

January 1995

## The Hospitality Gap: Bridging Russia into the 21st Century

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### Recommended Citation

Welsh, Dianne H. B. and Swerdlow, Skip (1995) "The Hospitality Gap: Bridging Russia into the 21st Century," *Hospitality Review*: Vol. 13 : Iss. 2 , Article 8.

Available at: <https://digitalcommons.fiu.edu/hospitalityreview/vol13/iss2/8>

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# The Hospitality Gap: Bridging Russia into the 21st Century

## **Abstract**

The new internationalization of the field of hospitality management has led to increased opportunities in the Russian Federation. At the same time, there are major challenges to be overcome. This article describes what needs to be accomplished to be successful at business in this New World Order.

# The Hospitality Gap: Bridging Russia into the 21st Century

by  
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Geographical expansion is a primary growth strategy of the hospitality industry. The industry is continuing to develop internationally, in part due to domestic competition. Also, some believe that the industry is in the mature stage of its life cycle, and that one of the few opportunities for increasing market share is through deep penetration of these new international markets.<sup>1</sup>

Ron Evans, CEO of Best Western International, states, "I think there's been a tremendous amount of over building in the U.S. in the past decade that has been spawned by segmentation, and to that extent, its impact on the entire industry has upset the supply and demand balance. I truly believe the world is getting smaller, that globalization is more than just a trendy word. The lodging chains of the future will be those that are world players.<sup>2</sup> Hotel and restaurant chains have found that internationalization now means globalization.<sup>3</sup>

New opportunities have emerged in the last five years in many previously closed parts of the world, such as the former Soviet Union, the Eastern Bloc, and China. The July 1993 issue of *World Trade* earmarked hotels and restaurants as one of the best investment bets in Eastern Europe.<sup>4</sup> The Russian Federation, because of its vast natural resources, immense population, fascinating history, tourist interest, and potential wealth, is considered to be one of the brightest prospects for expansion by the hospitality industry. Their potential purchasing power has drawn the support of the Group of Seven Industrialized Countries (G7).<sup>5</sup> This could have a major effect on the bottom line in the 21st Century and beyond for both sides.

Initially, for many American hotel chains, international expansion was generally driven by the profit motive. Providing a home-away-from-home service to Western business people allowed growth and profit.<sup>6</sup> With the advent of *Perestroika* and the subsequent breakup of the Soviet Union, people from all over the world are traveling to Russia to develop business and reap the rewards. Tourism has increased dramatically. The hospitality industry is in the enviable position of being able to care for these people as their guests. A number of hotels (Sheraton, Finnair, Marriott), as well as some food service establishments (McDonald's, Pizza Hut, Baskin-Robbins), have been operating for quite some time.<sup>7</sup> Commodore Cruise Lines has plans to park one of its cruise ships in St. Petersburg as a temporary hotel over a three-year period beginning in 1993. Russians themselves are traveling more than ever due to the easing of restrictions. Their demand for quality travel and tour facilities and their appetite for fast food is growing.<sup>9</sup>

### **Many Areas Are Ready For Development**

Moscow has approximately 11,000 hotel rooms for foreign guests, while the need during peak season is nearly 45,000.<sup>10</sup> Overall, occupancy percentages average well into the 90th percentile.<sup>11</sup> Western hotel operators have concentrated on expanding into Moscow, St. Petersburg, and Kiev. Other possible expansion sites include seaside and mountain areas. The Black Sea and the Caucasuses are areas ripe for resort development. Intourist, the former official Soviet travel agency, is now privatized, and is looking for joint venture partners to invest hard currency in order to provide the amenities and style of service Westerners expect. The agency is implementing management systems to include reservation systems, communication networks, property management, employee training, and total quality management.<sup>12</sup>

