

# [Rivalry among firms in global hospitality](https://assignbuster.com/rivalry-among-firms-in-global-hospitality/)

The Porter’s 5 forces framework is an outside-in approach whereby the industry forces affecting the business performance is analysed to facilitate managers in decisions to direct their resources in achieving maximum profitability. The 5 forces identified by Porter are the horizontal competition from substitutes, new entrants and existing rivals as well as the vertical competition from the bargaining power of suppliers and buyers (Porter, 1980). In this essay, the author would like to analyse the competitiveness of the hospitality industry by critically evaluating the strength of each force individually with relevant examples and identify the most influential force.

## 2. 1 Threat of new entrants

Threats of new entrants are one of the principal forces of Porter’s theory of five forces (Porter, 1980). Bain (1956) who initiated the study of entry barriers identified the major barriers as capital requirements, economies of scale, product differentiation, government approval and absolute costs. These barriers create constraints for new entrants to enter the industry, creating fewer competitors therefore retaining the market shares of existing firms to achieve higher profit (Botten and McManus, 1999). International hotel chains enjoy large economies of scale (Salinger, 1990) as they have huge numbers of hotel chains and brands therefore expanding their market power. The Hilton Worldwide brand shares the same source of supply through their supply management system and customer database through their technology platform, the OnQ system across all hotel chains (Hilton Worldwide, 2012; Hilton Franchise, 2012), forcing new entrants with small scales to accept the cost disadvantage which directly affects their profits and sustainability (Pearce and Robinson, 2009).

Due to the analogous product and service offerings, brand identification is the best way for hotel chains to differentiate themselves from competitors (Dubé & Renaghan, 2000; Makadok, 2010). International hotel chains has succeeded in creating brand awareness through rapid expansions of brands such as Hilton and Holiday Inn (Okumus et al., 2010) with assurance of quality as well as the implementation of different loyalty programmes, causing new entrants the challenge to overcome customer loyalty (Kandampully and Suhartanto, 2000). Capital requirement of opening a new hotel is very high. It incurs high fixed costs (Chung, 2000) for the land and the construction plus renovation of the hotel. Huge amount of start-up and running cost is also required to recruit employees and roll-out marketing activities such as the development of the hotel brand through advertising as well as research and development activities (Matovic, 2002). Huge budgets must also be allocated for maintenance and upkeep of the hotel property (Hall, 1987).

Besides structural barriers which are influenced by the nature of the industry, there are also behavioural barriers which Sigfried and Evans (1994) describe as the retaliation strategies firms implements such as patents, predatory pricing, and exclusivity agreements with suppliers and distributors. However, the liberation of trade barriers by governments due to the trend of globalisation lowers the entry barriers especially in developing countries which do not have the resources to provide sufficient hospitality services and requires foreign firms to help develop the tourism sector (Hitt and Hoskisson, 1999). Conversely certain government do limit entries and provide exclusive rights to the local firms.

Weighing the facts in this study, barriers of entry to the hospitality industry is still considered relatively high, especially to the luxury segment where more investment and development of brand is required, and customers loyalty in existing luxury brands are already high which is proved by the high prices the consumers are willing to pay for a hotel room. In the budget or midscale segment, new entrants could attempt price penetration but the sustainability of the business could be unfeasible if consumers’ choices are dependent on the pricing only (Graf, 2011). Generally the threat of new entrant is fairly low, but could increase if there is liberal trading policies and high concentration of the industry in the particular location. But once a new entrant decides to take the high risk of entering the industry and has the ability to innovate and make differentiation in products and services, they will aggressively pursue market share to cover the high fixed cost invested (Matovic, 2002), raising the competition level in the industry.

## 2. 2 Threat of substitutes

Porter (1980) has also identified the threat of substitute in increasing intensity of rivalry. Substitutes give consumers more options often with better prices or value in achieving the same basic needs or wants. Substitutes are often not identified as primary rivals, making them difficult to be anticipated by firms (Magretta 2012). The presence of substitutes limits the profitability of firms by placing a ceiling in prices and increase price elasticity of the hotel product (Porter, 1980). When the pricing factor is considered, threats are formed when substitutes offer lower prices for the similar product, offer better quality products with a slight increase in price and when lower quality of products is provided with a significant drop in prices (Lewis et al., 1989).

