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RING THE CHANGES

The industrial evolution of the corporate hotel industry

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The value chain of the corporate hotel industry has become restructured, such that different stages are controlled by different firms, rather than being vertically integrated within the boundaries of individual firms. This article examines the industrial economic drivers that have facilitated this change.

The hotel industry is currently in a 'golden era' of growth and development. Major hotel chains are undergoing unprecedented growth as a result of voracious demand, currently having the largest development pipelines in their histories. Whereas previously only a few luxury hotel brands – such as Hilton and Intercontinental – were seen internationally in capital and gateway cities, the explosion of the economy and mid-market segments has led to some of these brands nearing one million hotel rooms mark globally. We have also just witnessed the biggest and, arguably the most important takeover in the industry so far, with Marriott International's acquisition of Starwood Hotels & Resorts Worldwide for over $12 billion creating the world's largest hotel chain.

At the same time, the leading hotel chains are experiencing challenging times. They are opting to get out of hotel ownership and are also being pushed to relinquish the operation of hotels. Added to this, in the booking process, hotel chains are surrendering some of their direct access to customers to online travel agencies. They are also losing their supply dominance to alternative accommodation sectors such as hostels, short-term home rentals, timeshare and cruises. There are three million listings on the Airbnb platform and this is on the increase.

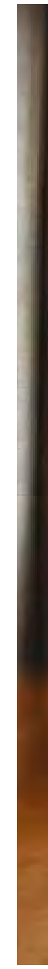
As a competitive response what is being witnessed is hotel chains giving up parts of their value-chain, enabling new intermediate markets to emerge, which has divided a previously integrated production/service process and facilitated the entry of sets of specialised firms. In terms of industry structure, the corporate hotel industry (that part of the industry which is organised and comprises hotel chains) has become vertically disintegrated (Jacobides, 2005). Disintegration can be observed in a significant number of industries, as producers recognise that they cannot themselves maintain cutting-edge technology and practices in every field required for the success of their products and services (Gilson, Sabel and Scott, 2009).

What have been the drivers that have facilitated this industrial change? What are the consequences of this industrial evolution for management education and research?

Setting the scene

Tourism is the fifth biggest industry globally. The United Nationals World Tourism Organization (UNWTO) estimated that there were more than 1, 235 million international tourist arrivals worldwide in 2016, an increase of 46 million over the previous year. The global hotel industry comprises an estimated 15.5 million rooms and generates revenues of 550 billion U.S dollars (Hospitality, 2015). The global demand for hotels is insatiable, with new hotel openings every day. Independent hotels are still dominant on the accommodation market but they are suffering decline, having to operate ever-higher standards and to be digital entrepreneurs. It is branded hotels that have therefore experienced the most growth, now accounting for almost a third of the global market. The developed hotel markets of Europe and North America are the centre of the hotel universe (Slattery, 2012) in terms of supply and demand.

In line with many other industries, chains are now one of the dominant forms of organisation in the hotel industry; a single chain often having hundreds – even thousands – of units operating under a common trademark in diverse locations. The table below illustrates the size of the ten largest hotel chains globally.



Whilst hotel guests have experienced a profound upward improvement in the facilities of chain hotels over the past twenty years or so, what has probably gone largely unnoticed is the fact that the ownership, operations and brand trademarks of hotels have become separated and are often times in the hands of very different organisations. *The Economist* (2009) very aptly describes the current business model of the corporate hotel industry (that part of the industry which is organised and comprises hotel chains):

> 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)

The picture painted above of the 'virtual hotel' is perhaps an extreme scenario, but what it does illustrate is how overtime hotel chains have given up parts of the value-chain and this is a strategy which continues today. Previously, as well as designing and owning brands, chains undertook the marketing, sales and distribution of hotels; owned or leased hotel buildings (with internally generated capital or loaned finance); 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. With the exception of some chains, this is no longer the case.

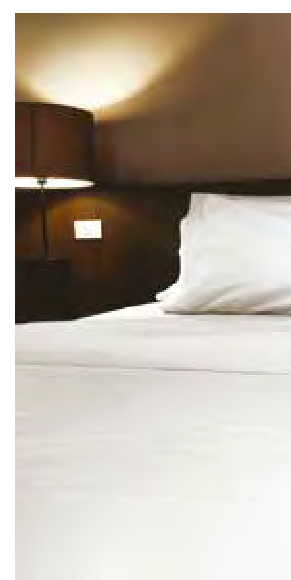
Relinquishing parts of the value chain has enabled new businesses to emerge that have divided a previously highly integrated production/service process into a number of profitable sub-business units. Specialist firms have entered the marketplace resulting in an industry which is becoming increasingly vertically disintegrated with a lot of opportunities for service providers and business transformers.