The government wheels seem to be moving rather than grinding ahead as they once were. Minimal government involvement is required for joint ventures to be formed. New hotel deals that took two years to complete in 1989 now take less than two weeks.<sup>13</sup> Since January 1, 1991, foreign joint venture partners are allowed 100 percent ownership.<sup>14</sup> Although 3,500 joint venture firms were registered by the end of 1991, only 20 to 30 percent are currently viable. Eighty percent of German firms that attempted to open subsidiaries by 1991 have failed.<sup>15</sup> Russian Federation Prime Minister Chernomyrdin on a July 1993 visit to Germany said that although Russia's attractiveness to new investors was still "quite weak," new legislation permits foreign firms to acquire property for manufacturing facilities.<sup>16</sup> Taking into consideration that the country was just beginning to edge away from a socialist system to a semi-market economy, the success rate is not as poor as could be expected. For instance, in 1987 the Department of Commerce reported that eight out of 10 businesses in the U.S. failed. The people of Russia need to learn that there is no clear cut formulas for capitalistic success, even in America.<sup>17</sup>

Franchising has the potential to succeed in Russia because of its very nature: it offers a package of systems already in place for operating, training, marketing, and management. Franchisors have the capital and entrepreneurial skills bundled together with a proven product. Russians also have high regard for American-made products.<sup>18</sup> The failure rates of franchises are significantly lower than independent businesses. Statistics indicate that only an average of 5 percent fail in the U.S. during the first five years in business. Although the validity of these statistics has been challenged recently in Congressional hearings, it is generally accepted that the overall franchise success rate is greater than independent business development.<sup>19</sup> A 1990 survey of over 400 college students, the future entrepreneurs of Russia, indicated that franchising would be commonplace by the year 2000. The Russian people understand the concept of franchising because of the notoriety of McDonald's and Pizza Hut, although the majority completing the survey had never heard the word "franchise."<sup>20</sup>

### **Tourism Begins to Expand**

This part of the world is a new international travel frontier. In addition to business travelers, there are adventure and educational travelers. In the move toward privatization and the great need for hard currency, the military is converting transportation equipment, such as cargo planes and helicopters, for tourism use. Unreachable places are quickly becoming accessible.<sup>21</sup> However, a number of recent fatal airplane crashes have brought about major safety concerns.<sup>22</sup> A new joint venture airline, SLDA (Super Long Distance Airlines), is being formed with Boeing. The company intends to offer non-stop service to and from the United States, Canada, South America, Western and Southern Africa, Asia, Australia, and New Zealand. Tickets will be sold in hard currency for travel outside Russia, but in rubles for flights between the northern and far eastern regions of the resort areas.<sup>23</sup> The business is there. On a typical snowy weekend, approximately three million people, one-third of Moscow's population, leave the city to go cross-country skiing.<sup>24</sup> A Russian/U.S./Kazakh joint venture gambling casino has become a huge tourist success. It is the only casino anywhere between Moscow and Macau.<sup>25</sup>

A recent article in *The Economist* tagged Russia as, "a country stumbling toward stability."<sup>26</sup> It is attempting to control hyper-inflation, despite the recent ruble crisis. Privatization has been roaring ahead. At least a third of heavy industry and almost all small firms are now private. The creation of all these private firms will help calm fears of disintegration because the trading links will bind the country together.<sup>27</sup>

There are four main reasons that political conditions are likely to stabilize. First, the new Constitution should add some stability for the government and the pro-Yeltsin forces. Second, the central bank has agreed to stick to tight monetary policies. Third, the Tokyo Summit of the Group of seven largest industrial countries (G7) produced a handsome sum of foreign aid. A large portion of the aid will go to Western

exporters. Lastly, the timing is right. The parliament should lend its support to the reform.<sup>28</sup>

*Perestroika* did not just happen. It was grounded in more than 15 years of research with in-depth computer simulation experiments. Economists from the Soviet Academy of Sciences, Gosplan (the former Soviet planning agency), and Moscow State University simulated the effects of decentralized management, free-market prices, flexible wages, profits, incentives, financial markets, and a convertible ruble on the economy. Studies were undertaken on how worker productivity, absenteeism, and turnover would be affected by the introduction of participatory management.<sup>29</sup> Major economic change could not take place without political change occurring.<sup>30</sup> Blueprints for dismantling the institutions of central planning were published in 1991.<sup>31</sup> The perception that change “just sort of happened” in Russia is not true.

