CHAPTER 10

Strategic alliances in the hospitality industry

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Introduction

Strategic alliances have been increasingly used by firms over the past three decades as a key source of competitive advantage (Chathoth and Olsen, 2003; Hagedoorn, 1996). Cooperative strategies have grown in importance as firms expand and innovate (Insch and Steensma, 2006). Firms have used the networking strategy to sustain their competitiveness and address the challenges they confront in their business environment. In order to address the business risks associated with investments, firms need to identify appropriate strategies to manage these risks and ensure that the strategies they implement result in long-term returns. This is even more the case in an international setting when the risk exposure of firms is higher. This is why alliances with international firms provide a basis to mitigate such risks.

An alliance as a strategy is viewed from the perspective of reduction of a firm's risk exposure in terms of environmental uncertainty (Burgers *et al.*, 1993; Dickson and Weaver, 1997). Networking can be seen as a strategy that helps companies share costs of risky projects (Harrigan, 1985) and at the same time, equip them to respond to environmental uncertainties (Burgers *et al.*, 1993). Moreover, alliances are effective in countering the effects of mature, low growth markets. In fact, it can be viewed as an organizational survival strategy (Staber, 1996) that can help firms reestablish themselves in their competitive domain.

Firms have realized the importance of using alliances as a key component of the competitive strategy development and implementation process. Environment scanning is also more effective through the use of alliances as a result of the access firms have to information. Since value-adding resources are scarce, firms have taken steps towards building strengths and addressing weaknesses through alliances. Networks with competitors, suppliers, and customers, have provided firms with the required strengths to compete more effectively (Lewis, 1990). Value addition through alliances is more viable as this strategy provides firms with the ability to address weaknesses and counter threats with a low-cost commitment.

Given that researchers and practitioners alike have viewed the alliance strategy as a key source of value addition to the firm, it becomes imperative to delve into this source of competitive advantage in more depth. With this as the precursor, this chapter aims at reviewing the conceptual underpinnings of strategic alliance with the overall objective of bringing together the concepts researched and proposed by numerous researchers. The aim is to provide insight into the alliance strategy to highlight the

sources of competitive advantage that can be drawn from it so as to address the challenges faced by industries/firms. Specifically, the focus of this chapter is to highlight the use of alliances in the hospitality industry from a strategic management perspective.

Strategic alliances: definitions

Strategic alliances are vehicles of growth and learning that allying firms use to accomplish joint and individual objectives (Iyer, 2002). Alliance partners use each others' resources and competencies for joint accomplishment of their objectives (Gulati, 1995). In an alliance, the parties remain independent to the alliance being created, but jointly govern the activities related to the alliance. The partners pool-in co-specialized assets that are used to generate relational rents (Dyer and Singh, 1998). These co-specialized assets could be in functional areas such as marketing, technology, research and development, and production. Alliances become a viable option when the cost of resources and capabilities is more when acquiring them through the market or creating them internally (Gulati and Singh, 1998). Moreover, in an external environment that is uncertain and turbulent, firms would need to have the flexibility related to investments in core technology and competencies. Since alliances provide greater flexibility in dealing with external environment conditions, they are preferred as a vehicle to address such factors.

The growth of alliances seen over the past three decades has been from various perspectives. In the seventies, firms predominantly used alliances from a product perspective for market reach as well as raw material procurement. In the eighties, the use of alliances evolved to building economies of scale and scope, and in the nineties, firms developed alliances in developing core competencies through innovation in technology and capabilities.

Objectives and characteristics of strategic alliances

The objectives of strategic alliances can be summarized per Contractor and Lorange (1988), which include:

- Risk reduction
- Achieving economies of scale
- Technological exchanges
- Creating barriers to entry/blocking competition
- Overcoming government-mandated trade or investment barriers

- Facilitating international expansion of inexperienced firms
- Vertical quasi-integration of linking the complementary contributions of partners in a value chain.

Other objectives that align with the above objectives include: access to co-specialized resources and capabilities, cost reduction, sharing information, reacting to market opportunities faster, and sharing and enhancing firm-specific knowledge and learning.

