



## Governance structures in the hotel industry <sup>☆</sup>

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### ABSTRACT

This study investigates alternative governance forms in the hotel industry. Agency theory maintains that the need for control over service quality, financial risk, and the market environment affect the choice of governance form. Prior agency research emphasizes alternative governance structures that principals employ, given local market conditions, agent incentives, and risk preferences. The study augments the established principal–agent perspective with a discussion of entrepreneurial motivations to join hotel alliances. The study analyzes the choice between independent ownership and affiliation with a voluntary chain as well as the choice between integration and franchising. Data analyses from 650 hotels indicate that the hotel size, amenities, population, and distance to headquarters influence governance.

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A transformation in organizational structures accompanies the worldwide expansion of service industries. Firms that formerly managed wholly owned, independent establishments now operate in complex networks of arrangements that include voluntary groups, franchised systems, and vertically integrated outlets (Contractor and Kundu, 1998a). Despite substantial anecdotal evidence, few studies (Brown et al., 2000; Pak, 2002) consider whether properties that agency theory outlines provide insight into multiple governance structures. The limited number of agency applications in the hospitality industry is surprising given that agents operate in contexts characterized by conflict between principals and agents, marked outcome uncertainty, and substantial challenges associated with evaluating agent performance (Eisenhardt, 1989). The brand owner must evaluate the extent to which alternative governance structures deliver brand value and limit opportunism. Substantial research

addresses governance structures, yet the information asymmetry endemic to service delivery challenges the perspective drawn from research in other industries (Bergen et al., 1992).

This study increases understanding of factors relating to interfirm contracts in the hotel industry. Prior studies (e.g., Contractor and Kundu, 1998b) focus on the challenges global hoteliers encounter. The present article reports on research that augments this perspective along several fronts. First, the study focuses on a single Western market in which the hotel industry is already well established. Analysis of a single mature market provides the opportunity to counterbalance the principal's perspective with consideration of the agent's motivations to forge alliances (Stanworth and Kaufmann, 1995). In a mature industry, entrepreneurs develop many markets before multinational enterprises (MNE) consider entrance. The context provides an opportunity to investigate conditions that favor independence over interfirm alliances. The study focuses on governance of vertical alliances. A typical aspect of the growth in strategic alliances in the last decades is the different structural alternatives (Gulati, 1998). These alternatives range from independent organizations (Larson, 1992) to formal hierarchies (Anderson, 1995; Walker and Weber, 1984). This research addresses vertical alliances from the perspectives of brand owners and entrepreneurs. Brand owners choose between franchising and corporate operations (Michael, 1999), whereas entrepreneurs choose between independence and membership in a voluntary chain.

A second contrast from prior research concerns the form of alliance under investigation. Research addressing the alternative principals

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have available examines the choice between integration and franchising (Brickley and Dark, 1987). This study adopts agency logic, yet augments this research with a complementary analysis of the choice between voluntary chains and independent hotels. This perspective enables research to augment rationales associated with a brand owner's desire to control service quality with discussion of an entrepreneur's incentives to join an alliance. Limited agency research examines a broad range of structural alternatives—from independence to full vertical integration—as the current data set covers. Only studies of computers (Mohr et al., 1996) and groceries (Corriveau and Tamilia, 2002) cover such a range of structural alternatives.

The third novel contribution of the research is the analysis of the amenities hotels offer. Several studies examine hotel contracts (e.g., Ingram and Baum, 1997), yet these studies do not consider the influence of the hotel's services on contractual structure. By contrast, this study employs logic from the resource-based view of the firm (Wernerfelt, 1984) to investigate the relationship between service offerings and governance structures in the hospitality industry.

This research investigates interfirm contracting in the Norwegian hotel industry. Over the last few decades, the industry has witnessed an increased focus on chains, brands, and strategic alliances. The mix of contracts European entrepreneurs employ varies considerably from the contracts North American hoteliers use (Walsh, 2004). In North America, independent owners own less than 10% of hotels, and franchise agreements or management service contracts manage 80%. In Europe and in Asia, franchisers and management service contracts own many hotels, but independently owned hotels represent a larger portion of the industry than in North America. Many Norwegian hotels operated before multinational chains gained a foothold in the market. The empirical setting provides the opportunity to augment rationale from principal–agent theory with consideration of entrepreneurial incentives to join hotel chains.

