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Strategic Alliances in the Hotel Industry

Abstract

[Excerpt] Strategic alliances are becoming an important form of business activity in many industries, particularly in view of the realization that travel and tourism companies are competing on a global field. In the words of one analyst, globalization mandates alliances.¹ In the travel industry, which is global by definition, we are witnessing the formation of global alliances between firms of different types (e.g., hotel firms with airlines) as well as by similar businesses (e.g., Marriott and New Otani). In this article, we will elaborate on the development of such alliances in the hotel industry and offer some implications for hospitality managers.

Keywords

hotel industry, market share, marketing, competitive strategy, strategic alliances

Disciplines

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Comments

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Strategic Alliances

in the Hotel Industry

Although strategic alliances have their pitfalls, a well-conceived alliance can offer both partners competitive advantages that they could not attain separately

by **Chekitan S. Dev**
and **Saul Klein**

STRATEGIC ALLIANCES are becoming an important form of business activity in many industries, particularly in view of the realization that travel and tourism companies are competing on a global field. In the words of one analyst, globalization mandates alliances.¹ In the travel industry, which is global by definition, we are witnessing the formation of global alliances between firms of

different types (e.g., hotel firms with airlines) as well as by similar businesses (e.g., Marriott and New Otani). In this article, we will elaborate on the development of such alliances in the hotel industry and offer some implications for hospitality managers.

Industry Environment

The key to prosperity in the current hotel-industry environment is growth. With the location-specific nature of the hotel industry, growth translates into greater market coverage, increased visibil-

ity, and greater opportunities for cross-destination marketing—in addition to the benefits of economies of scale and scope. Hotel companies continue to seek new ways to increase their market share in changing markets.

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¹Kenichi Ohmae, *The Borderless World: Power and Strategy in the Interlinked Economy* (New York: Harper Collins, 1990).

The first factor driving this push for expansion is globalization. In the United States, globalization is manifested as an increase in the number of customers from overseas² and greater acquisition of domestic hotels by international investors. Recent examples include the acquisition of Hilton International by Ladbroke (United Kingdom), Inter-Continental by Seibu Saison (Japan), Westin by Aoki (Japan), Ramada International by World (Hong Kong), and Motel 6 by Groupe Accor (France). Regardless of the location or ownership of a company, there is pressure on all hotel companies to become significant players in the global hotel business. For example, Choice Hotels' CEO Robert Hazard has indicated that global expansion is the ticket to Choice's future.

Another strong driving force for strategic alliances is heavy competition and low profitability. Despite the growth in demand of the 1980s, supply expanded even faster, leaving hotel occupancy rates to decline from 71 percent in 1979 to 61 percent in 1991.³ (The estimated break-even point is in the mid-60s.⁴) Driven by a need to gain greater market presence and market share, hotel companies have continued to acquire, convert, and build new properties.

Although there has been considerable consolidation in recent years, the hotel industry remains relatively fragmented. In contrast to the airline industry, where the top five companies control over 80 percent of domestic capacity, the top 12 hotel companies account for just over 50 percent of capacity.⁵

²PKF International, annual report, 1991.

³Pauline Yoshihashi, "Hotel Recovery Will Be a Late Arrival," *Wall Street Journal*, July 27, 1992, p. B1.

⁴Faye Rice, "Where the Bargains Are in Hotels," *Fortune*, April 20, 1992, pp. 91-98.

⁵Michael S. Morgan, Chekitan S. Dev, and Frank S. Chaing, "Service Market Structure and Strategic Groups," Cornell University School of Hotel Administration, 1992, p. 47.

Companies operating in a fragmented environment must seek growth and counter the diseconomies of scale associated with small market shares.⁶

While the pressure for expansion mounts, the industry's illiquidity creates problems in achieving expansion. With the unfavorable treatment being accorded to real estate by U.S. tax law and the dismal performance of most investors' hotel portfolios, the pool of capital available for hotel development has been severely restricted. The shortage of funds is not expected to ease in the near future, since lenders have been slow to return to making loans to the hotel developers.