It is contended that for the corporate hotel industry, there have been profound implications of this structural disintegration: 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 greatly altered (Roper, 2015). So what have been the main drivers or motivations for this changed industry structure and what might the future hold in terms of industrial evolution? Key strategic drivers include gains from specialisation, pure gains from trade and co-specialisation and technological advancements.

Ranking	Hotel Chain	Origin	Existing Hotels		Total hotels after pipeline openings	
			Hotels	Rooms	Hotels	Rooms
1	Marriott International (including Starwood Hotels & Resorts)	USA	5,456	1,071,096	7,557	1,444,096
2	Hilton Worldwide	USA	5,456	737, 922	6,035	997, 922
3	InterContinental Hotels Group	UK	4,480	726, 876	6,282	944, 585
4	Wyndham Hotel Group	USA	4,963	671, 900	8,670	784, 700
5	Jinjiang International	CHN	7,760	640, 00	N/R	N/R
6	Choice	USA	6,000	504, 357	7,017	N/R
7	ACCOR	FRN	6,379	500, 366	N/R	662, 366
8	Best Western	USA	3,815	303, 768	4,393	352, 308
9	Home Inns	CHN	3,903	311, 608	3,022	N/R
10	Carlson Rezidor Hotel Group	USA	1,092	172, 234	1,372	222, 384

TABLE 1: Reproduced with permission from T*he 10 largest hotel companies by room count* (2015) accessible online: http://www.hotelnewsnow.com/Articles/28560/The-10-largest-hotel-companies-by-room-count

InterContinental Hotels Group and Marriott International now own less than one per cent of their hotel portfolios, enacting what is known as 'asset light' strategies. For them, this has resulted in faster growth, scalability, more scope for efficiency gains and improved stock market valuations



Specialists vs. generalists

It is claimed that doing everything in the value chain reduces the effectiveness of production (Jacobides, 2005). Bearing this in mind, the major hotel chains have chosen to compete now as experts in hotel branding, systems and franchising rather than be involved in everything in the hotel-keeping value chain. Most significantly, their preferred strategic choice is to do business without the ownership of the pillar with the most value – the ownership of the bricks and mortar of hotel properties. For example, InterContinental Hotels Group and Marriott International now own less than one per cent of their hotel portfolios, enacting what is known as 'asset light' strategies. For them, this has resulted in faster growth, scalability, more scope for efficiency gains and improved stock market valuations.

They have been able to choose not to own hotel property due to the sheer volume of investment which has been driven into hotels – in terms of equity and debt – which has allowed hotels to become a tradable item running on a longer term cycle. This has brought in a whole raft of other investors who are more institutional and more aligned with broader property investment markets.

Investing in hotel real estate assets is now a serious asset class in its own right and has allowed a symbiotic relationship to develop between those who wish to park significant capital chunks and those who wish to be part of rolling out significant hotel assets worldwide. This clearly would not have been possible if the old 'own-and-operate' hotel model had stayed in place; roll out would have been much slower and traditional capital markets would have been able to cope with the significant on-going demand from traditional stock market and banking sources alone.

The ready capital provided by new property entrants has also provided a catalyst to push disintegration. In addition, new hotel owners such as private equity houses, Real Estate Investment Trusts (REITs), institutional investors, sovereign wealth funds, private investors and family offices have subsequently developed a sophisticated knowledge of hotel property investing and have implemented sophisticated hotel monitoring and asset enhancement tools to profit from what can be a high percentage returning capital asset. These specific investors have benefitted in ways financially which was never possible previously and industry fragmentation has provided an investment platform that has allowed extra billions to flow into the hotel industry.

Increased trading opportunities

Franchising has proved increasingly popular over the years and is a great way of expanding quickly in conjunction with an asset light model. Essentially the hotel chains provide brand and operating know-how and the franchisee provides the property as owner, leaseholder and/or manager (the heavy lifting in terms of capital cost). The franchise concept has further fuelled the disintegration model now in place.

Whilst the very first operating agreements were underpinned by lengthy procedures, manuals and training programmes, covering all aspects of hotel operations, it was the advent of franchising which really enabled a more industrialised model of hotel-keeping to emerge which has served to further allow the fragmentation of the hotel value chain, whilst also providing specialisation gains.