The paper begins with a description of the organizational forms the empirical setting employs. A presentation of the theoretical perspectives underlying the research follows. Hypotheses link economic antecedents to governance, and the method and empirical test follow. The study closes with a discussion of implications and limits of the research.

## 1. Organizational forms in the Norwegian hotel industry

In their 1989 study, Bradach and Eccles recognize that distribution processes are coordinated via integrated channels, networks of independent agents, and hybrid arrangements. Moreover, they call for efforts to account for selection among governance structures. Hotel firms forego independence for alliances for several reasons. For example, a local entrepreneur that has controlled the entire operation may not be able to attract international visitors, and thus may decide to enter into an agreement with a hotel chain. In this way, the local hotel gains access to a recognized brand name and an international reservation system.

The hotel chain provides the local hotelier with managerial competence. At the same time, the interfirm alliance enables the hotel chain to expand its operations without incurring investments associated with acquiring a new location (Carney and Gedajlovic, 1991; Combs and Ketchen, 1999). The chain rests its operations on the local entrepreneurial drive, management talent, and local market knowledge (Lafontaine and Kaufmann, 1994). By cooperating on specific activities, local operators and hotel chains secure access to resources the other actor provides, yet they retain control over other activities (Harrigan, 1984).

Contractor and Kundu (1998a) argue that four dimensions are especially important to control in the hotel industry: (1) operational management and quality, (2) capital and property, (3) competence and expertise, and (4) the brand and reservation system. The control of these dimensions varies with the interfirm contract. Fig. 1 shows the four organizational forms identified in the Norwegian hotel

industry (Coughlan et al., 2001). In the case of a *vertically integrated hotel*, the chain organization owns and operates the hotel. Hence, the chain controls all four dimensions. *Franchise agreements* establish interfirm alliances between a franchiser and the local representative, a franchisee. The franchisee remains an independent company, but operates the hotel given strict regulations and surveillance from the franchiser. The franchisee usually maintains control over local capital investments and is the residual claimant to profits. The franchiser's operating and monitoring systems wield control over operations, and the franchiser maintains control over the branded operating system. A *voluntary chain* is a loosely organized alliance among independently owned and operated hotels. Member hotels maintain control over capital and oversee operations, quality, and competence, but the chain controls the brand and reservation system. Finally, *independent hotels* are not members of a chain, own and operate the hotel on an independent basis, and oversee all aspects of operations. Consider now several factors that favor alternatives among these governance forms.

## 2. Theory and hypotheses

### 2.1. Governance, control, and ownership of hotel services

The organizational forms represent contractual alternatives, but hoteliers ordinarily consider a subset of these contracts (Shook and Shook, 1993). Internationally branded hotels establish franchises or vertically integrated operations, whereas independent hoteliers evaluate whether to establish an alliance with a voluntary chain or remain independent. The costs associated with monitoring agent performance should influence governance decisions (Brickley and Dark, 1987; Eisenhardt, 1989). Market size, hotel scale, and the competitive environment are exogenous factors that also influence governance (Hart, 1983). Consider first the role of monitoring costs.

### 2.2. Monitoring costs

#### 2.2.1. Distance

An important task for all service operations is to provide and secure quality at the local level in a manner that maintains the value of the brand. Operations achieve quality via superior execution of service delivery that establishes a symbolic and evocative image (Muller, 1998). Each local hotel provides service quality via the interaction between the hotel and the customer, and the control of service quality is an important function that produces price premiums and customer loyalty.

According to agency theory, the principal's ability to control service quality closely relates to the principal's ability to acquire valid and accurate information about the agent's actions (Dahlstrom and Nygaard, 1999). Franchisers deciding between corporate ownership and franchising have financial incentives to establish interfirm agreements as locations become more remote (Brickley and Dark, 1987). Assessment and control costs are lower for hotels located close to major metropolitan areas. As the distance from a metropolitan area to the hotel increases, the costs to monitor vertically integrated outlets increases (Brickley and Dark, 1987; Shepard, 1993), resulting in fewer corporately held locations and more franchised outlets (Holmstrom, 1979). Independent hoteliers also have financial incentives associated with the desire to increase consumer awareness and occupancy. The independent actor's costs to generate awareness and patronage are appreciably greater in remote locations, but affiliation with a chain markedly lowers these costs. Therefore, the study tests the following hypotheses.

