Abstract

Overtime, and with the advent of moving to asset-light, the companies in the corporate hotel industry have given up parts of the value-chain. This has enabled new intermediate markets to emerge which have divided a previously integrated production/service process and enabled sets of specialised firms to enter and for the industry to become vertically disintegrated. This paper examines the drivers, as well as the necessary conditions and enabling processes, which have facilitated this industrial change. For the major hotel companies, competing in a disintegrated industry has far-reaching consequences which have a spill-over effect on tourism education and research.

Keywords

Hotel companies, vertical disintegration, value chain, industry evolution

1. Introduction

The Economist very aptly describes the current business model of the corporate hotel industry:

> 'YOU book a room on the website of a famous international hotel chain. As you arrive to check in, its reassuring brand name is above the door. Its logo is everywhere: on the staff uniforms, the stationery, the carpets. But the hotel is owned by someone else—often an individual or an investment fund—who has taken out a franchise on the brand. The owner may also be delegating the running of the hotel, either to the company that owns the brand or to another management firm altogether. The bricks-and-mortar may be leased from a property firm. In some cases, yet another company may be supplying most of the staff, and an outside caterer may run the restaurants. Welcome to the virtual hotel.' (The Economist, 2009)

It has not always been this way. Previously, as well as designing and owning brands, hotel companies undertook the marketing, sales and distribution of hotels; owned or leased hotel buildings; managed hotels; oversaw day-to-day operations; employed all hotel staff; and owned or maintained strong links with suppliers. They were involved in all of the structured activities which taken together lead to the construction of a hotel experience for the consumer; in this they resembled large vertically integrated, horizontally diversified, managerially-directed 'Chandlerian' corporations (Lamoreaux, Raff & Temin, 2004; Langois, 2003).

This paper is focused on the largest hotel companies – the corporate hotel industry - the top ten of which; all operate internationally, together account for some 89 brands and are listed on stock exchanges globally.

- Take in Table 1 about here –

Overtime, and with the advent of moving to asset-light, companies have given up parts of the value-chain, as described above. This has enabled new intermediate markets to emerge which have divided a previously integrated production/service process and enabled sets of specialised firms to enter the industry (Jacobides, 2005). It is argued that the industry has become vertically disintegrated. Disintegration can be observed in a significant number of industries, as producers recognize that they cannot themselves maintain cutting-edge technology and practices in every field required for the success of their products and services (Gilson, Sabel & Scott, 2009); for hotel companies, competing in a disintegrated industry has far-reaching consequences which then have a spill-over effect on tourism education and research. This paper examines the drivers, as well as the necessary conditions and processes, which have facilitated this industrial change. These are summarised in Figure 1.

- Take in Figure 1 about here -

2. Motivating factors driving disintegration

It is said that doing everything in the value chain reduces the effectiveness of production. Surrendering parts of the value chain to other firms, enables specialisation gains (Jacobides, 2005). For major hotel companies, competing now as experts in hotel branding, systems and franchising (and sometimes managing) rather than in hotel-keeping has meant less exposure to high risks, better returns and faster growth for major hotel companies. The stock market has favoured this narrower business model and shareholders have received large dividend pay-outs from property asset sales (Slattery, Gamse & Roper, 2008).

Technology companies are said to precipitate a change in vertical structure insomuch as they change information or modularize a production process (Jacobides, 2005). Online travel agents (OTA's) recognised the potential gains from a reorganisation of production – when hotel companies themselves modularised and computerised the distribution process. Hotel companies correspondingly supported latent gains in trade by embracing the business model of OTAs, especially when the hotel cycle was in a trough period. Specialised production is also incentive-intensive and the OTAs and metasearch platforms, as outside agents, have managed to be closer to the consumer market (and other linked services) and have been more effective.

Pure gains from trade can also play a significant role in disintegration. Franchised brands such as Holiday Inns are testament of how firm capability differentials push disintegration. Franchising is very attractive as a global growth method because it does not create future foreign competitors over time that come back to compete in domestic economies. The franchising of global hotel brands can therefore be seen as a way of curtailing national competitors in international markets, a by-product of gains from trade.

Other new entrants who have benefited from the disintegrated industry structure include real estate and institutional investors who have sought to spread risk over a number of markets and property-types to reap benefits of demand smoothing. With the purchase of hotel properties, real estate investment trusts (REITs), in particular, have developed knowledge of this new property investment class and implemented very sophisticated performance monitoring and financial modelling techniques to maximise their investments in what they see as a pure property-play business. They have gained financially from disintegration in a way never possible by integrated hotel companies.

3. Enabling processes

The gains from intra-firm specialisation, talked about above, have also set off a process of intra-organizational partitioning, which simplifies coordination along parts of the value chain and drives disintegration (Jacobides, 2005). Overtime, and with the advent of moving to asset-light, hotel companies have partitioned their organization structures, as such having different divisions for diverse entry modes. In the hotel companies investigated by Brookes and Roper (2012), organisational designs featured the administrative separation of (1) owned, leased and managed, (2) franchised, and (3) master-franchised hotels. In the last two divisions, transactions were with outside agents rather than with other internal divisions. Their market procurement activities largely explained why there were cultural and perceptual distinctions between divisions. The fact that the performance of the different divisions could be assessed has also led to financially-driven decisions being made to exit parts of the value chain; to get out of owning and leasing and acknowledge the cash flow benefits of the franchise model.