Routes to Expansion

Hotel companies can expand in different ways. They can grow through internal, incremental means, but the process is slow and ties up considerable capital in facilities. Moreover, incremental expansion offers a company only a limited ability to respond quickly to either customer demand or competitive pressure. Companies can also grow by acquisition, a popular route in recent years. Ownership of several brands, however, may be unwieldy and compromise an organization's ability to respond to changing market conditions. Choice Hotels, which once offered a clearly diversified portfolio of hotel brands, has been having indigestion ever since it gobbled up Econolodge, Rodeway, and Friendship. Customers are confused about the positioning of the brands, and franchisees are concerned about the impact of having co-owned brands on adjacent corners. Likewise, franchisees of Ramada, Howard Johnson, and Days Inns are not certain that their best

⁶Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980).

interests are being served in the wake of Hospitality Franchise Systems' purchase of those brands. Moreover, recent acquisitions have not been free of legal entanglement. Bass Brothers has filed suit against Promus Corporation for unloading what Bass says is a non-performing asset in the form of Holiday Inn Worldwide. In another case, SAS reversed its partial purchase of Inter-Continental for financial reasons and because the two companies' operational procedures and corporate cultures did not mix well.

We think it is fair to conclude that the aggressive-acquisition strategy to grow market share has had mixed results. The challenge for hotel chains, then, is to find a way to maximize market coverage, while also achieving economies of scale and scope and minimizing capital investment.

One such methodology is to form alliances by which firms develop long-term relationships for specific purposes. Having full control of an asset does not necessarily mean it is being managed ideally. In fact, performance may be enhanced when one company compensates for another firm's weak points. Advocates of alliances argue that acting independently is usually more difficult, expensive, and time-consuming than acting collaboratively.⁷ To date, little systematic analysis of the benefits and risks of such collaboration has been conducted, and the particular characteristics of the hotel industry with regard to alliances have not been assessed.

Types of Alliances

Alliances are relationships between independent parties that agree to cooperate but still retain their separate identities. Still uncommon, alliances between hotel companies are beginning to

⁷Ohmae, p. 135.



emerge. There has been a longer history of alliances between hotel companies and other firms in the travel industry, such as airlines and car-rental companies. Alliances are akin to interpersonal relationships and may be categorized accordingly.

One-night stands. There are short-term, opportunistic relationships that have a limited focus—essentially, one-night stands. While each party receives some satisfaction through a clearly defined set of expectations, there is no commitment to the relationship. Hotels have engaged in limited promotions with other businesses, including cross-advertising and joint coupons. Between hotel companies, one example of an opportunistic alliance is the cross-selling agreement between Radisson Hotels and Britain's Edwardian Hotels.

Affairs. A second category is medium-term, tactical relationships, similar to affairs or liaisons. While such relationships are characterized by some degree of sharing and are clearly deeper than the short-term relationships, there remains a strong sense of self-protection among the partners, and the alliances' durations are limited. Hotels participate in such alliances with airlines in their frequent-flyer programs. Between

hotel companies, an example of a tactical alliance is the marketing-services agreement between Marriott and New Otani.

I do. The third alliance category is long-term, strategic relationships, the equivalent of marriages. The parties in these arrangements clearly expect continuity and mutual commitment. The level of sharing is high, and these relationships offer considerable opportunity for synergy. Strategic relationships are becoming common in industries other than hospitality, and hotel companies are beginning to follow suit. Competing computer giants IBM and Apple have formed an alliance, as have General Motors and Toyota and SAS and Continental Airlines. In many cases, such alliances are cemented by equity cross-investments. Alliances need not be confined to two parties. Sixteen of the largest hotel chains in the United States, for example, are cooperating in THISCO, The Hotel Industry Switch Company. THISCO involves a computer product aimed at giving travel agents more-direct access to member companies' databases of more than four million rooms worldwide.

The three types of alliances represent a hierarchy, in the sense that relationships can progress from a simple level to a more-

involved arrangement. Reversion to a lower level, however, is rare. Problems arise when the parties disagree as to what type of alliance they are consummating.

Only the strategic alliance offers companies the ability to respond to the pressures of global competition and illiquidity. Potential benefits include enhanced market coverage, both geographically and by segment; and greater economies of scale in advertising, sales, distribution, and purchasing; and complementary strengths in operations and marketing.

Benefits from alliances may be reflected on the cost or revenue side of a firm's business. Alliances intended to minimize costs aim to enhance efficiency by improving operations. On the revenue side, alliances aim to increase effectiveness by attracting more, higher-paying customers. We expect that strategic alliances will become the market-expansion strategy of choice in the hotel industry.