**H<sub>1a</sub>.** As the distance from major metropolitan areas increases, voluntary chains are more likely than independent hotels.

**H<sub>1b</sub>.** As the distance from chain headquarters increases, franchises are more likely than corporately owned hotels.

| Governance                                                                                                                                                                                           | Independent                                                               | Voluntary Chain                                                                                                                                                                                                       | Franchise Chain Hotels                                                                                                                                                                                                                                 | Vertically                                                      |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Description                                                                                                                                                                                          | Hotels                                                                    | Hotels                                                                                                                                                                                                                |                                                                                                                                                                                                                                                        | Integrated Hotels                                               |
| General description                                                                                                                                                                                  | Independently owned and operated hotel.                                   | Independently owned and operated hotel.<br><br>Chain system – chain members organize and own a loose alliance.                                                                                                        | Independently owned hotel, the franchisee operates in a tight alliance with the chain (franchiser).                                                                                                                                                    | National/international chain owns and operates hotel            |
| Investments and incentives                                                                                                                                                                           | Local owner makes the investments and is the residual claimant.           | Local owner makes most investments and is the residual claimant.<br><br>Chain expenses covered on a collective nonprofit basis, and/or chain revenues (cost-) based on services delivered to the individual hotelier. | Both franchiser and franchisee make investments.<br><br>Chain (franchiser) revenues (franchise & royalty fees) a function of the hotel revenues.<br><br>Local hotelier residual claimant (after local operating costs and franchise fees are covered). | The chain makes the investments and is the residual claimant.   |
| Control of resources and activities: (1) operational management and quality, (2) capital and property, (3) competence and expertise, (4) the brand and reservation system, (5) procurement function. | Local hotelier controls hotel (external investor may own hotel property). | The chain controls brand, reservation system, and to some degree procurement.<br><br>Local hotelier controls other dimensions (external investor may own hotel property).                                             | The chain controls directly or through strict chain regulations and surveillance of franchisee operation, except of (2) capital/property decisions and some HRM decision (e.g., hiring/staffing)                                                       | The chain controls (external investor may own hotel property.)  |
| Nature of service offered                                                                                                                                                                            | Low cost or value added based on variation and “atmosphere.”              | As for independent hotels, but given broad quality standards that chain policies and brand position set.                                                                                                              | Service offering that chain policies and brand position define.                                                                                                                                                                                        | Service offering that chain policies and brand position define. |
| Examples                                                                                                                                                                                             |                                                                           | Best Western                                                                                                                                                                                                          | Holiday Inn                                                                                                                                                                                                                                            | Hilton                                                          |

Fig. 1. Governance structures in the hotel industry.

### 2.2.2. Hotel amenities

Hotel amenities refer to physical assets and related service provisions a hotel develops to enhance a patron's stay (Goldberg et al., 1984). The resource-based view (RBV) of the firm and agency theory offer insight into governance decisions designed to support amenities. The resource-based view addresses organizational designs that influence the employment of knowledge to raise effectiveness (Barney, 1991). Assessment of organizational forms involves examining the ability to acquire and use information via alternative governance structures. Interfirm agreements enable firms to access information they develop within the alliance and through local efforts to develop expertise, yet independent operations rely solely on local development of expertise. Increases in information requirements should increase the attractiveness of interfirm agreements over independent operations (Conner and Prahalad, 1996). Task-specific knowledge and resources support each service amenity a hotel offers. As the number of resources increases, the firm must weigh the benefits and costs of alternative governance modes. Because alliances offer greater ability to apply current and future knowledge, hotels should increasingly favor alliances over independent operations as the number of amenities increases (Poppo and Zenger, 1998). Thus, hotels that offer many amenities should prefer voluntary chain affiliation to independent operations.