A second enabling process for disintegration - vertical co-specialisation - emerges as firms come up with mutually complementary roles in market transactions (Jacobides, 2005: 484). Organizing transactions across the boundaries of firms takes time however; it is a gradual learning process. It is possibly for this reason that the industry is at its most disintegrated currently even though the separation of the ownership, management and operation of hotels from brand management have been in evidence since the early 1940s. Further, the economic, legal and political contexts have also influenced knowledge about innovative ways to transact. For example, the economic recession pushed transactions to occur and then mature between hotel companies and OTA's. The regulatory set-up of REITs and the outward investment strategies of trophy wealth funds and property companies led to sale-and manage/franchise-back market exchanges. Even the fact that customers are thought to patronise a franchise due to its brand reputation in the marketplace and the implicit promises of a standardised product or service offering, regardless of who the operator of a specific franchised outlet might be (Dant, 2008), can be said to have further driven the growth of franchise systems and the need to transact across the boundaries of existing hotel firms. In addition, supplementary stakeholders have emerged with important roles in making these transactions across the boundaries of firms possible. Specialist lawyers, accountants and consultants have become established offering services which create and augment business relationships between the many agents involved in the hotel value chain.

4. Necessary conditions

Given standardised information and simplified coordination, it is suggested that new intermediate markets emerge which break up the chain, allowing new types of vertically specialised firms to participate in an industry (Jacobides, 2005).

Governments have long taken ownership positions in internationally-branded hotels, beginning when InterContinental and Hilton Hotels choose to expand outside their home market. For the latter, managing enabled the reduction of risk and opened up opportunities to develop in countries where ownership was restricted. More importantly, the establishment of management contracts prompted the emergence of a more formulaic method for operating hotels. This was important to establish: far-off hotel managers needed controlling and hotel owners required tangible evidence of managerial competence. The very first operating agreements were therefore underpinned by procedure manuals and training programmes, covering all aspects of hotel operations. However, it was the advent of franchising which really enabled a more industrialised model of hotel keeping to emerge which served to further fragment the value chain.

Franchising requires the highest level of standardisation and replication and the issue of control is paramount as it is external parties who are managing and operating hotels on behalf of hotel companies. Control is gained by the latter through legal contractual stipulations (usually fee structures, termination clauses and restrictions, territory rights and adherence to operating manuals) and administrative control which is usually exercised via operational processes used to achieve goal congruence between the two parties and the processes used to monitor adherence to them (Brookes and Roper, 2012). These controls are administered through the system's format facilitators: the wide range of policies and procedures that form the foundation for the format's effective and efficient functioning. At the individual level they include specification of equipment and detailed operating instructions. Thus, the whole operation and management of hotels has become codified -– simplified, transmissible and more universally understood allowing for the modularisation or commoditisation of the value chain.

Coordination between firms in this disintegrated industry and the standardisation of information has also been facilitated by a wealth of specialist legal, financial and consulting firms who have been able to assist new entry firms to do business successfully. They have developed, for example, standard contractual agreements and templates and made available (often free of charge) sources of comparable hotel performance data.

5. Conclusions

The original products, services and core technologies of the hotel industry have remained much the same and the sequence of activities needing to be done has also not changed radically. However, there have been profound implications of disintegration amongst the major hotel companies: the number and nature of firms that participate in the industry has increased; entry to the industry has fallen in certain parts of the value chain; and the nature of competition has altered.

Competing in a disintegrated industry has far-reaching consequences, with a spill-over effect on tourism education and research:

- For the major hotel companies, scale is needed as specialist brand and franchise systems. However, the hotel industry globally still remains largely fragmented in the hands of independents. The model of relying on these independents and outside investors to increase market share is therefore challenging; CEOs in Starwood, ACCOR and Four Seasons have all lost their jobs as a result of lagging growth. There have been calls from activist investors for mergers between the largest companies in order to accomplish more scale and better growth prospects. There is therefore an enhanced level of vulnerability in firms competing in this disintegrated value chain.
- There is no doubt that disintegration will continue with new markets opening in the very heart of the value chain – in hotel supply. Alternative accommodation types and those experiences offered by the sharing economy could further separate the hotel value chain.
- In terms of tourism management education, we need to develop a new generation of corporate managers who can develop and maintain relationships, globally network and manage in a federal way. We need graduates with competencies in 'the business of hotels' rather than operations. In research, we need to engage much more with this new competitive landscape, exploring further the firms in new intermediate markets and building theory based on practice (Roper & Hodari, 2015).

One cannot end without mentioning a worrying trend. Returning to The Economist piece at the start of this paper, hotels are ultimately selling a hospitality experience, however, one is sometimes left searching, without success, for the mention of the 'guest' in the reports of the incumbents in this emerging disintegrated industry. The 'virtual hotel' of the future might be just that in terms of dehumanisation.

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Table 1: 10 largest hotel companies by number of rooms, 2014

Ranking	Hotel Company	Origin	Hotels		Rooms		Brands (2015)[i]
			2014	2013	2014	2013	
1	InterContinental Hotels Group	UK	4,840	4,602	710,295	675,982	9
2	Hilton Worldwide	USA	4,278	3,992	708,268	659,917	11
3	Marriott	USA	4,044	3,672	692,801	638,793	
4	Wyndham Hotel Group	USA	7,645	7,342	660,826	627,437	15
5	Choice Hotels Intl	USA	6,379	6,199	505,278	497,023	11
6	ACCOR	FRA	3,717	3,515	482,296	450,199	16
7	Starwood Hotels & Resorts	USA	1,222	1,121	354,225	328,055	10
8	Best Western	USA	3,931	4,013	303,522	307,305	6
9	Home Inn	CHN	2,609	1,772	296,075	214,070	3
10	Carlson Rezidor Hotel Group	CAN	1,092	1,077	172,234	166,245	8

Source: Companies reported data from 2014, accessed from The 2015 Big Brands Report, Hotels News Now: http://hotelnewsnow.com/media/File/PDFs/Misc/BIG%20BRANDS%20REPORT%202015_compressed.pdf

[i] Companies reported data from 2015