The characteristics of strategic alliances can be summarized as:

- Independence of partnering firms is retained.
- Most forms of strategic alliances are non-equity based alliances.
- A separate entity is not created in an alliance, which distinguishes such alliances from joint ventures.
- Firms use their strengths (competencies) to create co-specialized assets to tap market opportunities.
- Alliances can be formed by firms across industries (airline, hotels, and car rentals) or between competitors within a given industry (e.g., Marriott, Hilton, Hyatt, and Starwood).

Advantages and disadvantages of the alliance strategy

Strategic alliances lead to competitive advantage for the firms that participate in the alliance. Key advantages that alliances provide to incumbent firms include:

- Respond to environment uncertainties and turbulence
- Deal with the risk exposure in domestic and international markets
- Create avenues for growth in mature and new markets
- Be able to put the core resources and competencies to productive use
- Develop new competencies through interorganizational learning

Although alliances are a source of competitive advantage, there are certain disadvantages of strategic alliances that need to be highlighted. They include:

- Difficulty in identifying strategic partners
- Compatibility among partners
- Resources and time commitment required in getting partnering firms to agree to each other's terms and conditions
- Opportunism and potential for entering into conflict

- Evolving internal and external factors that lead to a change in firms' objectives related to the alliance strategy
- Barriers to terminating the alliance including cost
- Governance costs and mechanisms especially during the initial phase of the alliance
- Coordination costs and mechanisms related to alliance activities

Alliance networks

The alliance network theory has evolved during the past two to three decades of research work ranging from network theory in multinational corporations to present day interorganizational network theory. From a network theory perspective, strategic alliances are a source of revenue addition and value creation (Dyer and Singh, 1998). This result when allying firms are able to optimally combine alliance-specific assets to tap market opportunities. Since firms are constantly looking to tap market opportunities within a short time period, acquiring and developing resources, and capabilities may be a more costly option. Hence, firms pursue alliances to manage the costs of input factors so that the value addition is optimized when the combined resources and capabilities of allying firms lead to rent maximization. This provides the basis for firms to create networks that involve one or more firms as part of the alliance strategy.

According to Amit and Schoemaker (1993), asset specialization is an integral part of the value-creation process. Since acquiring specialized assets from the market or developing them internally would require time, strategic alliances provide firms with the option of achieving their objectives faster and more efficiently. For an alliance to succeed, it is imperative that allying partners are able to combine their resources to create co-specialized, alliance-specific assets (Dyer and Singh, 1998). It must be noted that allying firms are able to create relational profits and advantage if they combine specialized assets effectively (Dyer and Singh, 1998; Teece, 1987). Dyer and Singh (1998) point out that "relational rents" come about only when firms combine assets in a way that leads to effective leveraging of complementary resources.

The exchange relation is at the core of interorganizational theories, which is defined as consisting of transactions involving the transfer of resources between two or more actors for mutual benefit (Cook, 1977). Several perspectives exist that define the formation and development of strategic alliances. Foundations for the development of alliances have been based

on economic theories such as market power theory (MPT) and transaction cost economics (TCE) (Child and Faulkner, 1998), as well as resource-based view (RBV), industry structure view, and the relational view (Dyer and Singh, 1998).

MPT is developed on the underpinning that firms succeed if they are in a stronger competitive position. Cooperative strategies play an integral role in strengthening the competitive position of the firm. Hymer (1972) was among the first researchers to apply MPT to cooperative strategies in his emphasis of the difference between offensive and defensive coalitions. The intended strategy of firms using offensive coalition according to Child and Faulkner (1998) is to attain competitive advantage by increasing market share at a faster rate as compared to competition or by increasing their production and marketing-related costs.

However, defensive coalitions are those that are used to create/enhance barriers to entry with the objective of securing the firms' market position and/or to stabilize the industry to increase profits. The MPT also emphasizes on the economies of scope through sharing of strategic resources, sharing and transferring knowledge, rationalizing capacity, and/or sharing risks (Child and Faulkner, 1998). The key underpinnings of this theory is that firms can be successful by choosing to ally with other firms that have complementary resources enabling partnering firms to gain competitive advantage in terms of time (faster) and cost (cheaper).

This is similar to the industry structure view suggested by Dyer and Singh (1998), which attributes the mechanism of preserving profits to industry entry barriers that stresses on government regulations and production economies/sunk costs. The RBV on the other hand identifies scarce physical resources, human resources, technological resources, financial resources, and intangible resources as the source of supernormal profits, which is similar to the value chain underpinnings of cooperative strategies suggested by Child and Faulkner (1998).

