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Quantifying the Impact of Inflexible Cost Structures in The Horeca Industry

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ABSTRACT

This passage explores a cost phenomenon known as "sticky costs." These are expenses that rise disproportionately when business activity increases, but don't decrease as readily when activity slows down. This can lead to a gradual accumulation of hidden costs, especially in the hospitality industry (hotels, restaurants, and catering).

Traditionally, cost behavior is analyzed by comparing growth in overhead costs (selling, general, and administrative) with revenue growth. Recent research has revealed factors that influence the "stickiness" of these costs, including management practices, regulations, and company culture. Notably, the dependence on past decisions seems to be a key factor in reducing cost stickiness. This can vary depending on a company's size, governance structure, and ability to make costs more flexible.

This paper delves into the most significant attributes affecting sticky costs. It then explores real-world applications of managing these costs in the hospitality industry, using Goa as a case study. The research employs qualitative methods with ATLAS.ti software to uncover key insights.

KEYWORDS

Cost Management, Overhead Costs, Qualitative Research, Uncertainty in Business (VUCA)

RESEARCH PAPER

Introduction

Goa is the crown of India. Its hospitality industry (hotels, restaurants, and catering) thrives on a combination of exceptional service, a rich historical tapestry, and breathtaking natural beauty. These elements create a seemingly foolproof recipe for economic success.

However, beneath the surface lies a complex challenge. Goa faces fierce competition from other world-class tourist destinations vying for the attention (and wallets) of high-end travelers. This constant pressure compels HoReCa businesses to continuously elevate their offerings.

Private business owners in Goa find themselves caught in a vice. On one hand, they must cater to the ever-increasing demands of a sophisticated clientele. On the other hand, they grapple with a growing web of regulations that add to their operational burdens. This relentless squeeze on profits often leads to difficult decisions, with deferred investments in maintenance and upgrades becoming a common coping mechanism.

While cost pressures are readily acknowledged, a more granular understanding of the situation is crucial. This research delves deeper, examining the specific ways in which rising business activity (measured by revenue) correlates with increases in long-term fixed costs.

In simpler terms, the study will explore how growth in revenue impacts the level of fixed costs that HoReCa businesses in Goa have to shoulder over the long haul. Are these fixed costs rising proportionally with revenue, or are they outpacing revenue growth, creating a financial strain?

By understanding this relationship, the research aims to shed light on the underlying cost dynamics within Goa’s hospitality sector. This will provide valuable insights for businesses in navigating the delicate balance between growth, cost management, and maintaining high standards to attract discerning tourists.

This research employs a well-established qualitative method called Grounded Theory to uncover the forces driving the seemingly contradictory state of Goa's hospitality industry. Some studies, like Cerovic et al. (2014), suggest a lack of innovation hinders the region. Conversely, Slivar (2016) points to a focus on "innovation as a priority" driving new tourism products. This contrasting information suggests a critical issue worth exploring further.

The apparent contradiction might stem from a phenomenon known as "sticky costs." This term, coined in financial management circles (Sorros et al., 2013), describes how costs incurred in the past can be difficult to reduce, even if the original justification for them no longer applies. Studies like Cheung (2018) provide ample evidence for this phenomenon.

However, a key question remains unanswered: How do HoReCa business leaders in Goa grapple with sticky costs? This research aims to provide a qualitative answer through an inductive approach. Based on the findings, an "abductive research hypothesis" will be formulated. This hypothesis can then be tested in further research to confirm or reject its validity. The following sections of this paper will delve into the methodology used, the research results, a detailed discussion, and ultimately, the conclusions drawn from this investigation.

Methodology

This research utilizes Grounded Theory, a well-established qualitative approach. This methodology aims to develop a "mid-level theory" that explains real-world situations based on collected evidence (observations and data).

Grounded Theory ensures the resulting theory aligns with the collected data (Orlikowski, 1993; Eisenhardt, 1989). It guides every step of the research process: data collection, coding rationale, category integration, data abstraction, and ultimately, theory construction. The final theory is "grounded" in the evidence itself.