Technological advancement supported by the high speed of internet has posed significant threat to the meeting and conference facility of a hotel which are the main revenue source of business hotels with the availability of teleconferencing. Many corporate companies would consider teleconferencing to be an ideal choice as it eliminates the high cost incurred for flight tickets, lodging and rental of conference facilities and equipment as well as the time consuming trips (Leocha, 2009). Other potential substitutes for the business traveller segments could be corporate guesthouses and long stay hotels (Regal Wing, 2011) whereas leisure travellers could opt for cheaper alternatives such as rented apartments, informal lodging with friends or families, RVs, camping, simple capsule hotels or make plans for overnight rides by long hour flight, train or bus. Business of airport hotels are also affected by the availability of sleeping capsules and rooms in airports (USA today, 2009) which removes the need of transit passengers to rent day rooms in hotels.

However, threats of substitutes in upper-scale luxury hotels are relatively low because consumers of this segment demands for exceptional comfort along with exclusive service standards, amenities and recognition which typical substitutes could not meet (Griffin et al., 1997). There are many substitutes in the hospitality industry except for the high end hotels. The author concludes that the overall threat of substitute is moderate as the availability of substitutes is very dependent on the location of the hotel and consumer preferences as hotel provides more comfort, convenience and security compared to the substitutes.

## 2. 3 Power of suppliers

The power of suppliers has direct impact on the profitability of hotels as it controls the input of the hotel which is vital for the operations of any hotel and provides flexibility to a hotel to give surplus to their customers. The hospitality industry is considered a matured industry (Martel 1974) and there are many suppliers who are readily in the market (Kim and Oh, 2004; Olsen and Roper 1998). Hotel suppliers include outsourced firms providing operational services such as accounting, maintenance, security, promotion and storage (Burt and Pinkerton, 1996) or even off-premise laundry services.

Real estate agencies are important suppliers when hotels are planning their pipelines and there are many which are available and competing for businesses from hotels as the investment is very huge. With active mergers and acquisitions in the industry, many hotel chains are actually affiliated with real estate companies such as Hilton Worldwide, La Quita Inn and Motel 6 being acquired by Blackstone group with active real estate businesses (Wikipedia, 2012) eliminating the need of suppliers. However, power of a particular supplier would be high if hotels are searching for unique locations.

Another main input of a hotel would be the employees. With the development of hotel schools and relevant courses, many qualified personnel are available for management trainee programmes and further contribute to the hotels. Hotels are often given credit to the ability to reduce unemployment rate of an area, proving that the ratio of supplier to firm is higher (Hassan, 2000). However hotels face the issue of shortage in manpower during peak seasons due to the employment strategies of hotel establishments to have a core of full time employees and employ casual and part-time labour to meet fluctuation of demand (Lufferty, 1998). The nature of part-time employment results in high turnover rates and high training resources.

A centralised supply management system and is often integrated across brands of major hotel chains, giving strong negotiation power to the hotel, making business from hotels indispensable to suppliers (Cox, 1999). With the vast growth of the information technology sector, there are many property management systems without significant product differentiation for hotel chains to choose from, thus giving hotels high buying powers. Another plus point for hotel groups is the practice of vertical integrations and the opportunity of backward integration (Lafferty and van Fossen, 2001) by owning own real estate agencies, manufacturing plants and hotel schools such as the Accor training academy. Summing up the relevant facts shows that the power of suppliers in the hospitality industry is low.