Agency theory offers another perspective on governance decision that focuses on alignment of incentives and control over agency-related costs. As the hotel adds more amenities to a location, the costs of monitoring agents should increase (Shepard, 1993). Increases in monitoring costs raise the relative efficiency of outcome-based contracts over behavior-based agreements (Norton, 1988). Consequently, hotels should prefer the outcome-based contracts of franchises to behavior-based company outlets.

Agency theory and RBV offer alternative viewpoints on influences of amenities on governance decisions, yet both perspectives may operate within the hotel industry. Consistent with RBV, independent entrepreneurs are motivated to maximize the productivity of their physical assets. As they add more amenities, they should be motivated to establish alliances with voluntary chains. By contrast, franchisers focus on maintaining the equity of their branded operating systems. As the number of amenities increases, implementing franchise contracts becomes increasingly more efficacious.

Because different amenities have divergent monitoring costs, distinguishing between indoor and outdoor amenities is necessary. For example, a sauna incurs monitoring costs that should be substantially lower than costs to maintain a ski lift. As the number of indoor, relatively observable amenities increases, affiliation with a chain yields revenue advantages to entrepreneurs. Corporate principals favor franchises in such locations. Outdoor amenities are substantially more difficult to monitor and prompt brand owners to franchise these locations. By contrast, entrepreneurs contract with voluntaries to heighten awareness of these amenities. Therefore, the study tests the following hypotheses.

**H<sub>2a</sub>.** As the number of indoor amenities increases, voluntary chain hotels are more likely than independent hotels.

**H<sub>2b</sub>.** As the number of indoor amenities increases, franchised hotels are more likely than corporately owned hotels.

**H<sub>3a</sub>.** As the number of outdoor amenities increases, voluntary chain hotels are more likely than independent hotels.

**H<sub>3b</sub>.** As the number of outdoor amenities increases, franchised hotels are more likely than corporately owned hotels.

### 2.3. Market size

Local market characteristics influence hotelier's motivations for establishing alliances. As the market population increases, property

values serve as strong disincentives to independent operators. They have limited resources to invest in large markets with high population densities, and they do not have scale economies to support ongoing efforts to promote their establishments. Therefore, one would expect fewer independent entrepreneurs in populated markets.

Franchisers also incur costs for operating in urban areas, but management can benefit from scale economies (Rubin, 1978). The presence of several hotels in such markets may represent some degree of normative pressure that all hotel operators will try to follow. Furthermore, observing the behavior of the local hotel in larger markets should be less costly for the chain, as traveling costs to such locations are likely to be less than the costs associated with traveling to smaller markets. Similarly, the chain will see less monitoring costs if they locate multiple units in populated markets (Nygaard and Myrtveit, 2000). Area managers control multiple units at lower costs per location (Norton, 1988). Thus, integration is more feasible in urban areas. Therefore, the following hypotheses are proposed:

**H<sub>4a</sub>.** As markets become more populated, voluntary chain hotels will be more likely than independent hotels.

**H<sub>4b</sub>.** As markets become more populated, corporately owned hotels will be more likely than franchised hotels.

### 2.4. Competitive environment

Hart (1983) proposes that competition in the market represents a disciplinary device that controls agents' opportunistic behavior and managerial slack. Such agency costs exist only in imperfect markets. For example, when the competition is weak the hotel manager may eliminate hidden benefits in terms of pet projects, corporate luxury, and organizational slack (Milgrom and Roberts, 1992). Machlup (1967) states that less competition is the core reason for agency costs. Following this argument, when competitive intensity is high, franchisers choose to increase the level of vertical integration to incur fewer moral hazard problems. By contrast, independent entrepreneurs operating in such markets establish agreements with voluntary chains to secure an edge over competition via the reservation system.

**H<sub>5a</sub>.** As the level of competition in the local marketplace increases, voluntary chain hotels are more likely than independent hotels.

**H<sub>5b</sub>.** As the level of competition in the local marketplace increases, corporately owned hotels are more likely than franchised hotels.

### 2.5. Scale

When establishing a new hotel, a brand owner will be concerned about the investment itself, and the amount of capital locked into the investment. Such capital investments will also likely affect the choice of governance form. In relatively larger hotels, local hoteliers have incentives to establish alliances with voluntary chains. Affiliation with voluntary chains offers broad name recognition, reservation systems, and marketing competencies that enable the firm to recoup investments efficiently (Brickley et al., 1991; Scherer, 1980). Similarly, as the size of the hotel increases, franchisers should be inclined to develop corporate outlets. Higher levels of investments in a location increase incentives to uphold the value of the assets through corporately owned outlets (Brickley and Dark, 1987).