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 (Dant, 2008),

regardless of who the operator of a specific franchised outlet might be, can be said to have further driven the growth of franchise systems. It is the growth of select-service and economy brands, in particular, which have resulted in significant growth in hotel chain portfolios because these appeal to mass markets. Franchised brands, such as Holiday Inns and Hampton Inns, are evidence of how firm capability differentials also push disintegration. These brands are workforce brands; they have the most potential to grow globally and there is evidence that they curtail national hotel chain competitors.

Co-specialisation

Vertical co-specialisation, the restructuring of industry-wide value chains, such that different stages are controlled by different firms, has emerged as firms come up with mutually complementary roles in market transactions. These ready 'business partners' prepared to co-exist and work together pre-knowing the boundaries of their responsibilities has allowed the industry to quickly fragment. There is no doubt surrendering parts of the value chain (the business operation) to other specialist firms enables significant gains in terms of cost and time saving and enhances experiences, at least when all goes well.

All this has led to gains being seen and easily recorded from intra-firm specialisations. These specialisations have given the industry an ability to organise itself along different lines from those previously and in itself led to further disintegration. One such example, predicated by the influx of new hotel owners, has been the emergence of a new breed of hotel management companies – known as third party managers. Interstate Hotels, BDL Redefine and Bespoke all act as 'white label' hotel management companies (they provide tailored management services without a hotel brand) working on behalf of owners, albeit juxtaposed with hotel franchise brands. As specialist managers they are said to be more operationally savvy and cost-focused and, most importantly, more aligned with individual hotel owner interests.

In addition, supplementary stakeholders have emerged with important roles in making these transactions across the boundaries of firms possible. Whereas previously, as major holders of assets hotel chains were a route to work, now specialist lawyers, real estate brokers, accountants and consultants have all had to adapt to offer services which create and augment business relationships between the much extended agents now involved in the hotel value chain (for example, more global and larger institutional clients, major REITs, insurance companies, pension funds and so on). They have provided coordination between firms in this disintegrated industry and a wealth of comparable data and advice which has assisted new entrants to do business successfully.

Technology as a driver of disintegration

Technology companies have been a major force in changing the traditional model. The emergence in the past 20 years of online travel agencies (OTAs) as a distribution partner has had a profound effect on the hotel industry. They have changed industry information and further modularised the hotel production process. OTAs recognised the potential gains from a reorganisation of production – when hotel chains themselves modularised and computerised the distribution process. Hotel chains similarly reinforced latent gains in trade by embracing their business model, especially when the hotel cycle was down. OTAs now account for well over one-third of hotel bookings.

Specialised production is also incentive-intensive and the OTAs and meta-search platforms (such as Kayak and Skyscanner), as outside agents, have managed to be closer to the consumer market and have been more effective. Customers have much confidence in them and they have been seen as a force for good, driving pricing lower as well as increasing overall customer demand. Leisure customers are thought to search a minimum of 38 online sites before booking a trip.

Whilst the relationship between these technology and hotel chains continues to develop and grow all the time it is pushing the latter to become even more focused on being brand, distribution and marketing companies, dedicated service providers (with expertise also in technology) rather than hotel owners and operators.

Conclusion

Although 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 for some 70 years, the structure of the corporate hotel industry is unrecognisable from a few decades ago.

However, whilst the largest chains, influenced by American hotel-keeping methods, have specialised into the areas they feel they are best at and outsourced other activities regarded as the traditional business model, the strategic picture is different for the nascent Chinese hotel chains now entering the top rankings. The HNA Group and Jinjiang International operate as a conglomerate, integrated tourism firms and are investing heavily in the hotel sector to be followed by an expectant surge in Chinese visitors worldwide. Working in a more centralised way, they may well push resurgence of the original integrated model and are worth watching. Chinese capital investment will continue to have a significant impact on the western hotel industry in coming years.

For those studying, researching and working in the sector the changes in the industrial dynamics of the industry are important to know and understand now, and for the future. The process of development is exciting, and holds many opportunities not only to take part in this evolution, but also to develop ways of further enhancing and improving upon the emergent model.

In terms of management education, the industry needs graduates with competencies in 'the business of hotels' rather than operations and individuals who are entrepreneurial and proficient relationship builders. Vertical disintegration provides opportunities for setting up specialist service companies that run individual sectors, becoming franchisees, carving out careers in a host of different corporations – as owners, advisors, brokers, third party managers, in addition to leading hotel chains into the future.

As a result of these mutations, researchers need to engage much more with this new competitive landscape, exploring further the firms in new intermediate markets in order to build theory based on real industry practice and not on out-dated notions of what the hotel industry used to be.

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