturation	Degree of product differentiation Price/cost structure Experience curves Degree of integration Economies of scale	Market share Quality of products Length of the production cycle Newness of plant and equipment Relative wage rate Marketing intensity
Decline	Degree of products differentiation Price/cost structure Marginal plant size Transportation and distribution costs	Market share Quality of products Length of the production cycle Relative wage rate Degree of customer concentration

Source: Adapted from Hofer (1975).

technological change in product design at the introduction and growth stage, which evolved into the rate of change in process design at the maturity stage. As industries grow, new product development is a critical element to market share building and sales growth, while as growth slows down, business processes that produce or distribute products or services become more important to sustain operating margin and profit

growth. It is also interesting to note that, as the industry (or market) matures, the number of critical variables increases; variables are more often added to the list than removed. Indeed, it appears that CSFs are cumulative rather than specific to stages in the life cycle. Consequently, it seems unlikely that firms actually gain a competitive advantage through CSFs, but rather avoid failure by considering them. This view is consistent with that of Simons (1991) and other information system scholars.

Another important notion put forth by Porter (1980) and IO students is the concept of strategic group and mobility barriers. Strategic group represent clusters of firms within an industry that follow essentially the same strategy. In this context, strategy is defined by the actual activities undertaken by firms at all level of the organization. These activities include functional-level, pricing, and positioning strategies among others things. The existence of such groups within industries rests on the assumption that firms not only attempt to raise entry barriers and leverage their bargaining power in relation to participants outside their industry, but also try to distinguish themselves from rivals by investing in mobility barriers (Caves and Porter, 1977). Much like industry entry and exit barriers, these mobility barriers can be tangible or intangible assets firms developed or acquired, such as a strong brand name, a loyal customer base or some distribution channels (Mascarenhas and Aaker, 1989). They can also be skills and capabilities, such as the ability to perform a task better than others or to design products or services that are reliable and inexpensive to produce or deliver.

Mobility barriers are principally assets and capabilities that delineate strategic groups, and because strategic groups have been viewed as key determinants to success, they appear to be closely related to the CSFs concept. In other words, firms that enjoy sustained high performance due to their group belonging would have to pay special attention to the determinants of their mobility barriers which are CSFs to them. From this perspective, CSFs are defined as being those resources (i.e., assets and capabilities) that help firms buffer themselves against external forces present in their task environment as well as from their competitors.

Critical success factors and the market for strategic resources and capabilities

While management scholars are still debating whether superior performance is mostly driven by industry- or firm-specific factors (Hawawini, Subramanian, and Verdin, 2003; McGahan and Porter, 1997; Schmalensee, 1985), it appears that both

are important to strategy. Where IO researchers saw firms' resources as determinant of strategic groups and industry structure, students of the resource-based view (RBV) of the firm envisioned resources as firm-specific factors and key differentiating elements among companies or business units. Wernerfelt (1984) advocated the value of analysing firms from a resource perspective instead of the product-market side. He argued that, unlike the entry barrier concept of IO students, resources created position barriers that provide its owner an advantage over other industry members as long as it is not replicated by other competing firms or new entrants.

Similarly, Barney (1986a) argued that the creation of imperfectly competitive product markets (i.e., generic strategies) may not suffice to explain above normal economic performance. In his reasoning, abnormal economic performance can only exists when the cost of implementing product-market strategies (e.g., differentiation or cost leadership) is lower than the returns. According to economic theories, this can only be achieved when competition is not perfect. Barney (1986a) suggested that the imperfections are more likely to reside in the way resources are distributed among firms. In other words, the principal competitive market is not about positions in industries, but more a market for strategic factors in which firms attempt to control unique resources or to acquire resources of which the future value has not been well recognized by competitors.

Building on this resource approach, Prahalad and Hamel (1990) suggested that the roots of competitive advantage were not product market related, but entrenched in the core competencies of companies. Using historical examples of corporate successes and failures, they posited that "the real sources of advantage are to be found in management's ability to consolidate corporatewide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities" (p. 81). They defined core competencies as "the collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies" (p. 82). In terms of resource allocation, they distinguished between the traditional view of the firm, where capital is allocated to discrete business units, with a competence-based approach, where capital and talents are allocated to competencies and businesses at large.

In an attempt to formalize the RBV of the firm, Grant (1991) proposed a practical, 5-step framework to strategy analysis. Synthesizing the work of RBV proponents such as Wernerfelt (1984), Barney (1986a, 1986b), Shoemaker (1990), and Prahalad and Hamel (1990), as well as prior works of Penrose (1959),

Andrews (1971), and Thompson (1967); he suggested that firms should first analyse their resources, and appraise their strengths and weaknesses relative to their competitors, as well as identify opportunities to better utilize them. Then, firms should identify their capabilities (i.e., competencies) and understand what they do better than their competitors. They should gain an understanding on which resources are necessary to their capabilities. Next, firms should appraise the rent-generating potential of their resources and capabilities, and select their strategies on the basis of the best possible exploitation of their internal strength (i.e., resources and capabilities) relative to external opportunities. Finally, firms should identify any gap between the strategy pursued and their resources and capabilities endowment, and, if necessary, invest in refilling or maintaining their resource base. Grant (1991) concluded that "key to a resource-based approach to strategy formulation is understanding relationships between resources, capabilities, competitive advantage, and profitability—in particular, an understanding of the mechanisms through which competitive advantage can be sustained over time" (p. 133).