The relational view purported by Dyer and Singh (1998) is based on the complementarity of the pooled-in assets of allying firms. From such a perspective, the primary sources of supernormal profit returns are relation-specific investments, interfirm knowledge sharing routines, complementary resource endowments, and effective governance. The mechanisms that preserve profits in the case of relational view is because of dyadic/network barriers to imitation, causal ambiguity, time compression diseconomies, interorganizational asset stock interconnectedness, partner scarcity, resource indivisibility, and institutional environment (Dyer and Singh, 1998). The uniqueness of the combined resources may be a source of sustained competitive advantage

as compared to individually owned set of resources. Firms will enter into such relationships if and only if the period of sustained competitive advantage generates rents that can cover the payback period (Dyer and Singh, 1998). In other words, the sum of the cost of entering into such relationships and the cost of owning resources should be lower than the returns that the firms will benefit by entering into the relationship.

However, TCE delves into the costs related to market transactions (Williamson, 1975). The essence of TCE lies in the governance mechanism that alliance partners use to transact across markets that lead to the cost optimization related to managing and governing alliance-specific transactions. Opportunism is considered to be a cost-enhancing factor that firm's entering into alliances should protect themselves from (Williamson, 1985). This factor leads to added costs in terms of governing the transactions between partners.

There are limitations associated with TCE. It does not take into consideration that tacit relationship could exist between partnering firms that is informal in nature. In other words, according to TCE all transactions are explicit in terms of their mode of governance/organization, supporting the concept that markets and hierarchies are the only two forms of governance mechanisms. Furthermore, the theory supports the view that opportunism may be a source of concern when two or more contracting parties seek to benefit from transactions. According to TCE, the opportunistic behaviour of contracting parties can be controlled through: (a) formal contracts that explicitly defines the role each contracting partner in the transaction and (b) governance mechanisms that controls the actions of parties involved in the transaction. Yet, the growth of collaboration as opposed to equity alliances (joint ventures) is an indication of how informal contracts/arrangements are a source of advantage to firms. Although opportunism is a concern between allying firms, it decreases as trust develops between partnering firms and the relationship between networking firms mature (Chathoth and Heiman, 2004). To understand and interpret the alliance concept in a better way, it is essential to study the different types of alliances.

Types of strategic alliances

There are two basic types of strategic alliances that include formal and informal arrangements of cooperation. The two modes used by firms include equity participation and non-equity based cooperation, which define the nature of the relationship between

partnering firms. Formal relationships are seen in joint ventures wherein two firms come together to create a new entity, in which equity participation from both parties take place. Therefore, joint decision-making in the new venture becomes the basis of effective management in such an alliance. Non-equity mode of alliance formation leads to cooperative arrangements which result in collaboration entailing informal relationships rather than the use of formal governance methods.

Child and Faulkner (1998) proposed a taxonomy of alliance forms, which entails three factors that influence alliance formation. They are: scope, size, and entity. Scope is determined by the motive of the partnering firms to form the alliance. It is a function of the type of resources the partnering firms decide to combine to achieve their objectives. The scope of the alliance could range between two extremes, that is, focused set of objectives and activities to complex set of objectives entailing a wide range of activities.

The size of the alliance can range from two to several partners. An alliance that involves more than two partners is called a consortium, which is effective when more than two firms' resources are required to create competitive advantage. The alliance entity ranges from joint ventures to collaborations depending on how the alliance partners seek to manage the networking relationship between them.

Collaboration is appropriate when task uncertainty exists between the partnering firms of the cooperative venture, flexibility between the partners is essential to maintain the effectiveness of the collaboration, and there are no distinct boundaries between the collaborating firms (Child and Faulkner, 1998). An important element of collaborations is that they are based on trust between partnering firms. This results from the awareness that both firms are better of trusting each other in the partnership. The opportunistic behaviour of partnering firms does not come into play in their relationship, as this may be an impediment to the realization of individual firm's objectives. Moreover, collaborations are a result of matured relationship between firms with a clear understanding of each other's long-term objectives, behaviour, and culture. Hence, firms with little understanding of each other's way of functioning will not seek to use collaborations.