**H<sub>6a</sub>.** The larger the hotel, the greater the likelihood of voluntary chain hotels rather than independent hotels.

**H<sub>6b</sub>.** The larger the hotel, the greater the likelihood of corporately owned hotels rather than franchised hotels.

## 2.6. Method

The study examines the hypotheses in the Norwegian hotel industry. The database comes from the *Norwegian Travel Book (2000)*, the most complete Norwegian hotel directory, which offers information about hotels, hostels, cabins, and camping sites. Because the study examines hotels with the potential of affiliating with a chain, the focus is on hotels with more than twenty-five beds. The 650 hotels in the study represent more than 55% of the hotels operating in Norway, and reflect the vast majority of alliance candidates. Among these hotels, the directory lists 306 as independently owned, 151 as members of voluntaries, 70 as franchises, and 123 as belonging to vertically integrated chains.

The following data, from the *Norwegian Travel Book (2000)*, include (1) whether the hotel is an independent, voluntary, franchise, or vertically integrated chain, (2) where the chain headquarters is located, (3) where the hotel is located, (4) how many beds the hotel contains, and (5) how many activities the hotel offers. The *Statistical Yearbook for Norway (1998)* provides information about the number of inhabitants in the local community of each hotel and the total number of hotel beds in these communities. After developing this database, the following variables are constructed and measured:

### 2.6.1. Governance form

The four governance forms include independent hotels, voluntary hotel chains, franchises, and vertically integrated hotel chains. These governance structures represent degrees of the level of integration. Independent hotels are close to market transactions. Voluntary groups are less integrated than franchises, and franchises are less integrated than vertically owned hotels (Coughlan et al., 2001).

## 2.7. Customer environments

### 2.7.1. Distance

The distance in kilometers from chain headquarters to each hotel is established (Brickley and Dark, 1987). For independent and voluntary chain hotels, the distance from Oslo to the hotel serves as the measure (as Oslo, the capitol, is the major metropolitan area in Norway).

### 2.7.2. Hotel amenities

Two measures address the breadth of recreational activities at the hotel (Shepard, 1993; Nygaard and Myrtveit, 2000). *Indoor amenities* include swimming pool, fitness room, sauna, solarium, bicycle rental, hiking, tennis, and squash. *Outdoor amenities* include horseback riding, boat rental, fishing, alpine skiing, and golf. The variables are the sum of respective services each hotel offers.

### 2.7.3. Market size

The number of inhabitants in the local community serves as the proxy for market size (Chung and Kalnins, 2001).

### 2.7.4. Competitive environment

The Herfindahl index (Kwoka, 1985) assesses the extent of competitive concentration in the hotel industry. This proxy variable incorporates market share data from each local hotel to evaluate competitiveness in the market. Because of scaling, higher values reflect less competitive markets, and lower values indicate markets that are more competitive.

### 2.7.5. Hotel size

The number of beds in the hotel (Chung and Kalnins, 2001) provides the size measure. Descriptive statistics are in Table 1.

## 3. Results

Two logistic regression (maximum likelihood) models provide tests of the hypotheses. Logistic regression is suitable for classifying

a categorical dependent variable based on a set of criterion variables. Model I tests the entrepreneurial choice between the independent organizational form and voluntary group membership. Model II analyzes the brand owner choice between a franchise organization and company-operated structure. Table 2 exhibits the correlation matrix of independent variables.