In an effort to integrate apparently contrasting views of strategy, Amit and Schoemaker (1993) developed theoretical propositions that linked the RBV and the industry analysis perspectives. Drawing on the concept of key success factors (Vasconcellos E Sa and Hambrick, 1989) and on the industrial economics notion of strategic factors (Ghemawat, 1991), they linked firms' resources and capabilities to the structure of the industry. Using Ghemawat's (1991) notion of sunk cost, they stated that "When the industry (or product market) is the unit of analysis, one may observe that, at a given time, certain *Resources* and *Capabilities* which are subject to market failure, have become the prime determinants of economic rents" (p. 36). Additionally, they argued that these *Resources* and *Capabilities*—labelled strategic industry factors—were characterized by their propensity to market failure and consequent asymmetric distribution over firms. In contrast, by focusing on the firm unit of analysis, unique bundles of resources and capabilities can be identified that enable the firm to earn economic rents. The authors labelled these firm-specific resources and capabilities strategic assets. Further, they argued that the rent-generating potential of these strategic assets was dependent on their applicability to a particular industry setting; "the overlap with the set of *Strategic Industry Factors*" (p. 40). The authors concluded that strategic analysis would gain from a more multidimensional approach, including both industry structure, defined by strategic industry factors and environmental forces, and firms-specific strategic

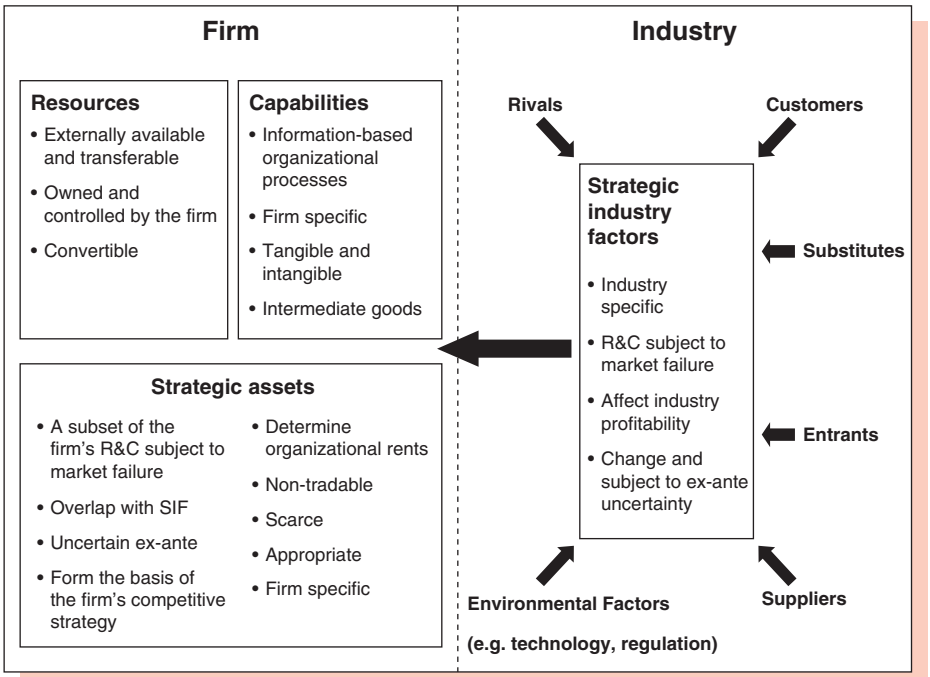

Figure 4.1
Strategic assets and strategic industry factors. (Reproduced with permission from Amit and Schoemaker, Strategic Management Journal. © 1993 by John Wiley & Sons Limited.)

assets that are asymmetrically distributed within the industry. These constructs and relationships are depicted in Figure 4.1.

In another attempt to theoretically synthesize and clarify the earlier works on the RBV, Peteraf (1993) proposed a model describing four conditions to gaining a sustainable advantage through resources. To her, all four conditions need to be met if firms want to generate superior rents on the long run (i.e., earnings in excess of the cost of capital). The first condition is that firms should be heterogeneous in a given industry and that superior resources exist in limited supply. These superior resources enable firms to produce at a lower average cost than competitors with inferior resources, and as they are limited in supply, efficient firms are able to sustain that competitive cost advantage. The second condition results from the need to maintain some degree of heterogeneity across firms. What the author coined as *ex post* limits to competition refer to forces that restrict competition for rents that have been gained by a firm. Some factors shaping these forces have been recognized in the RBV literature as resulting from imperfect imitability and imperfect substitutability. The third suggested condition

is what Peteraf (1993) labelled imperfect mobility. This notion is related to Ghemawat's (1991) sunk costs and Shoemaker's (1990) idea of asset specificity. Resources that are imperfectly mobile are hard to trade as their use and value is firm specific. The fourth condition, *ex ante* limits to competition, refers to the importance of the cost of implementing strategies brought out by Barney (1986a). The argument is that the future potential value of resources needs to be perceived differently by competing firms so that one that perceives it as valuable can acquire it at a relatively low cost.

Whether taken from an industry structure perspective or from a firm's resource side, some resources and capabilities appear to be major determinants of financial and competitive success. Thompson and Strickland (1996) noted that "Key success factors point to the things a firm must concentrate on doing well, the specific kinds of skills and competences that are needed, and which aspects of the which internal operating activities at the most crucial and why" (p. 76). They also observed that these CSFs varied from industry-to-industry as well as from time-to-time. To them, because such factors have to be of utmost importance to the financial success of firms, CSFs are to be related to major value adding activities. Put differently, the way firms perform on these CSFs need to have a direct and major influence on its key value drivers, be them revenue or cost related. For example, in the beer industry, CSFs are the utilization of brewing capacity, the dealer distribution network, and the advertising effectiveness. In industries with high transportation costs, the location of production plants and the ability to sell products within an economical shipping distance are CSFs. The authors highlighted that the identification CSFs, while necessary to successful planning, was a difficult task that had to be performed regularly and at industry level.

Critical success factors in the hospitality industry

Several authors have discussed or studied CSFs in the context of the hospitality industry. Some research were carried toward the identification of industry-wide competitive methods (CMs) and CSFs. These efforts principally looked at the strategic actions taken by hospitality firms and how quickly they were copied. For instance, Olsen, West, and Tse (1998) defined strategy choice as being investments in CMs and CSFs, which are products and services that are bundled in a unique way and that attract customers from within the overall demand curve of the industry. The authors also made a distinction between CMs and CSFs. To them, competitive advantages, resulting from

the investment in CMs, are rarely sustained for a long period of time as competitors, principally in the service sector, tend to quickly and successfully copy them. CMs that are copied become CSFs, and shape the boundaries of the industry as they develop into benchmarks. This idea is consistent with Porter's (1985) mobility barriers, where he argued that "firms, through their strategies, can influence the 5 forces" (p. 7). It is through the dynamic evolution of CMs and CSFs that those firms define their industry domain. Consequently, CSFs are defined as those things that are necessary for firms to invest in if they aspire to compete within an industry (Olsen *et al.*, 1998).