Contractor and Kundu (1998) in their study of global hotel firms highlight the difference between joint ventures and collaborations. While studying various entry modes into international markets ranging from joint ventures to non-equity contracts, the authors found that non-equity contracts or collaborations have low transaction cost with a potential for higher

rent generation. Such alliances use revenues to calculate firms' returns. However, joint ventures use bottom-line profits to assess the firm' returns. While explaining this further, Chathoth and Olsen (2003) point out that Contractor and Kundu's (1998) study provide a basis to understand the difference between collaborations and joint ventures in terms of measuring the rent/profit generating process. They point out that "collaborations are measured by the revenue it generates, as the marginal cost associated with it is not significant; while joint ventures are measured by the profit it generates because the allying partners create a new entity which has a significant cost component attached to it" (p. 423).

Alliances are categorized based on vertical and horizontal collaborative arrangements. Ghemewat *et al.* (1986) categorized alliances as either "*x*" or "*y*" based on such arrangements. Vertical collaborations are "*x*" alliances, in which allying partners specialized in different functions, whereas, horizontal alliances are "*y*" alliances, in which the alliance partners specialized in similar functions. Vertical or *x* collaborations are seen in alliances between buyer and seller firms, while competitor alliances depict horizontal or *y* type collaborations. Other categorizations are based on functional arrangements between partners. For instance, Pucik (1988) categorized alliances on technological relationships, co-production agreements, sales and distribution networks, product development ventures, and joint ventures.

The strategic alliance process

The development of an alliance entails a process that involves several stages. As stated previously, the fundamental principle of the alliance concept is based on the fact that distinctive resource(s) of one company when held in combination with that of another creates a set or bundle of resources that add more value than when the resources where held in isolation. This raises the barriers to imitation and is a source of competitive advantage for the alliance partners. The strategic positioning as a result of combined resources is the key to the value-creation process for alliance partners. The alliance process stems from firm needs that can be met through various alternatives. The firm's decision to use alliance as a strategy is the first step to the alliance formation.

Child and Faulkner (1998) state that the alliance decision should be based on the firm's strategic orientation even if it does not have the capabilities to carry the strategy forward.

This is why pursuing alliances with firms that have capabilities to accomplish the goals would be beneficial to the firm. The ability in terms of scale (assets), technology, market access, and other factors that lead to competitive advantage are essential components of screening while selecting partners (Porter and Fuller, 1986). Hence, screening becomes an important factor in the pre-alliance phase. Criteria identified as essential while selecting partners include strategic and cultural fit (Child and Faulkner, 1998). Strategic fit is the value creation resulting from combining resources, and the synergistic effects ought to be superior to the competition. Cultural fit, on the other hand, is the ability of partners to cope with each other's cultural differences. The key to such a fit lies in the willingness of alliance partners to compromise when they differ in orientation and action related to the joint activities undertaken.

Organizational screening results in a clear understanding of where synergies among partners exist, and which partner would be able to contribute more to the overall objectives of the alliance. The step following screening is organizational complementarity (Dyer and Singh, 1998). This step forms the basis of identifying the mechanisms of access to each other's resources and the benefits related to the resource complementarity. According to Dyer and Singh, the degree of compatibility among partnering firms related to systems, processes, and culture impact the value-creation process. Research in this domain suggests that decision process, operating systems, and culture are important factors in developing organizational complementarity. Strategic complementarity is related to the potential combinations of resources to tap future opportunities while revealed complementarity reflects the outcome related to joint activities undertaken in the past (Doz, 1996). It should be noted that identifying complementarity among prospective partners' resources forms an essential part in the partner selection phase of the alliance.

Governance mechanisms sought during the inception and development phase of the alliance will impact the rate at which the alliance moves forward. Opportunism could be an impeding factor in the progress of the alliance at the outset. Firms may choose a formal governance structure to closely monitor the actions of its partners. A more informal structure might develop as the alliance matures resulting from the development of trust (Chathoth and Heiman, 2004). This may lead to the development of informal contractual relationships among partnering firms.

It must be noted that organizational cultural similarities influences the type of contract employed in the alliance.