The laws governing business are constantly being fine-tuned. This can discourage even veteran investors. Business is personal in Russia; knowing whom to go to can make or break a transaction.<sup>32</sup> A number of U.S. law and accounting firms specializing in joint ventures have branches located right off Red Square in Moscow.<sup>33</sup> They help Western firms establish joint ventures as well as meet the ever-changing regulatory requirements that occur on a national and local basis. Companies organizing trade summits offer some similar services, but specialize in publicizing opportunities and matching joint venture partners.<sup>34</sup>

### **Status of the Ruble Is a Problem**

The instability and inconvertibility of the ruble is a major hurdle for investors. Non-convertibility makes getting profits out of the country a major task. A “direct generation” of hard currency has been suggested as a partial solution to this problem. A firm has two options under this plan: to manufacture a new product that is competitive on the world market, thereby physically increasing the hard currency stock of the country, or to form a company that attracts additional hard currency assets to Russia.<sup>35</sup> An example of the latter would be the Savoy Hotel in Moscow which operates at 90 percent occupancy and accepts only hard currency.<sup>36</sup> The petroleum and mineral industries would be examples of the former.

McDonald's spent 14 years working out arrangements for entry into Russia. They reinvest rubles earned at the restaurant into businesses primarily patronized by hard currency customers and are buying additional sites with rubles.<sup>37</sup> They now have three locations operating in Moscow. McDonald's also set up its own processing and distribution systems internally. All payments are made in rubles.

Banking can also be a challenge. However, the system is in the process of improving. Currently only one Moscow bank controls international monetary transactions. Radisson Hotel transferred \$500,000 and the bank lost it for six weeks. Checks are not used, but individual purchase orders require numerous signatures from bank personnel.

Radisson was told money could only be withdrawn twice a month, so no more than two purchase orders would be allowed per month.<sup>38</sup> The banking system is in the process of improving with the voluntary aid of many visiting finance professors and bankers. In Spokane, Washington, a number of banks banded together to sponsor an exchange with the bank of Tver for educational purposes. Tver is located 90 miles northwest of Moscow and has a population of 500,000.

### **Ecology Is Another Issue**

The magnitude of the environmental problems in Russia (e.g., Chernobyl), have produced a broad-based green movement that the hospitality industry needs to address. Environmentalist movements have started in virtually every city, involving both local and central governments.<sup>39</sup> Citizens are frustrated but active. The hospitality industry has the opportunity to be at the vanguard of environmentalism. The Russians' latent, well-founded environmental concerns could be tapped and combined with Western technology and environmental systems in house. Sharing simple recycling and cleaning techniques with hotel and restaurant employees will improve morale and have a long-term effect on public relations.

Russia has the airports, roads, cabs, utilities, and transportation necessary to support tourism. However, what exists is badly deteriorated, inefficient, and unreliable. Some estimates indicate that 25 percent of all goods are lost in transit. Rebuilding and effective management and maintenance are necessary, and managers must be innovative and patient. McDonald's of Canada spent approximately \$40 million to open McDonald's in Moscow, much of which was earmarked to deal with these infrastructure challenges.

The educational system is responding to the need to learn about business on all levels—in secondary schools, trade schools, and universities. The first two years at the Moscow Commercial Institute are devoted to the study of general business.<sup>40</sup> Throughout the Russian federation, classes are now offered in sociology, psychology, and management, most of which were previously banned. Individualism is being encouraged.<sup>41</sup>

A number of American universities have established satellite programs as well as joint programs with Russian universities. The Department of Commerce sponsors a program called "Sabit" that enables Russian managers to attend practical training courses at U.S. firms for six months. On-site corporate orientation and training is being utilized by a number of hospitality firms. Radisson hired 25 core department heads and brought them to the U.S. for two months of hands-on training before the hotel opened in Moscow; managers were cross-trained in all departments.<sup>42</sup> The ability to travel and learn how other hoteliers run their properties often helps the pupil as well as the teacher, according to *Hotel* magazine. Hyatt Hotels, at the request of the Russian government, set up a traveling training program for hotel and tourism managers. The seminars included extensive training on

customer service, quality control skills, front office management, food and beverage preparation, quality assurance, customer relations, and service. Attendance was high and the participants showed a genuine interest in learning.<sup>43</sup>