Table 3 depicts the results. Model I fits the data reasonably well ( $-2 \text{ Log likelihood} = 548$ ;  $R^2 = 9.4\%$ ) and correctly classifies 69.2% of the hotels. Four of the six hypotheses have significant relationships in the expected direction. Neither distance ( $H_{1a}$ ) nor competitive intensity ( $H_{5a}$ ) produces significant predictions of structural choice. In line with  $H_{2a}$ , indoor amenities lead to choice of voluntary group membership ( $\beta = 1.25$ ,  $p < 0.01$ ), yet outdoor amenities ( $H_{3a}$ ) are associated with increased independent organizational forms ( $\beta = -1.24$ ,  $p < 0.05$ ). Although this difference is statistically significant, the mean ( $x = 0.32$ ) level of outdoor amenities is comparable across groups. In accordance with  $H_{4a}$ , hotels in voluntary groups are more likely to be located in more populated areas ( $\beta = 0.43$ ,  $p < 0.01$ ). Finally, as predicted ( $H_{6a}$ ), size is significantly related to voluntary group memberships ( $\beta = 0.58$ ,  $p < 0.01$ ).

Model II analyzes the choice between franchising and integration. The model fits the data reasonably well ( $-2 \text{ Log likelihood} = 231$ ,  $R^2 = 10.0\%$ ). The model classifies 68.0% of the cases correctly. Neither indoor amenities ( $H_{2b}$ ) nor competitive intensity ( $H_{5b}$ ) affects the brand owner's structural choice. In contrast to  $H_{1b}$ , franchising is less likely than integration as the distance from headquarters increases ( $\beta = 0.01$ ,  $p < 0.05$ ). In line with  $H_{3b}$ , outdoor amenities reduce the tendency toward fully integrated units ( $\beta = -1.23$ ,  $p < 0.05$ ). Consistent with  $H_{4b}$ , populated areas seem to increase the tendency toward integration ( $\beta = 0.46$ ,  $p < 0.05$ ). As predicted ( $H_{6b}$ ), hotel size motivates increased integration over franchising ( $\beta = 0.37$ ,  $p < 0.05$ ).

## 4. Discussion and implications

The goal of this research is to gain an understanding of factors related to interfirm contracting in the hotel industry. The results underscore a dual dichotomy operating in the Norwegian hotel industry. Relative to hotel voluntaries, independent hotels offer fewer indoor amenities and operate smaller hotels in smaller markets. Corporate facilities, in contrast to franchised locations, are farther from headquarters, offer fewer outdoor amenities, and serve larger markets with larger hotels. Consider now the limitations and implications of the research.

### 4.1. Limitations and future research

This study offers a refined model that includes traditional systems and the different structural alternatives included in vertical marketing systems. This operationalization is consistent with the perspective of

**Table 1**  
Summary statistics.

|                                    | Independent | Hotel cooperative | Franchise | Franchiser-operated |
|------------------------------------|-------------|-------------------|-----------|---------------------|
| Sample size                        | 306         | 151               | 70        | 123                 |
| Population                         | 32,063.3    | 64,516.3          | 69,118.4  | 130,328.2           |
| Kilometric distance                | 532.0       | 481.2             | 451.2     | 621.1               |
| Hotel size (number of beds)        | 90.8        | 129.3             | 211.8     | 229.7               |
| Competitive intensity <sup>a</sup> | 6032.2      | 5340.5            | 4153.6    | 3783.3              |
| Indoor amenities <sup>b</sup>      | 0.29        | 0.39              | 0.53      | 0.41                |
| Outdoor amenities <sup>c</sup>     | 0.32        | 0.32              | 0.33      | 0.23                |

<sup>a</sup> Herfindahl index (Kwoka, 1985).

<sup>b</sup> Indoor amenities = Percentage of indoor activities offered (squash, sauna, tennis, hiking, solarium, fitness room, swimming pool, and bicycle rental).

<sup>c</sup> Outdoor amenities = Percentage of outdoor activities offered (golf, fishing, boat rental, alpine skiing, and horseback riding).

**Table 2**  
Correlations among predictor variables.

|                                    | Population | Distance | Size  | Competitive intensity <sup>a</sup> | Indoor amenities <sup>b</sup> | Outdoor amenities <sup>c</sup> |
|------------------------------------|------------|----------|-------|------------------------------------|-------------------------------|--------------------------------|
| Population                         | 1.00       |          |       |                                    |                               |                                |
| Kilometric distance                | −0.25      | 1.00     |       |                                    |                               |                                |
| Hotel size (number of beds)        | 0.22       | −0.15    | 1.00  |                                    |                               |                                |
| Competitive intensity <sup>a</sup> | −0.51      | −0.13    | −0.26 | 1.00                               |                               |                                |
| Indoor amenities <sup>b</sup>      | −0.14      | −0.13    | 0.46  | −0.02                              | 1.00                          |                                |
| Outdoor amenities <sup>c</sup>     | −0.44      | −0.09    | 0.03  | 0.33                               | 0.39                          | 1.00                           |

<sup>a</sup> Herfindahl index (Kwoka, 1985).