Firms that have similar cultural characteristics tend to use equity joint ventures (EJVs) as compared to contractual joint venture (CJV) and vice versa (Tallman and Shenkar, 1994). Furthermore, the use of EJVs over CJVs is more likely when: (a) the parent firms involved in the alliance are from more individualistic national cultures as compared to collectivist national cultures, and (b) there is greater scope for sharing organizational skills than specific technologies. CJVs could be used in alliances wherein trust becomes the basis of developing the relationship, and when partnering firms use lower level of control to monitor each other's actions.

Dyer and Singh (1998) summarize the benefits of governance mechanisms in an alliance, which they point out is best when informal governance modes are used to manage alliance-specific transactions. This is attributable to: (1) lower marginal costs, and (2) difficulty of imitation. On the other hand, the limitations of such a structure are that they take considerable time to develop and that the partnering firms are exposed to the risk of opportunism that may potentially emanate if safeguards to protect themselves from partner's opportunistic behaviour are low. However, it is essential to note that the development of trust between partners forms the key to alliance success on the long run (Chathoth and Heiman, 2004).

The alliance creation process is summarized in Figure 10.1. As depicted in the figure, the alliance creation process starts with the decision to pursue alliance as a strategy. Once this decision is made, the alliance creation process could then proceed to the next step, which pertains to developing a plan that identifies the long-term objectives of pursuing the alliance strategy with a given partner. The search criteria could be specified subsequently that pertain to the business objectives related to the alliance strategy.

The process of finding suitable alliance partners could begin once the above aspects of alliance formation are in place. Similarity theory suggests that firms with similar strategic focus form alliances with each other (Insch and Steensma, 2006). This is possible if information is available for decision-making related to alliance partner selection. For this to happen, firms seeking an alliance should use various sources to obtain information. Once a suitable partner is identified, the negotiation and contract development phase (if applicable) could be initiated. During this phase, firms discuss the governance structure and control mechanisms related to the alliance. It should be noted that alliances that succeed in the long term are able to combine both formal and informal control mechanisms as part of the governance structure.

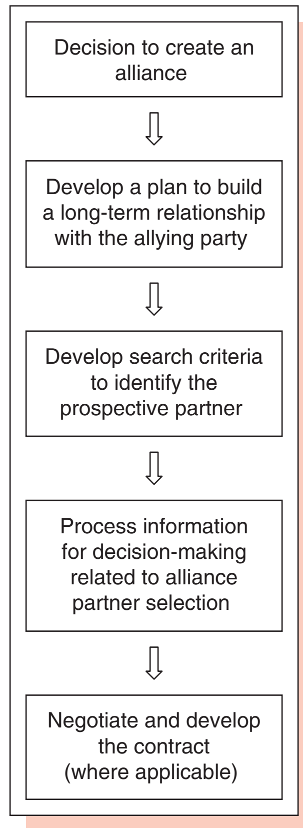

Figure 10.1
The alliance creation process.

Alliances in the hospitality industry

Alliances in the hospitality industry have grown from contract-based equity alliances to non-contract based relational alliances (Chathoth and Olsen, 2003). Many examples of alliances exist within the hospitality industry to support this. Contract-based alliances could be seen in a management contract or franchising wherein one partner allies with another partner while combining strategic resources. Examples include management contracts developed by Hilton Hotels and franchising contracts developed by Holiday Inn, subsequently emulated by competing firms that include leading hotel and restaurant firms such as Marriott, Hyatt, Accor, Intercontinental Hotels, Best Western, McDonald's, KFC, and others. These firms have pursued management and/or franchising contracts as vehicles for growth globally.

Alliances have been used as vehicles for market access by companies in matured as well as growing markets. For instance,

a marketing alliance within the Asian context includes The Taj Group of Hotels and Raffles International. The main objective of this alliance was to create access to market for both firms where they do not have a good enough presence (Tata.com). A similar alliance was established between the Oberoi Group and the Hilton International as well as the ITC-Welcomgroup (Indian Tobacco Company) and Starwood Hotels. Other examples of marketing alliances in the hospitality industry include the alliance between Starwood Hotels and Vacation.com. This alliance was created to provide Vacation.com's members with access to Starwood Hotels products, which, according to the President and CEO of Vacation.com, provides "initiatives and incentives for our member agencies to promote and sell more hotel accommodations" (m-travel.com).