### **Service Mentality Progresses Rapidly**

The service mentality is gradually growing in Russia. A Marriott Corporation manager believes that Eastern Europeans have a "my home is your home" philosophy, and he finds them warm and gracious to visitors.<sup>44</sup> Others have found that the level of service is quickly progressing toward acceptable standards. Managers are introducing Western amenities, training and reward systems, and service techniques in their hotels with great success.<sup>45</sup> The old rewards of recognition by a plaque or the employee's picture on the wall are now being successfully replaced with financial, as well as non-financial, incentives. The results have had a positive effect on employee productivity.<sup>46</sup> Currently workers and managers receive a sizable bonus, equivalent to one month's pay, for meeting established goals.<sup>47</sup> Bonuses are also given for showing up on time.<sup>48</sup>

The need to maintain control in order to guide development created a centralized political and economic structure in the former Soviet Union. Information flowed up and commands came down. This structure, in part, caused the long term deterioration of the economy in Russia. This highly bureaucratic structure imposed constraints on workers and directors at all levels. It sorely limited information to decision makers and inhibited lower-level directors from responding to problems and implementing directives.<sup>49</sup> Flexibility was lost.

Hotels in Russia are similarly structured to the hotels in the United States. Departmentalization is comparable and allows for flexibility.<sup>50</sup> For example, the Hotel St. Petersburg has 1,000 rooms (of which only 400 are available for occupancy) with all of its functions identical to properties of the same size in the United States.<sup>51</sup> Employees in Russian hotels are organized around a work brigade comprised of a single department on one to three floors of the hotel. They are extremely loyal to their work group and leader. Communication between groups has been minimal because of low levels of trust in the old Soviet system. Hospitality managers are aware that this has to change to a team approach to encourage cooperation.<sup>52</sup>

Cross-cultural communication presents perhaps the biggest challenge for American management.<sup>53</sup> Recognition of these differences is essential at all stages of joint venture activity.<sup>54</sup> Evidence suggests that over time the cultural differences become less important as trust builds in these ongoing relationships.<sup>55</sup> For example, Russians are known to be hard bargainers. They are generally more cautious and deliberate in negotiations. Therefore, negotiations usually last longer. Be well prepared and be willing to explain your stance. It is not time but timing that makes a difference. The price of impatience is the frus-



tration of an unexpected disappointment. Americans are most concerned with how quickly a project will be completed and become profitable. Time was not as critical in the former Communist system. In the West time is money, while in Russia time makes money.<sup>56</sup>

Russians are apt to be less verbal in a group than their Western counterparts. Generally, they are more open on a one-to-one basis. This is partially due to a history of verbal repression and cultural differences. They will participate in consensus building, but it is usually toward the end of a long process.<sup>57</sup>

### **Communication Styles Are Similar to U.S.**

Managers use a face-to-face communication style. Similar to the West, they know what is going on by walking around and being visible throughout the firm. An observational study of Russian factory managers at all levels found that they did the following in order:

- traditional management activities of planning/coordinating, decision making/problem solving, and monitoring/controlling performance
- communication activities of exchanging routine information and processing paperwork
- human resources management activities of motivating/reinforcing, managing conflict, staffing, and training/developing
- networking activities of interacting with outsiders and socializing/politicking<sup>58</sup>

From a cross-cultural perspective, it is interesting how closely the activities of the Russian factory managers parallel the comparable study in the United States. The successful Russian managers spent the most time networking, while the effective Russian managers spent the most time communicating. Networking made the biggest contribution to U.S. managers' success, while communication made the biggest contribution to their effectiveness. What real managers do in the U.S. is extraordinarily comparable to what they do in Russia.<sup>59</sup>

Russian hotel managers in two studies were found to be well informed, articulate, hospitable, and busy. They had comparable responsibilities to Western managers, including hiring and firing. They could award bonuses, set room rates, and retain half of all excess hard currency earnings for internal use, such as employee training and remodeling.<sup>60</sup>

Russia offers believable challenges as well as opportunities. The risk is great but so are the possibilities. Five years from now the conditions may be somewhat more predictable. By then the hospitality industry pioneers will have already established an advantageous position in the Russian marketplace. History has shown the importance of getting established in a country early and learning how it operates. These pioneers have already been successful. The odds are not impossible, and the obstacles can be overcome with patience, fortitude, and optimism.

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**Note:** The researchers would like to thank Jeffrey R. Ronan, University of Guam, for his invaluable help and assistance.

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