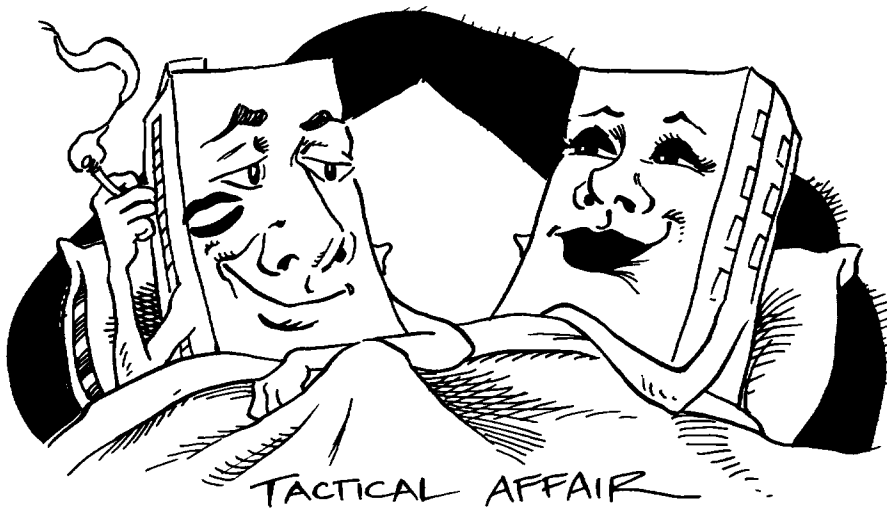
In theory, alliances allow firms to focus on their core strengths and offer a stronger product line with better market coverage. In practice, however, alliances are characterized by high rates of failure.⁸ An alliance-based expansion strategy carries risks, as divorce rates are high and the pitfalls are many (as explained in the next section).

Partner Selection

Choosing the right partner is a critical part of making an alliance work. Some writers argue that alliances between strong and weak partners rarely work; they fail to provide the missing attributes necessary for growth; and they lead to mediocre performance.⁹

⁸Michael Hergert and Deigan Morris, "Trends in International Collaborative Agreements," in *Cooperative Strategies in International Business*, eds., F.J. Contractor and P. Lorange (Lexington, MA: Lexington Books, 1988).

⁹Joel Bleeke and David Ernst, "The Way to Win Cross-Border Alliances," *Harvard Business Review*, November-December 1991.



Ascertaining that the partners offer complementary strengths is the key matter, but care must also be taken to find companies with compatible objectives and styles. Alliances raise the possibility of conflict between the partners and the risks of dependence on one another. They also bring about new problems in performance evaluation. It is often difficult to establish whose performance should be measured, to agree on the appropriate time schedule for evaluation, and to make trade-offs between partners' divergent interests.

Alliances invariably create tension. Would-be partners should be aware of the sources of that tension, its potential negative consequences, and possible coping strategies for dealing with the unavoidable by-products of alliances.¹⁰ Socio-cultural forces can create differences in perception and interpretation of phenomena. The chief reason for the divorce of Inter-Continental and SAS Hotels was a poor fit of corporate culture. SAS is an entrepreneurial-style company with a tiny executive staff and a flat organizational pyramid.

¹⁰Arvind Parkhe, "Interfirm Diversity, Organizational Learning, and Longevity in Global Strategic Alliances," *Journal of International Business Studies*, 22, No. 4 (1991), pp. 579-601.

Decision-making authority is left with the property GM as much as possible. On the other hand, Inter-Continental has a deep organizational pyramid, with several layers of executive staff. Decisions are generally made centrally. Those two cultures could not coexist.

To overcome sources of misunderstanding, both formal and cross-cultural training programs and extensive informal contacts must be maintained. Differences in home-country environments, as reflected in government policies toward cooperation, industry structures, and institutional support systems, create differences in expectations and experiences. Different corporate cultures, with unique ideologies and guiding values, may require alliance partners to restructure their norms and belief systems.

Differences in the strategic direction between partners may emerge from changes in their individual external or internal

environments. Selecting a compatible partner at one point in time is no guarantee that this will also be true in the future. Hilton Hotels (United States) and Hilton International worked together on sales and advertising efforts, but now the international company is suing the U.S. firm for going overseas under the "Conrad International" brand (despite the fact that Hilton International does business in the U.S. as Vista). Flexible partnership structures must be developed, either through a commitment to incrementalism or by building in

extra slack at the outset. On a functional level, because different management practices and styles and different organizational structures exist, authority and levels of dependence must be clarified. An alliance may otherwise become bogged down in



poor communications and slow decision-making processes.

Further research. Alliances are not a panacea for the hotel industry's current ailments. In fact, alliances can be difficult to manage and prone to failure if they are not thought out and negotiated in advance. Nevertheless, the use of alliances will grow in the future because the combination of strengths found in a well-arranged alliance will serve as an antidote to many of the industry's difficulties. We predict that an analysis of strategic alliances in the international travel industry that focuses on the issues of risks and rewards would confirm the value of such organizational partnerships. **CQ**