While traditionally applied in healthcare research (Hughes & Wood-Harper, 1999), Grounded Theory has gained traction in business management (Boadu et al., 2015). It allows for fresh perspectives on existing quantitative explanations.

In this study, Grounded Theory will be used to explore how HoReCa businesses in Goa manage "sticky costs." This iterative process involves continuously challenging concepts with data and vice versa. By constantly scrutinizing the evidence, a robust conceptual framework will emerge, ultimately leading to a mid-level theory explaining the phenomenon of sticky costs in this specific context.

The arguments presented in this paper will be built upon the concepts, categories, and ideas generated through the Grounded Theory process. Additionally, ATLAS.ti software will be employed to organize and analyze the qualitative data collected during the research. This software facilitates multi-layered coding, allowing for the creation of core categories and a comprehensive understanding of the phenomenon.

This research utilizes a six-step approach to develop a theory grounded in evidence, specifically focused on understanding how HoReCa businesses in Goa manage sticky costs. ATLAS.ti software facilitates the iterative nature of this process, allowing for continuous refinement.

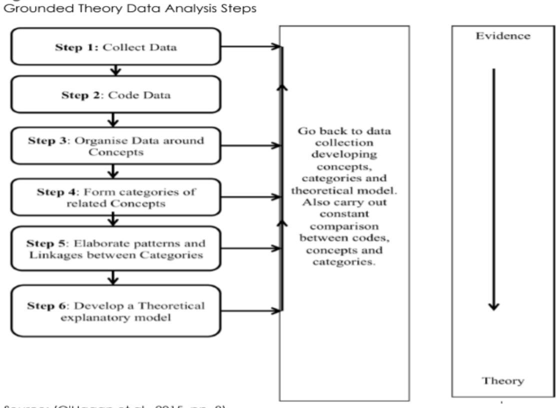
Twelve qualitative interviews were conducted with key decision-makers in Goa's hospitality sector, primarily directors of major resorts. A standardized interview guide (not shown for brevity) ensured consistent and comparable data collection.

Early interviews revealed a recurring theme: the impact of VUCA (volatility, uncertainty, complexity, and ambiguity) on business decisions related to sticky costs. However, the research delved deeper to gain a more nuanced understanding, as explained in the results section.

Insights from Interviews

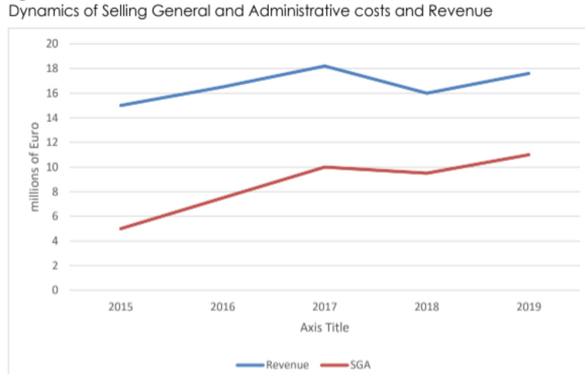
Twelve qualitative interviews were conducted with HoReCa leaders in Goa. The "saturation point" was reached after eight interviews, meaning no significant new information emerged from subsequent conversations. This indicates a strong foundation for the qualitative analysis.

Figure 1
Grounded Theory Data Analysis Steps



Source: (O'Hagan et al., 2015, pp. 8)

Figure 2
Dynamics of Selling General and Administrative costs and Revenue



Source: Authors' illustration

Anonymized example of a local HoReCa facility. It reveals a concerning trend: Selling, General, and Administrative (SGA) costs rise faster than revenue in the initial two years. Notably, even when revenue dips in year three, SGA costs only decrease gradually. Finally, a revenue increase in year four is mirrored by a nearly parallel rise in SGA costs. This suggests a troubling characteristic of sticky costs - they tend to cling to the business regardless of activity level. Over four years, SGA costs climbed a staggering 120% compared to a revenue increase of just 17%. This example serves as a springboard for deeper analysis.