As shown in Olsen and Zhao (1997), distinguishing between CMs and CSFs can be a daunting task as CMs "frequently have very short life spans" (p. 57). Reporting on Olsen's (1995a) work, commissioned by the International Hotel and Restaurant Association (IH&RA), the authors also stated that "the leading or innovative firms were always the first to come up with a new or better method and they were then copied within a very short period of time" (p. 57). Thus, the primary distinguishing factor between CMs and CSFs appears to be time, where the leading firms take an advantage over the time period during which its CM is unique.

Olsen (1995a) and Olsen and Zhao (2000) researched the CMs used by international hotel firms during the 1985–1994 and 1995–1999 periods. Using content analysis techniques, information on 20 international hotel groups from 10 different countries were analysed and resulted in the identification of a number of CMs. These CMs are listed in Table 4.3.

Other scholars have also tried to uncover key CSFs in the hospitality industry. Geller (1985) interviewed 74 executives of 27 hotel companies and asked them to identify the most important CSFs to the performance of their firm, to which strategic goals they were related, and how they would track them. The most frequently cited were employee attitude, guest satisfaction (service), superior product (physical plant), superior location, maximization of revenue, and cost control.

Another attempt to identify those CSFs can be found in the explanatory study of Brotherton and Shaw (1996). Using mailed questionnaires, the authors initially attempted to identify corporate and unit level CSFs, yet they had to concentrate solely on unit level as they received only one response from corporate offices. In their study, they asked respondents to identify and rank CSFs, as well as to classify them according to functional areas.

Reporting on multiple studies performed on the U.S. lodging industry, Dubé and Renaghan (1999) described the best

Table 4.3 Competitive Methods in the International Hotel Industry: 1985–1999

Period	Category	Competitive Method
1985–1994	Customer products and services	Frequent guest programs
		Amenities
		In-room sales and entertainment
		Business services
	Technology development	Technology innovation
		Database management
		Computer reservation systems
	Market efforts	Branding
		Niche marketing and advertising
		Pricing tactics
		Direct to consumer marketing
	Market expansion	International expansion
		Strategic alliances
		Franchising and management fee
	Operation management	Cost containment
		Core business management
		Service quality management
		Travel agency valuation
		Employee as assets
		Conservation/ecology programs
1995–1999	Rapid information technology development	Customer-oriented technology
		Management-oriented technology
	International expansion and market cooperation	Mergers and acquisitions
		Management contracts
		Franchise agreements
		Joint ventures
		Strategic alliances
	Relationship management	Customer relationships
		Employee relationship
		Franchise relationship management
		Travel agency relationship management
	Customer-oriented products and services development	New segments, brand names, hotel room design and style
		Health awareness amenities
		Time-share programs
	Structural engineering	New presidents and CEOs
		New divisions
	New market initiatives and campaigns	Heavy advertising investment
		Co-promoting activities
		Brand and image marketing
		Competitive pricing tactics

(*Continued*)

Table 4.3 (Continued)

Period	Category	Competitive Method
	Quality control	Use of brand name products Renovation and modernization Quality performer rewards Employee as assets Training
	Social awareness and environmental protection	Social responsibility Responsible corporate citizenship Protecting the natural environment

Sources: Adapted from Olsen (1995a) and Olsen and Zhao (2000).

practices of "29 overall champions" (p. 16). While not labelling them CSFs, the authors established their ranking based on strategic actions commonly practiced in the industry. For instance, they classified Four Seasons as Deluxe-segment champion based on its leading performance in customer service that was attributed to investments in employees' training and selection. For Embassy Suites, the Upscale-segment champion, the deciding factors were the physical attributes, amenities and service, such as the size of the room, as well as quality service and breakfast quality.

In the foodservice industry, Olsen and Sharma (1998) offered a review of the CMs used by multinational companies between 1993 and 1998. Using the content analysis research method, the author summarized the key CMs described in trade journals and magazine, company and consultant reports as well as academic journals. Table 4.4 summarizes these CMs.

After more than two decades of applied research and theory development, it appears clear that CSFs are important to the enduring success of hospitality firms. What remains unclear, however, is what these CSFs really are. The next section provides a synthesis of the definitions provided for the concept as well as illustrative examples.

Defining critical success factors for hospitality strategy

The business and academic literature offers several definitions of CSFs. While it appears that there are as many definitions as

Table 4.4 Competitive Methods Multinational Foodservice Companies: 1993–1998

Competitive Method	Examples
Strategic expansion	Franchise/master franchise
	Management contract
	Strategic alliance/joint venture/partnership/co-branding
	Merger and acquisition
Technological development	Internet communication with target market
	Management information systems
	Production and service-oriented technology
	Training and development systems
Internal competency development	Quality management
	Employee training and retention
	Organization restructuring
New product/service development	Modifying the menu to adapt to local needs
	New product/concept/theme development
	Safety and cleanliness
	Chain and brand name domination
	Facility renovation
Target marketing	Heavy advertisement
	Internet advertising and promotion
	Database marketing
	Sponsorship, community service, and charity
	Environmental awareness
Pricing strategies	Price/value relationship
	Discounting war
	Coupons

Sources: Olsen and Sharma (1998).

articles or books published on the subject, several definitional attributes are commonly mentioned:

- CSFs are related to CMs and other strategic and tactical actions;
- CSFs are related to the cost structure of the industry (specifically, to sunk costs);
- CSFs are tangible or intangible assets that are developed over time through investments rather than acquired.

Similarly, authors' perspectives on what CSFs actually do to firm performance varied. Yet again, several similarities can be observed:

- CSFs help managers concentrate on the few elements that are necessary to compete successfully in a given industry;

- Sustained high performance on each CSFs is necessary for firms to sustain a positive performance;
- Failure to perform on CSFs is detrimental to the performance of firms;
- The nature and evolution of CSFs in relation to the task environment influences the performance potential of the industry or strategic group participants.