## 2. 4 Power of buyers

The hospitality industry has many buyers including corporate companies, travel agencies and individual travellers or the user itself. Price sensitivity of buyers depends on the hotel segmentation (Go and Pine, 1995). Buyers of budget hotel segments are generally more price sensitive than those of the luxury segment who appreciates higher quality of services rather than affordability. Switching cost of buyers could be increased through loyalty programmes which provide more value and benefit to buyers as a reward of repetitive patronisation (Kandampully and Suhartanto, 2000). Corporate and travel agent discounts are also given reduce the power of buyers to switch their suppliers (Jones et al, 2007). Buyer power has increase through distribution channels of hotels in the internet. It gives buyers access to information and reviews of different hotels available and compare them instantly (Law and Hsu, 2005).

Gu and Canoon (1998) suggest that buyer power could be subject to seasonality depending on the availability of disposable income and leisure time or the geographical factors of the location such as weather, and hotels implement yield management to gain maximum profitability with considerations of these factors (Burgess and Bryant, 2001). During peak seasons when there is an undersupply of rooms and lower price elasticity, hotel products would be sold at rack rates, decreasing buyer power of price negotiating. In contrast with low season and periods of slow economy growth where hotels strive to fill up occupancy to achieve minimum profit to breakeven, buyer power will increase significantly with attractive packages of value and choice of accommodation in the available hotel chains (Kandampully and Suhartanto, 2000). In summary, the power of buyers in is moderate depending on different circumstances.

## 2. 5 Rivalry among firms

The level of competition within existing firms in the hospitality industry also affects the profitability of firms (Porter, 1980). Despite the uncertainty in economy, the tourism sector is showing steady growth and remains strong across the globe. It is forecasted that at the end of year 2012, there would be 1 billion international tourist arrivals globally. Growth is shown in every region, with comparison with the previous year, Asia Pacific showed the highest growth of 8%, Africa with 7%, America with 5%, and Europe with 4%, Middle East only showed growth of 0. 7% as the region is still recovering from the effect of the Arab Spring (UNWTO, 2012). The growth in tourism increases the demand in the lodging industry therefore encouraging international hotel chains to develop strategic planning to accommodate the tourist by the expansion of their brands in potential markets (Lafferty and van Fossen, 2001). Expansions can be done rapidly with the trend of franchise licensing and management contracts (Chen and Dimou, 2005).

The hospitality industry involves many firms including international and domestic hotel chains ranging from luxury, full service, mid-scale, boutique and budget hotels to accommodate needs of different customer segments. Main international chains found around the globe would be The Intercontinental group, Wyndham Hotel Group, Marriot International, Hilton Worldwide, Accor group, Choice hotels, Best Western, Starwood, Carlson and Global Hyatt with growing numbers of room each year. The hotel industry performance outlook of 2012 provided by tripadvisor shows that 58% of global hotels believe that their firm can gain more profitability in future. Survey done by Travelocity shows that 76% of consumer are planning to spend more on travelling and 53% of consumers are planning to travel more compared to year 2011. This implies a positive growth in the hospitality industry (Marketing chart, 2012).

The nature of the hotel business shows the need of international expansion to meet demands with wide dispersion of geographical spectrum (Matthews, 1997) as the carrying capacity is fixed and the services provided by hotels can only meet the demand of consumer if it is present in the location. Firms such as international hotel chains operating in the same location have market similarities as they share the same sets of market (Chen, 1996). They compete for the same resources or customers and face the same constraints affected by the external environment. Location is the key determinant of one’s rival as the role of a hotel is to satisfy the guest need to get accommodation at that specific area. The strategic decision in deciding the geographical location of a hotel is very crucial as it is the attribute of a hotel that is fixed the fixed cost incurred is very high and (Matovic, 2002). Hotel chains develop in the same location to justify the attractiveness of the area thus reducing the perceived risk of investment by managers (Markussen, 1990). Go and Pine (1995) argues that product segmentation which includes pricing and level of facilities should be considered while determining primary rivals but pricing is highly variable and the change in pricing could cause the hotel to meet new competitors and increase the number of competitors (Roginsky, 1995) therefore damaging the profitability potential of the industry.