The interviews were transcribed and coded, revealing concepts that were then grouped into categories and sub-categories. Finally, a single core category emerged. Open coding identified initial concepts by meticulously analyzing the interview text. Axial coding then connected these categories, refined their characteristics, and reorganized the data to create a clearer picture of the findings. Selective coding culminated in the core category: "dependence on past performance." This concept has multiple layers, including the "corporate governance model" (established practices) and the "successful variolization of costs" (often at the expense of long-term sustainability).

Table 1
Concept – Categories – Core Category

Core Category	**Dependence on past performance**		
Sub-core Categories	Corporate governance model	Variablization of Costs	
Categories	External regulatory conditions	Managerial over-sight	Company culture
Concepts	Heritage Appearance National laws EU conformity GRI (Global Reporting Initiative) IFRS (International Financial Reporting Standards)	Transparency Objectivity Sustainability Long-term view Mid-term view Short-term view Short-term contracts Cost driver social media	Resources Leadership style Processes Organization Start-up mentality Maturity of organization Hire-and-Fire Development Training Sourcing (buying vs making)

Note: Result - The concepts are the qualitative aggregation of the interviews
Source: Authors' work

Further analysis led to the formation of three sub-core categories:

1. External regulatory conditions
2. Managerial oversight
3. Company culture

The first two sub-categories, in particular, contribute to the "silent" and progressive rise of SGA costs.

Based on this model, the research proposes a hypothesis: Sticky costs are primarily driven by a dependence on past performance within HoReCa businesses.

Strategies for Goa's HoReCa Businesses

This research investigated how HoReCa business leaders in Goa manage sticky costs. The findings reveal that past performance significantly influences how businesses approach this challenge. While external regulations are largely out of their control, there are opportunities for improvement within the realms of cost variolization and company culture.

Three practical strategies emerge from the analysis:

1. **Short-Term Contracts:** This strategy, applicable to staffing and services, falls under both managerial oversight and company culture categories. While short-term contracts offer a clear path to reducing dependence on long-term costs, they can foster a potentially damaging "hire-and-fire" mentality. Seasonal staff employment exemplifies this approach.
2. **Outsourcing:** This approach, aligned with practices in other industries (Krol, 2017), falls under the company culture category. It involves buying services instead of producing them in-house. While outsourcing may seem like a simple solution to reduce staff-related long-term commitments (e.g., using agencies), potential drawbacks include a loss of control over quality. Customer-tailored quality may be better managed through in-house development.

The discussion continues by analyzing the trade-offs associated with each strategy, providing a balanced perspective on their potential benefits and drawbacks for HoReCa businesses in Goa.

While outsourcing can be appealing, the reality is that managing legal aspects and ensuring quality control with external agencies can ironically lead to higher sticky costs.

Social media offers a promising approach (falling under managerial oversight) for attracting customers and securing better deals with suppliers. Hospitality platforms like Airbnb can help fill vacant rooms with a global audience. Conversely, online auctions allow businesses to find temporary bargains for supplies (spot business).

The discussion is further enriched by the perspective of a mid-sized hotel director. He argues that strategically leveraging sticky costs can be beneficial. Long-term employee contracts, for instance, can ensure stability and high-quality service. During off-seasons, these employees can be trained and involved in preparation for peak seasons. However, he acknowledges the practical challenges. Human resource departments might struggle to maintain full-time staff during slow periods, even with a part-time model, while others might resort to layoffs.

This example highlights the complexity of managing sticky costs. While cost reduction is a goal, factors like staff retention and quality service must also be considered.

Key Findings and Future Directions: This research explored how HoReCa business owners in Goa grapple with sticky costs. Three main categories of explanations emerged, with only the most significant elements detailed for conciseness.

While comparisons to other qualitative studies are recommended for a broader perspective, a lack of data from other regions currently hinders such benchmarking.

The research highlights the importance of corporate governance models and cost variablization strategies as key responses to sticky costs. Further investigation could delve deeper into the steps linking these categories. Additionally, a quantitative study encompassing the entire region would provide a more holistic understanding of the magnitude of sticky costs.

The study acknowledges limitations, primarily the relatively small sample size of twelve interviews. However, the rich insights gleaned from these conversations suggest a degree of serendipity, as all interviews consistently conveyed the core message: sticky costs are a challenge, but HoReCa businesses are adapting and learning to manage them.

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