What emerges from these similarities is that the CSFs concept is complex and multidimensional. While some CSFs are related to the ability of firms to optimize the use of some resources, others are actual resources directly part of the production or service process. This distinction is consistent with what Hansen, Perry, and Reese (2004) termed administrative and productive resources. Administrative resources refer to the ability of managers to make the right decisions as to the use of the resources they possess. This ability is related to the extent to which managers recognize the value-generating potential of their resources or of resources available to them through their development or acquisition. This idea is closely related to the notion of peripheral competences discussed by Olsen *et al.* (1998) and to the concept of supporting activities in the value chain of Porter (1985). Examples of peripheral competences and support activities include human resources, environmental scanning, business development and financial systems, or procurement, and technology development activities, which facilitate the functioning of the core competencies of the firm and of its primary activities. For instance, firms with higher scanning capabilities are likely to make better investments in CMs as they can recognize opportunities and threats ahead of their competition. When companies fail to recognize important forces driving change, or fail to understand how these forces will influence their domain, their reactions tend to be delayed.

Such failure has been observed in the international hotel industry. While the industry recognized early that technology, and more specifically the Internet, represented a major environmental force, its participants fell short of understanding how that force would revolutionize the way hotel rooms were sold. The identification of technology as a major force was first documented by Olsen (1995b). Motivated by industry recognized needs, and with the support of the IH&RA, the author initiated a series of *visioning the future*© workshops. These workshops were held across the globe, bringing together diverse groups of participants in order to obtain a broader view on issues facing the industry. The author used nominal

group techniques to monitor the sessions and to obtain consensus over the most central issues uncovered. The synthesis of the results of each workshop provided a global view of the forces driving change as reported by Olsen (1995b).

On industry request, this early work was taken a step further with the objective to provide more specific insights on each of the forces. A team of researchers, under the umbrella of the IH&RA, conducted another series of workshops entitled *Think Tanks*. The outcomes of those *Think Tanks* helped recognize the causal nature of those forces and resulted in several executive summaries published by the IH&RA. The initial efforts of Olsen (1995b) permitted the identification of five original forces, to which two other were later added: assets and capital, capacity control, new management, safety and security, technology, social responsibility, and sustainable development.

While the industry acknowledged the importance of technology advancements, its participants apparently did not understand that Internet-based distribution would become a major channel and would challenge their ability to control prices and room availability. Despite the development of their own websites, hotel chains started by early 2000 to massively sell large amounts of rooms to third-party websites. Faced with low occupancy rates driven by a rapidly declining economy (recession, Internet bubble, and 9/11), hoteliers perceived these third party websites as an opportunity to sell leftover inventory. By the end of 2002 and beginning of 2003, commentaries similar to the followings could be found in almost every industry trade magazine or business journals:

At first, hotel executives like Homestead Chief Executive Gary DeLapp viewed discount sites as a way to get a few hard-core bargain hunters into otherwise empty beds. Today, those executives hold a different view after watching the discount sites transform the way mainstream America buys travel. Instead of helping them, those sites have hurt the hotel firms' margins and made it difficult for the industry to rebound during tough economic times. Online discounters "are completely disrupting the pricing integrity of hotels," said Henry Harteveldt, analyst at Forrester Research.

(The Atlanta Journal, September 2002)

Observers say the burgeoning corps of online bargain hunters has helped to keep room rates below 2000 levels, and industry profits down 28 percent from that peak year. And hotel companies, in many cases, made it easy for them to do so. In their early forays into cyberspace, many hotel companies handed over too much control of inventory and pricing to third-party online travel agencies, observers say.

And now they are in the unenviable position of trying to take back the reins after early shopping patterns have been established.

(Chicago Tribune, January 2003)

"*They found they were losing out on some of the direct consumer sales and allowing the Expedias and Hotel.coms to come in and take a direct role," she said. "The margins got bigger in terms of what they were making, and the rates were getting smaller. Once online penetration passed 10 percent, hotels realized, 'This is a real important channel to us.'" They also realized that they were losing control of their rates, Sileo said, which prompted hotel companies to launch new initiatives luring customers to book directly with the hotel, either through its own Web site or over the phone.*

(Fort Worth Star-Telegram, July 2003)

Now that '03 is quickly coming to an end, let's make a resolution for '04 to do less whining about those big bad third-party suppliers that are ruining our average rates. As an industry, we chose to participate with them; we allocated rooms to them; and we gave them the low room rate ammunition to fire back at us. Let's face it; they do a better job than we do. They are in the primary search results for most major and secondary hotel-city searches. That doesn't happen by accident. Their sites are designed to lead people to make reservations, not to entertain users with fancy, but unnecessary flash animation. Few hotels make the extra effort and investment necessary to produce those results.

(Hotel-Online.com, December 2003)

What lead the industry into such a weak position? Could it have been avoided?

While the causes of the loss of capacity control are certainly many and complex, it is safe to argue that the industry's capabilities in scanning and technology development have been weaknesses rather than strengths when compared to the capabilities of third party websites and other distribution companies such as GDSs. These two types of capabilities are administrative CSFs, and clearly exhibit the characteristics discussed thus far. Indeed, when the performance on these CSFs is a relative weakness compared to the task environment, then the overall profit potential of the industry declines as the bargaining power shifts towards the upstream or downstream value chain participants.

When the unit of analysis is the firm, one can observe that some companies have been less negatively influenced by that loss of capacity control than others. For instance, Marriott International appears to have less suffered from the economic downturn and subsequent loss of capacity control than its peers. Over the 1998–2004 period, Marriott has consistently outperformed its direct rivals in both stock returns and operating

margins. Although this performance is certainly the result of a variety of ingredients, it is worth noticing that Marriott has been leading the industry in terms of technology, with the initial development of its Marriott Automated Reservation System for Hotel Accommodation (MARSHA) in the early 1980s, and with its $70 million investment in a centralized e-business system in 1998. As a consequence, the leading position of Marriott on the technology development CSF enabled the company to outperform its competitors and avoid the performance failures observed for other hotel chain companies.