<sup>b</sup> Indoor amenities = Percentage of indoor activities offered (squash, sauna, tennis, hiking, solarium, fitness room, swimming pool, and bicycle rental).

<sup>c</sup> Outdoor amenities = Percentage of outdoor activities offered (golf, fishing, boat rental, alpine skiing, and horseback riding).

Coughlan et al. (2001), but treats a host of diverse contracts within the same category. For example, royalty rates vary across franchises, yet the research treats all franchise agreements the same. Future studies should consider more refined measures of contracts and associated costs.

Idiosyncrasies of the Norwegian market must temper the results with respect to the distance hypothesis. In the brand owner model, distance positively relates to corporately owned hotels. These findings ostensibly contrast with Brickley and Dark's (1987) report that distant locations are likely franchised. Distant markets may reflect remote, sparsely populated markets (e.g., Finnmark) or urban markets (e.g., Trondheim), yet the analysis provides no opportunity to distinguish among these heterogeneous distant markets. Markets of the latter type likely have substantially lower costs to monitor and thus warrant corporate operations (Rubin, 1978). Future studies may augment the findings by examining not only the distance but also the costs incurred to reach the markets.

The study incorporates logic from the resource-based view of the firm to implicate governance decisions. Despite providing some support for this logic, the data in this analysis differ from prior resource-based studies. Previous resource-based research (Combs and Ketchen, 1999) employs variables such as brand name reputation and managerial experience that yield competitive advantages. The present research implicates amenities that reflect resource investments but may not provide competitive advantages in the market. Future studies should augment the analysis of amenities by focusing on service provisions that offer unique strengths relative to competition.

Finally, several factors not included in the model may affect governance structures. The predictions concerning the resource-based view of the firm presume heightened knowledge utilization in voluntary alliances, but the data do not capture utility of information across governance forms. A common critique of agency theory and related theories is that actor motives other than efficiency are ignored (Oberschall and Leifer, 1986; Perrow, 1987), and that the influence of social structure on economic action is neglected or poorly understood (Granovetter, 1985). For example, older hotels may stay independent or remain in business because the owners respect family tradition more than they intend to maximize profit. Such aspects are outside the scope of this study and available data.

#### 4.2. Theoretical implications

The theoretically derived hypotheses suggest that monitoring costs, scale, and market size are factors that affect contractual decisions in the hotel industry. The influence of amenities on governance structures receives some support. These results suggest relevance not only in examining the role of hotel services in determining organizational structures, but also in considering the type of amenities the hotel offers. As the number of indoor amenities increases, the entrepreneur that seeks to increase return on this investment is likely to forge an alliance with a hotel voluntarily. This empirical observation is consistent with the resource-based view of

the firm (Conner and Prahalad, 1996). By contrast and consistent with agency theory, as the number of outdoor amenities increases, corporations forego some monitoring costs endemic to operations by establishing franchises. Together these findings underscore an opportunity for theoretical contributions to agency theory. Although many studies support agency logic for ownership decisions (Bergen et al., 1992), further investigations can advance the field by examining the choices among multiple, alternative hybrid contracts (Bradach and Eccles, 1989). The resource-based view of the firm operates under markedly different assumptions that focus on efforts to employ information rather than contain monitoring costs. Additional research should examine conditions that lead to integration decisions that depend on some combination of logic from agency theory and the resource-based view of the firm (Conner, 1991).

In accordance with the propositions, market size relates to increased affiliation with voluntary chains and integration. The results from this study—that hotels belonging to vertical marketing systems dominate urban areas—are in line with previous findings from the hotel industry and other industries (Dahlstrom and Nygaard, 1994). Ingram and Baum (1997) find, based on longitudinal data from 1898–1980, that chain affiliation improves survival in the Manhattan hotel industry. Vertical integration in urban areas should enable the franchiser to raise productivity and control monitoring costs. In addition, affiliation with a voluntary chain enables hoteliers to improve investment productivity and reduce risk.