Rivalry is often high with firms existing in the same strategic group. Pearce and Robinson (2009) stated that a strategic group would consist of hotels with similar competitive strategies and market positioning; while Hatten and Schendel, (1977) propose that members of an industry can be classified into groups of similar strategy and structure. They have the same distribution channel, features of products and services provided, target market, and identical technology advancement. Strategic groups can be identified by comparing the competitive characteristics of firms by using almost a hundred possible variables (Ketchen et al. 1993) such as the quality range, geographic coverage, degree of service offered and degree of vertical integration. Firms that are present in the same strategic group are identified as a close rivals, assisting managers in constructing competitive strategies and allocate resources efficiently to be ahead of rivals (Matthews, 2000). Structural similarities of firms in the same strategic group cause them to be affected in the same way by external environmental changes and competitive strategies within the group.

Imitation of strategies can be easily done within the same group which is supported by the institutional theory that shows the occurrence of similar competence between firms (Selznick, 1996) under the same internal and external environment causing isomorphism (Oliver, 1988). Isomorphism is the condition when firms competing in the same population share same characteristics. The environmental forces have mimetic influences on hotels (DiMaggio & Powell, 1983), where the successful chain is often imitated by the rest to reduce uncertainty the need of investment in their own market research. Obligatory action also causes imitation, March (1981) quoted that ‘ obligatory action happens when enough firms do things in a particular fashion, it becomes the norm and from that point on, things are done that way without conscious thought.’ Caves and Porter (1980) suggest that the existence of strategic groups gives an advantage to members of a strategic group by creating a high entry barrier to new entrants because of the saturation of competition within.

Besides the factors mentioned above, rivalry among firms are intensified due to the high exit barriers (Dess et al, 2004) associated with significant capital investment as well as the high exit cost such as the depreciation cost of fixed assets, severance pay for employees and compensation cost for breach of contracts with suppliers and buyers. Exit barriers are especially high for large hotel chain with multiple locations, extensive interconnection with different suppliers and buyers, and large pool of employees. The high amount of sunk and exit cost pressures the exit- prospective hotel to keep its market share and continue running the business along with the implementation of new strategies in hope to revive the performance of the hotel and maintain the employment of the large labour force involved.

Perishable products offered by hotels create the urgency in selling the product as soon as possible to capture revenue, elevating the competition especially during off-peak season with oversupply of rooms (Matthews, 1997). For leisure travellers who do not travel frequently and has no brand preferences, the switching cost is very low or almost nothing as they would be attracted to any hotel chain which gives more perceived value or has lower price without considering the brand of the hotel chain, making them a potential customer for any hotel chain (Kandampully and Suhartanto, 2000). Hotel products have very limited potential of differentiation because the basic need of accommodation and shelter for tourist could easily be met and strategies of one hotel could be easily imitated by the other because of the lacking in patented knowledge and technology (Dunning & McQueen, 1982). Weighing the factors and reasoning contributing to the rivalry among firms, the author suggest that this is the strongest force in Porters five forces affecting level of competition in the hospitality industry.

## 3. 1 Conclusion

Given the analysis in the many competitive forces found between rivals, the author suggests that the intensity of rivalry among firm is strong but not to the brutal stage yet. Although growth in mature industries such as the hospitality industry is generally slower, the emergence of complement products such as cheap flights and additional frequent routes has facilitated tourism growth therefore benefiting the hotel businesses (Rey et al., 2011). Development of outbound tourism in emerging BRICS (Brazil, Russia, India, China, Africa) countries and other Asia Pacific region which is expected to capture 29% of total international tourist arrival in 2030 (UNWTO, 2012) encourages the growth of hotel pipelines, giving the hotel business a very good prospect of the future. The hotel industry is also a multi-billion dollar industry with signs of rebound due to the healing economy (Hotel News Now, 2012) with large hotel chains co-existing enjoying great amount of profitability especially with the increase growth in the tourism and motivation in travelling. Furthermore, although many hotel chains exist in the industry, different hotels define competitors with different criteria such as segmentation, price and proximity (Whitla et al, 2007) depending on its strategic group.

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