This example illustrates the importance of administrative CSFs and how firms with superior capabilities in administrative CSFs are better able to develop, acquire, and use resources related to productive CSFs. As introduced earlier, productive CSFs are associated with primary activities and core competences, and are directly related to the acquisition, and transformation of inputs into outputs. Examples of such productive CSFs include the operating system that organizes production and service activities, and marketing and sales systems. From a financial perspective, the use of most of these resources is translated into the statement of cash flows under operating, investing, and financing cash inflows and outflows. In every industry, a limited number of items in this statement have the most influence on the profitability of firms. For instance, in the fast-food segment of the restaurant industry, food and labour costs are critical to the ability of firms to generate operating margin that are sufficient to pay for non-operating costs and generate a profit. Any failure to manage these costs effectively has a dramatic influence on the firm's profit. In addition, as in most service-oriented industries, the aptitude of hotel and restaurant companies to constantly maximize the use of their perishable assets is of utmost importance. When one considers the drivers of most service firms' return on assets (ROA), the capability of continually generating a sufficient level of sales from the assets is paramount as most of the potential value from these assets is perishable and cannot be stocked in inventories. Consequently, the operation of these assets and the distribution of their capacity are productive CSFs.

The significance of these productive CSFs has been exemplified in the fast-food industry by the decline of McDonald's corporation in the mid-1990s and early 2000s, followed by the widely reported turnaround strategy led by its late CEO Jim Cantalupo. While the decline of McDonald's can be traced back to the early 1990s which witnessed a series of poor quality ratings and law suits, it really fully came into view in January 2003 when the company posted its first loss ever of

$343.8 million for the last quarter of 2002. According to Matt Paull, McDonald's CFO, *"The culture of the company was to produce more restaurants. That wasn't a healthy culture, given that the customers were shifting and we hadn't focused on it."* (Chicago Tribune, June 2004). This loss of focus was principally a lack of consideration of some productive CSFs such as production and service systems, which resulted in *"poor product and service quality"* (CNN Money, April 2004). While these two CSFs are well known in the foodservice industry (i.e., product and service quality), the failure of constantly monitoring the performance of the company on these two CSFs had immense consequences on the financial results of McDonald's. This again highlights the importance of CSFs to the conduct of a firm's strategy, and specifically, of performance evaluation of these CSFs. In the McDonald's case, the company's U.S. COO stated that *"McDonald's had abandoned many of the measurement methods that had led to its success. The company hadn't graded the performance of individual stores for 15 years. Store owners didn't have to worry about mystery diners, either, company employees who secretly visited restaurants and judged their performance."* (Chicago Tribune, June 2004).

The next section provides a framework of analysis for companies to incorporate CSFs into their strategic management practices and to develop performance metrics for monitoring their performance.

Critical success factors approach to strategy: a framework

As suggested earlier, the value chain (Porter, 1985) and the concepts of core and peripheral competences (Olsen *et al.*, 1998) provide some initial guidelines as to what firms need to consider when making strategic choices. Indeed, this chapter started by stressing the importance of aligning the firm's resources and competences to the environmental forces driving change. In order to do so, firms need only to develop innovative CMs which foster growth, but they also must continuously ensure a minimum performance on those administrative and productive CSFs that prevent them from failing. Even though CSFs are not necessarily sources of competitive advantage in themselves, they can become sources of superior performance when other firms in the industry fail to perform on them as illustrated by the case of the hotel industry and third party websites. Often, these CSFs are well known to industry participants. Yet, a number of examples exist that demonstrate the lack of focus of firms on CSFs and their

subsequent poor performance. The following framework provides a systematic approach to the evaluation of CSFs in the context of strategic decision-making and performance review.

Identify value-preserving activities and assets

The initial step in the identification of CSFs is to develop a thorough understanding of the revenue and cost structure of the industry. At this stage, firms need to consider the drivers of both the demand and supply curves for the industry. The major issue at stake is about value-preservation. In other words, firms must identify the activities and assets that allow them to sustain a profit and maintain their margins. For the demand curve, the questions to answer are directed toward the comprehension of what helps the industry prevents potential new competitors or substitute, or other external forces from eroding the demand (or shifting the curve to the left—the doted green

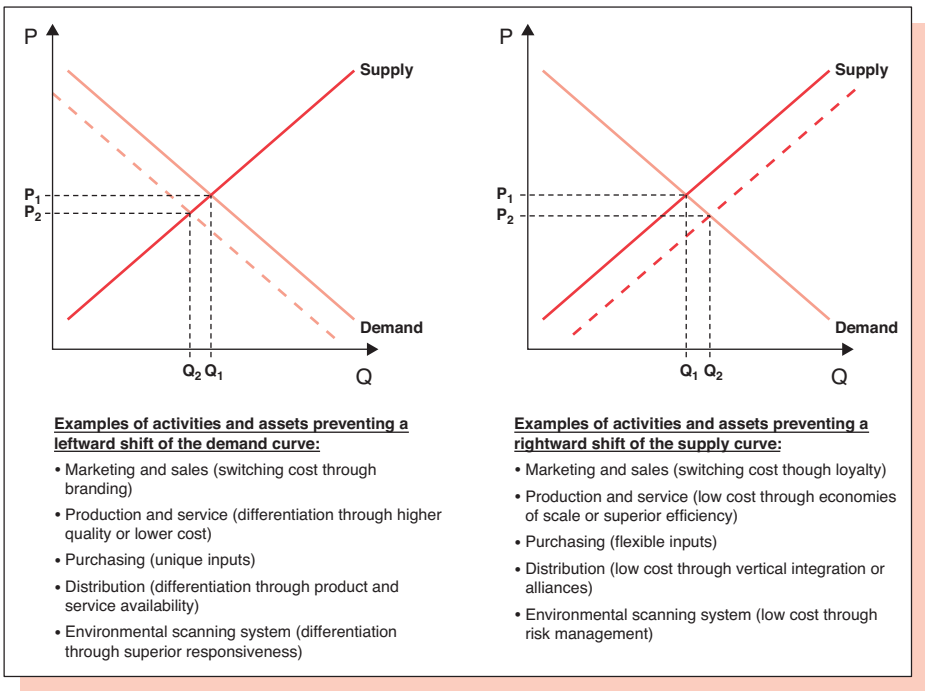

Figure 4.2
Value-preserving activities.

line in Figure 4.2). For the supply curve, attention should be paid to the threats that could potentially make the curve shift rightward (the doted red line in Figure 4.2). Examples of such threats include an increasing bargaining power from some suppliers following a wave of mergers and acquisition in this tangent industry. Figure 4.2 illustrates the idea of preserving the supply and demand curve balance and raising barriers to buffer the industry from environmental threats.