The theoretical model receives no empirical support for the expectation of a positive association between competitive intensity and vertical integration. Further investigation should consider the alternative theory that competitive pressure is itself a disciplinary

**Table 3**  
Binary logistical models.

|                                                     | Independent versus hotel cooperative Model I |      | Franchisee versus franchiser Model II |      |
|-----------------------------------------------------|----------------------------------------------|------|---------------------------------------|------|
|                                                     | $\beta$                                      | Sig. | $\beta$                               | Sig. |
| H <sub>1</sub> : Kilometric distance                | 0.01                                         | 0.30 | 0.01                                  | 0.05 |
| H <sub>2</sub> : Indoor amenities <sup>a</sup>      | 1.25                                         | 0.01 | −0.27                                 | 0.50 |
| H <sub>3</sub> : Outdoor amenities <sup>b</sup>     | −1.24                                        | 0.03 | −1.23                                 | 0.02 |
| H <sub>4</sub> : Population                         | 0.43                                         | 0.00 | 0.46                                  | 0.01 |
| H <sub>5</sub> : Competitive intensity <sup>c</sup> | −0.01                                        | 0.84 | 0.01                                  | 0.33 |
| H <sub>6</sub> : Hotel size (number of beds)        | 0.58                                         | 0.01 | 0.37                                  | 0.02 |
| Constant                                            | −0.42                                        | 0.07 | 0.45                                  | 0.20 |
| Model summary                                       |                                              |      |                                       |      |
| −2 Log likelihood                                   | 548                                          |      | 231                                   |      |
| Nagelkerke R <sup>2</sup>                           | 0.094                                        |      | 0.10                                  |      |
| Classification accuracy                             | 69.2%                                        |      | 68.0%                                 |      |

<sup>a</sup> Indoor amenities = Percentage of indoor activities offered (squash, sauna, tennis, hiking, solarium, fitness room, swimming pool, and bicycle rental).

<sup>b</sup> Outdoor amenities = Percentage of outdoor activities offered (golf, fishing, boat rental, alpine skiing, and horseback riding).

<sup>c</sup> Herfindahl index (Kwoka, 1985).

device for the brand owner. Hart (1983) confronts the prediction from agency theory that separation of ownership and control is costly no matter the competitive environment in the market. Under intense competition, opportunism or moral hazard is infeasible. Thus, the brand owner will cut costs by using vertical integration or less outcome-dependent contracts (Machlup, 1967). The need to respond directly and immediately to competitive forces also warrants vertical integration. Although some empirical evidence from the hotel industry supports this approach (Pak, 2002), these conflicting perspectives warrant further evaluation. Other empirical research from the hotel industry supports a noncompetitive strategy. Empirical evidence shows that friendship among hotel managers from competing hotels leads to increased performance (Ingram and Roberts, 2000). Further research should focus on how such informal interorganizational structures affect inter-brand competition, governance choice, and performance in local markets. Another allied aspect of this study is that a high degree of competition and unit density has a possible positive effect. Marshall (1920) argues that competition increases product quality and heightens demand. Such “agglomeration” effects might balance the loss that more intense competition causes. For example, Chung and Kalnins (2001) find that chain hotels and larger hotels contribute most to production efficiencies or increasing demand. Similarly, Baum and Mezias (1992) and Ingram and Inman (1996) find that the failure rate decreases with increasing local competition.

Consistent with prior industry analyses (PricewaterhouseCoopers, 2000), the results indicate that size is a critical factor in determining governance form. Vertical integration offers the local hotel benefits such as competence, a brand name, a reservation system, and better investment protection—particularly investment in larger hotels (Brickley et al., 1991). Vertical integration enables the chain to diversify risk more effectively, and larger facilities find these benefits becoming more important.

## 5. Conclusion

The study focuses on increasing understanding of factors relating to the variety of governance structures in the hotel industry. Hotel amenities and environmental factors are agency-based factors that offer insight into governance. Nevertheless, the principal–agency perspective provides only a partial explanation of contract decisions. This research may be informative to researchers seeking to make further theoretical and empirical contributions to this important managerial decision.

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