Other examples of marketing alliances include Le Meridian and Nikko Hotels. These hotel firms initiated a marketing alliance strategy with the focus on improving their booking system so that the customers could be provided with a worldwide "one-stop" option (Chathoth and Olsen, 2003). Yet another example of a marketing alliance that uses technology to create synergy is the Global Hotel Alliance. The objective of this alliance is to offer a "greater choice and enhanced recognition to customers in a growing collection of hotels, managed by individual, regional brands, which are respected in their home markets for reflecting and respecting local traditions and culture through their hotels' products and services" (globalalliance.com). This alliance has brought together seven prominent hotel brands that include Dusit Hotels & Resorts; Kempinski Hotels; Landis Hotels & Resorts; Marco Polo Hotels; Omni Hotels; Pan Pacific Hotels and Resorts; and The Leela Palaces and Resorts. This also provide the allying firms with a more global access to markets while at the same time providing customers with a one-stop internet site that provides customers and travel agents with attractive prices and access to all member hotels' products, while providing them access to airline products as well. Some of the member hotels have also recognize each other's guest recognition programs, which provides customers with the convenience of accumulating points and using them across these hotels.

A similar example that compares to the Global Hotel Alliance in terms of strategy is the Luxury Alliance. This alliance although similar to the Global Hotel Alliance in terms of strategy differs in scope as it brings together hotel, rail, and cruise companies in this technology-based marketing alliance to provide customers with a wide range of travel options in the luxury hospitality product segment. The companies participating

in this alliance include The Leading Hotels of the World, Relais & Châteaux, and the Orient-Express Hotels, Trains and Cruises (Luxuryalliance.com).

The alliance between Cendant, Marriott, Hyatt, and Starwood that came into being in the late nineties is an example of a consortia-like agreement. This agreement brought about a reservation system to compete with on-line travel intermediaries such as Expedia and Travelocity (Cline, 2000).

Co-branding has been used by hotel and restaurant companies as an alliance strategy. Some examples include the alliance between Doubletree Hotel Corporation and the New York Restaurant Group as well as the alliance between Four Seasons Hotels and the Bice Ristorante (Strate and Rappole, 1997). Other examples of co-branding include the Renaissance Hotels and Starbucks, Hilton and Neutrogena, and W. Hotels and Bliss.

From a historical perspective, alliances have been used as vehicles to address labour shortage issues. As seen in the 1996 Hospitality Business Alliance between the Educational Foundation of the National Restaurant Association and the Educational Institute of the American Hotel & Motel Association to address the US hospitality workforce development. Such examples provide support to the thesis that alliances are effective in addressing issues in all domains and functions of business.

Implications and conclusion

Strategic alliances are considered as vehicles of growth that provide partners with access to each other's resources and capabilities so that they could address their weaknesses and threats. In today's global economy, it is essential that hospitality firms use alliances to access markets globally. Acquiring resources or developing them internally may be a more costly option which could be done away with if alliances are pursued.

As discussed in the preceding section, more and more alliances are being formed that have made it easier for the customer and the provider alike to create a customized and complete travel experience. Through the effective use of alliances, providers are able to understand and take care of customer needs better while at the same time being able to reduce costs and manage their business in a better way.

For hospitality firms to be able to use this vehicle of growth in a more efficient and effective way, core concepts related to how alliances are created and maintained over a prolonged period of time is of the essence. Due to a high failure rate of strategic alliances observed by scholars in the business field, it

is imperative that hospitality firms are able to create alliances by identifying the right partners in the first place by using good selection criteria and at the same time managing the alliance process in an effective manner by using a governance structure that bring together the allying parties instead of alienating them. Examples of failed alliances suggest that opportunism is detrimental to the success of alliances. To make sure opportunism does not creep into the alliance at an early stage, it is imperative that allying partners take step towards each other to build trust as the alliance evolves. This would have an impact on the governance costs and mechanisms as well as the costs associated with managing the alliance.

Future research in the hospitality alliance domain should focus on the evolution of hospitality alliances. Researchers could delve into the alliance structure and governance mechanisms from an evolutionary perspective and the role of trust in an evolving alliance. This will provide industry practitioners with evidence of why alliances should be pursued as a long-term strategy. More research is needed in this domain as this strategy has been used by an increasing number of hospitality firms during the past decade.

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