In many situations, because these activities and assets are well recognized, one can rely on the analysis of trade journals, analyst reports or companies' annual reports to identify them. What is more difficult is to understand their relative importance; developing this understanding can be facilitated by completing the framework of analysis presented in Table 4.5.

This framework lists four steps—or questions—that can help clarifying the nature of the key value-preserving activities and assets. The first column asks for the identification of the key value-rich services, products, and processes. Value richness, in this context, refers principally to the importance of the service, product, or process to the revenues and expenses of the firm. The example provided in Table 4.5 uses purchasing as an important value-rich process in the restaurant industry. This process is deemed as important in terms of value potential because it is directly related to some of the major expenses found on income statements of restaurant firms, such as food and beverage costs. This process typically includes activities such as the selection of suppliers and the negotiation of purchase contracts, which are to be listed in the second column. In the third column, these activities or assets are detailed and their relationships with the supply and demand curves are explained. For instance, the negotiation of purchase contracts is directly related to the potential future price volatility of major food items such as beef or seafood. The sharp decline in stock price suffered by Darden Restaurants in the end of 2002 due to rising seafood prices is a good illustration of the value richness of such activity. Not all activities of a process, and not all assets used in delivering a service or a product share the same degree of value-richness. In the example in Table 4.5, storage and inventory-related decisions are not perceived as conveying as much value as other activities. While such activities can indeed help reduce part of the costs and volatility of important supplies, it is not considered as having as much influence on costs as other purchasing activities. The fourth column in the Table is designed to rate the relative importance of each activity. This rating will then be used in subsequent stages of

Table 4.5 Identification of Value-Preserving Activities and Assets: Example of the Restaurant Industry

Identify and Briefly Describe the Key Value-Adding Services, Products and Processes Existing in Your Industry Segment	Using Key Words, List the Activities and Assets Significant to the Delivery of These Services and Products, or Part of These Processes	Briefly Describe How These Activities and Assets Influence the Supply and Demand Curves	Using a 3-Point Scale (High Value, Moderate Value, Low Value), Assess How Much Value is Linked with the Activities or Assets
Purchasing: efficient, safe, and cost-effective purchasing processes	a. Suppliers' selection	a. A large number of suppliers offer more bargaining power as they will compete on price. Fewer suppliers may help develop a stronger relationship which could help shorten the lead time.	a. High value (cost)
	b. Supply chain control (including tracking and temperature control)	b. A strong control of the supply chain reduces potential defects and errors which lead to lower inventory levels and waste. The control of the temperature prevents waste and potential safety hazards.	b. High value (risk/cost)
	c. Financing, contract management	c. The management of contractual agreements and payment options reduces price volatility.	c. Moderate value (risk/cost)
	d. Storage and inventory management	d. Storage and inventory decisions affect the ability of dealing with changing prices.	d. Moderate value (risk/cost)

the analysis and permit the firm to prioritize its attention and focus more intensely on the most value-preserving CSFs.

Identify the administrative and productive CSFs (resources and competences) required to sustain a competitive performance in these activities and assets

The activities and assets identified in the previous stage are critical to the enduring success of firms and industries. The reason for performing well in these activities or maintaining the quality of these assets is to be found in the administrative and productive CSFs. For instance, if the relative age of the real-estate assets in a hotel or restaurant company is assumed to be a critical component of its sustained performance, managers need not only to acknowledge it, but they must also recognize the underlying causes to sustaining the quality of these assets at a competitive level. The ability to negotiate franchise agreements or management contracts that ensure the continued maintenance and preservation of the assets would then be an administrative CSF. Besides, the ability to operate the asset while preserving its original state would be a productive CSF.

As illustrated in the McDonald's case, firms may lose their focus on these CSFs. McDonald's strategy before the turnaround was to add value by growing its number of new restaurants at an exponential rate. Yet, the company witnessed its growth via expansion being offset by its decline in existing operations[1] as it failed to keep two crucial CSFs under control: the ability to control quality in its existing units (administrative CSF) and the ability to sustain quality in the delivery of its products and services (productive CSF). While it is always easier to discuss the past than to plan for the future, McDonald's could have avoided these pitfalls by answering the following question:

- What are the administrative and productive CSFs that must be kept under control in order to sustain the current performance on these critical value-preserving activities and assets?

The study and synthesis of the elements listed in Table 4.5 is a necessary step to answering this question. To achieve this synthesis, the concept mapping methodology is helpful as it permits to relate the activities of various processes as well as

[1] At some point, the decrease in McDonald's existing units' sales accounted for more than 100% of its increase in revenue from new units.

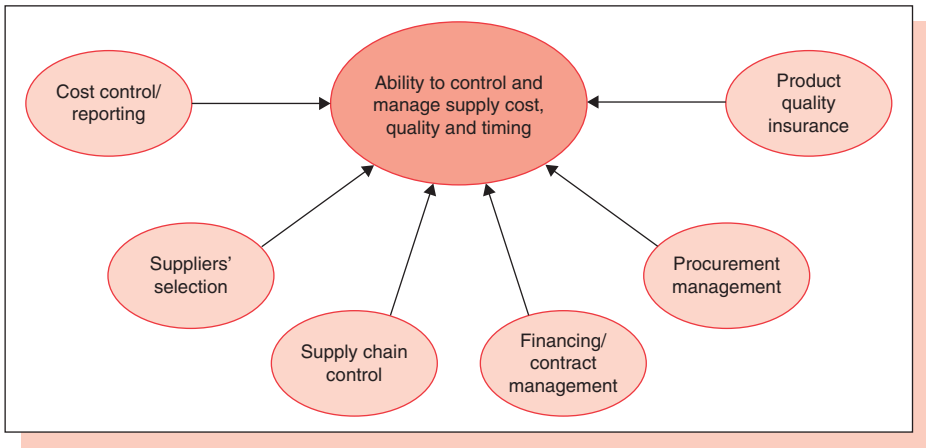

Figure 4.3
Identification of administrative and productive CSFs, example of the hotel industry.

diverse assets to identifiable abilities and competencies. Figure 4.3 provides an example of such concept map.

Identify the internal and external value drivers associated with these CSFs

Another chapter in this book discusses the notion of value drivers and their importance to strategy. Because these value drivers shed light on how and where value is created, they are necessary ingredients to the management of CSFs. The necessity of measuring and assessing how one performs on each CSF calls for firms to identify these value drivers that are associated with them. As in the case of capacity control in the hotel industry, firms can keep track of how well they control these critical activities and assets, and thus evaluate their performance on their CSFs. In this case, hotel chains could have tracked how much of their capacity they were controlling by measuring the number of rooms sold through owned channels versus intermediaries. In the McDonald's case, the lack of focus on service quality in its existing restaurants translated into the absence of measurement of key internal value drivers such as customer complaints or restaurant cleanliness and appearance. Assessing and evaluating the performance on CSFs requires firms to identify internal and external value drivers associated with their CSFs. Table 4.6 present a framework for listing and tracking these value drivers.

Table 4.6 CSFs and Value Drivers: Example of the Restaurant Industry

List and Briefly Describe Your Industry Segment CSFs	List the Key Internal Value Drivers Related to Each CSF, and Include Key Quantitative Measure	List the Key External Value Drivers Related to Each Internal Value Driver, and Include Key Quantitative Measure	Briefly Explain the Relationship Between the Internal and External Value Drivers
Ability to control and manage supply cost, quality, and timing	1. Food cost 1.1 Beef price (incl. volatility) 1.2 Seafood price (incl. volatility) 1.3 Average maturity of future contracts 1.4 Average payment period	1. Food cost 1.1 Beef supply 1.2 Seafood supply 1.3 Number of suppliers 1.4 Tax rate and quota on imports	1. The total domestic (incl. imports) supply of food items is directly related to the price level and volatility. The number of suppliers affects the bargaining power of the firm and influence prices. Tariffs and quotas imposed by the government on imports directly influences the available supply and overall price levels.
	2. Food quality 2.1 Number of defect 2.2 Waste percentage 2.3 Percentage of items controlled throughout the supply chain	2. Food quality 2.1 FDA quality standards 2.2 Number of suppliers in the supply chain 2.3 Number of food born illness cases	2. The FDA standards and quality insurance programs influence the overall quality of food supply in the US. The number of suppliers in the supply chain makes quality control and tracking more or less difficult. The number of cases of food born illnesses is related to risks of pandemic or other illness proliferation.
	3. Supply chain cycle 3.1 Average inventory turnover 3.2 Average days in cycle 3.3 Average lead time	3. Supply chain cycle 3.1 Average lead time 3.2 Transportation cost and efficiency 3.3 Average shipping distance	3. The lead time offered by suppliers is determined by their technological capabilities. This lead time influence directly the lead time of the firm, which influences the inventory turnover and average supply chain cycle.

Assess the competitive performance on these CSFs

Because performance is not only a function of how firms raise and maintain entry barriers to buffer themselves from external forces, but also an outcome of how firms perform relative to their peers, CSFs need to be looked at from a competitive perspective as well. As suggested by the introductory quote, some perform better than others because they simply are better at doing these things that are at the core of the business. When realtors appraise real-estate value in the hotel industry, they often conclude that the location, age of the assets, and distribution channels are crucial determinants of the competitive index as measured by RevPAR penetration. At this stage of the CSFs analysis, firms are required to understand how they perform on these CSFs relative to their competitors. This insight can be developed through a two-dimensional matrix analysis.

First, the performance of each firm on each CSF relative to the other firms within the industry must be evaluated. In Table 4.7, this evaluation is performed by the ranking of firms that appears in the lines. Firms that consistently rank better than others are expected to perform better and bear less risk of failing due to external changes. The second dimension relates to the relative strength of the industry as a whole relative to the industries in the task environment. For this second evaluation, the industry strength is evaluated as being stronger, neutral, or weaker than outside industries for each CSF. This analysis indicates the comparative bargaining power resulting from entry barriers for the entire industry. Categories in which the industry is weaker, and where the individual firm is weaker, indicate greater risk of failure.

Developing the ranking of firms on each CSF may be a daunting task and prone to too much subjectivism when

Table 4.7 CSFs Matrix Analysis

CSF	Comparative Industry Strength	Ranking			
		Firm No. 1	Firm No. 2	…	Firm No. *N*
CSF 1	Stronger	1	2	…	3
CSF 2	Weaker	1	4	…	2
CSF 3	Neutral	3	4	…	1
…	…	…	…	…	…
CSF *N*	Neutral	2	3	…	1

accomplished internally. While no explicit methodology exists, firms may take advantage of published ratings, rankings, or other awards. For instance, if the ability to consistently deliver high-quality service in the deluxe segment of the lodging industry is a CSF, then awards such as the Baldridge Award, or achievements in some kind of quality standards such as ISO and Six Sigma, provide a good sense of how firm actually perform on their quality promises. Another example could be the awards granted to firms offering the best loyalty programme, or customer ratings for restaurant companies.

Develop investment and maintenance budgets to achieve a minimum of competitive parity on these CSFs

When the relative strength and weaknesses of each CSF is assessed, firms need to take the necessary actions to correct or sustain their performance. As exemplified by McDonald's case, firms must ensure a minimum level of competitive parity or edge before they can attempt to develop new growth strategies without taking too much risk. Correcting or sustaining that level of performance requires the development of investment and maintenance budgets. Due to capital constraints, these budgets should be elaborated on the basis of urgency of the action. A recent example in the foodservice industry may help explain this point. In April 2006, Compass Group announced the sale of its station, airport, and roadside divisions (SSP and Moto) for about £3.2 billions. While the divisions were not performing poorly and showed good future potential, Compass recognized it had to concentrate on two CSFs that had been detected as being important weaknesses. Compass used part of the proceeds to (1) strengthen its balance sheet by paying back part of its huge debt, and (2) reduce its massive pension deficit. In other words, the company acknowledged the need to develop a budget to overcome two serious weaknesses that related to two CSFs: the ability to raise cheap capital and the ability to manage its HR practices and pension fund. While Compass would certainly have had other opportunities to spend the proceeds, the urgency of correcting these CSFs forced them to postpone other investments. When developing the investment and maintenance budgets for CSFs, companies need to consider the following questions:

- What are the risks associated with the current underperformance on these CSFs?
- How quickly can these risks materialize?

- How much investment is required?
- When are the investments required?

In order to answer these questions and properly allocate the necessary resources, a marginal investment analysis must be performed. Table 4.8 provides an example of such marginal analysis.

Develop an ongoing and systematic approach to CSFs analysis

The evolutionary nature of industries and CSFs mentioned earlier require firms to continuously apply the framework suggested. The CSFs approach to strategy involves an ongoing and systematic analysis of the industry value chain and of the firms' competences. Regular updates and reports on how the firm is performing on each CSF as well as on what new CSF has emerged should be an important source of information and subject of analysis and discussion for the top-management teams. As suggested by early studies on CSFs, firms should tailor their reporting systems in a way that facilitate the collection, storage, and dissemination of data related to CSFs. Figure 4.4 provides an overview of the system.

Concluding remarks

The quest for sustainable competitive advantage has often relegated the importance of other business practices to a second place. IO students have argued that firms should strive to find a position within their industry that allows them to gain a sustainable advantage. RBV authors, on the contrary, have claimed that firms should concentrate on some of their resources that were valuable, rare, inimitable, and that their organizations were using effectively. In this chapter, it has been contended that these sources of competitive advantage should only be sought after if the firm is already able to perform well on those CSFs that prevent it from failing. The CSFs approach to strategy implies that companies must do well the basic activities that are at the core of its business before it can successfully attempt to gain a competitive advantage. In their pursuit of infinite growth, firms may be tempted to tradeoff some of these principles, but as history shows, a lack of focus on CSFs inevitably ends with long-term performance failure.

Table 4.8 Marginal Investment Analysis: Example of the Restaurant Industry

	Year 0	Year 1	Year 2	Year 3	Year 4
Revenues with investment in CSF	–	105,000,000	105,000,000	105,000,000	105,000,000
Less revenues at current performance level on CSF	–	−105,000,000	−105,000,000	−105,000,000	−105,000,000
Less operating expenses with investment in CSF	–	−84,000,000	−84,000,000	−84,000,000	−84,000,000
Plus operating expenses at current performance level on CSF	–	+85,500,000	+85,500,000	+85,500,000	+85,500,000
Equals marginal EBIT	–	1,500,000	1,500,000	1,500,000	1,500,000
Less marginal interest expenses	–	–	–	–	–
Less marginal tax expenses	–	−250,000	−250,000	−250,000	−250,000
Less marginal working capital changes	–	−(−15,000)	−(−15,000)	−(−15,000)	−(−15,000)
Equals marginal operating cash flows to equity	–	1,265,000	1,265,000	1,265,000	1,265,000
Less marginal equity investment	−2,000,000	−100,000	−100,000	−100,000	−100,000
Equals net marginal cash flows to equity	−2,000,000	1,165,000	1,165,000	1,165,000	1,165,000

Net present value of the project at 15% discount rate:

$$\text{NPV} = \text{CF}_0 + \sum_{t=1}^{N} \frac{\text{CF}_t}{(1+i)^t} = -2,000,000 + \frac{1,165,000}{(1+0.15)^1} + \frac{1,165,000}{(1+0.15)^2} + \frac{1,165,000}{(1+0.15)^3} + \frac{1,165,000}{(1+0.15)^4} = 132,650$$

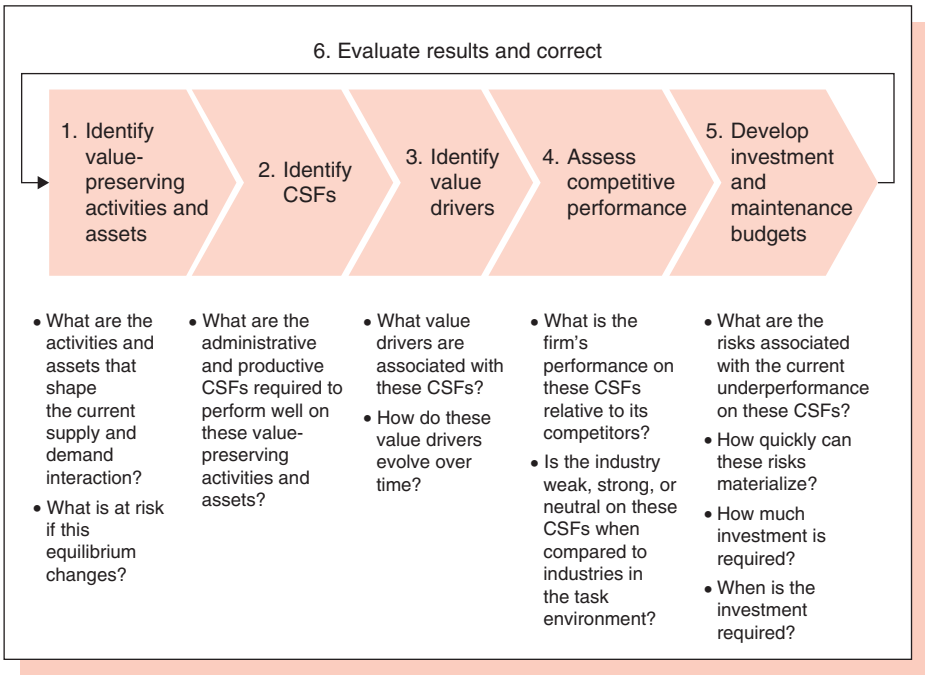

Figure 4.4
A systematic approach to CSFs analysis.

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