Hotel Management: a Transaction Cost Approach

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Abstract

Transaction Cost Economics is a tool used to better understand the “make or buy” decision in hotel management. This paper tests Transaction Cost theory by analyzing 75 transactions at five hotels. Examples of transactions include accounting, transportation, sewage, guest services and laundry. A hotel manager with over twenty years of experience characterized each transaction with respect to its associated asset specificity, frequency, uncertainty and presence of economies of scale. Transaction Cost theory predicts that these four characteristics influence firms’ make or buy decisions. A tabular analysis is used to test the hypothesis that make or buy decisions in hotel management are consistent with predictions of Transaction Cost theory.

Keywords: Transaction Cost Economics, Hotel Management, Test

1. Introduction

1.1. Hotel management and the TCE framework

Every hotel, no matter the size or scale, faces a seemingly simple set of “make or buy” decisions. Whether it’s the First World Hotel in Malaysia (6,118 rooms) or Hotel Woodpecker in Sweden (one room), every hotel must decide which of the goods and services it provides it will produce itself and which it will purchase from an outside vendor. This set of decisions is a small but important part of hotel management. Most hotels, even the smallest ones, usually have a dozen or more departments, all facing “make or buy” decisions. The owner, manager, department heads and financial controllers comprise the chain of command responsible for making these decisions.

Decisions like these are examined in detail in the sub-discipline of economics known as Transaction Cost Economics (TCE). An example of a “make or buy” decision in hotel management would be: Do you wash your own linens or do you hire a laundry service? Many factors must be considered in making such decisions. TCE identifies these factors and makes predictions regarding how each should influence make or buy decisions. The complete version of this paper tests these predictions using 75 decisions made in five different hotels. This version will introduce the results of the 75 decisions, although discuss in detail only two of the fifteen transactions.

Section 2 of this paper introduces the theory of TCE. Section 3 describes briefly the nature of the hotels being analyzed. Section 4 describes the transactions being examined; while Section V explains the implementation and methodology of test as it applies to two transactions (The complete version of this paper analyzes fifteen transactions in detail). Section VI will discuss the results of 75 transactions and summarize the findings.

2. Theory

TCE is a tool that is used to better understand the institutions that coordinate economic transactions. Most economics courses focus on a particular economic institution: the market. TCE helps us understand non-market institutions such as for-profit firms, non-profit firms, governments, households, churches and universities.
2.1. transactions and transaction costs

A Transaction is best defined by Oliver Williamson\(^1\) as “the exchange of a good or service across a technologically separable interface.” Transaction Costs are costs incurred from finding a trading partner, writing an agreement, monitoring whether the agreement is being followed, enforcing the terms of the agreement and modifying the terms over time. Transaction costs do not include production or distribution costs.

2.2. governance structure

The institutions used to coordinate economic transactions are called Governance Structures. Thomas Palay\(^2\) defines a governance structure as the “institutional framework in which contracts are initiated, negotiated, monitored, adapted, enforced and terminated.” All transactions generate transaction costs. Transaction cost economists believe that governance structures are matched to transactions with an eye to reducing these costs. The study of this matching is interesting because different governance structures differ in their ability to reduce particular types of transaction costs, and transactions differ in the types of transaction costs they generate.

It is appropriate to think of governance structures as lying along a continuum. At one extreme, you have spot market contracting. Referring back to the hotel laundry example, an example of spot market contracting would be the hotel sending all of their laundry to an external service. At the other end of the governance structure continuum is vertical integration. If a hotel vertically integrated their laundry service, they would be responsible for washing all of their own laundry. In between spot market contracting and vertical integration, you have what is called “relational contracting,” or a “relational tie.” Relational contracting can take the form of a wide range of contracts and agreements. Relational contracts can have elements of both spot market contracting and vertical integration.

2.3. behavioral assumptions

The matching of transactions to governance structures is no easy task. Oliver Williamson identified two key behavioral assumptions that further complicate the process\(^1\). (1) “The recognition that human agents are subject to bounded rationality.” (2) “The assumption that at least some agents are given to opportunism.” If humans are subject to bounded rationality, it implies that their ability to solve complex problems and process information is limited. This does not refer to the human’s ability to think rationally, rather their inability to make completely informed decisions all of the time. The second assumption is that some humans may act opportunistically. This implies that humans tend to act advantageously and in their own self-interest, often times at the expense of morals, ethics, promises and agreements.

Opportunistic behavior is most likely to occur when market forces are weak. To illustrate, consider a trader who needs a service that is offered by many different companies. If the trader pays for company X’s services, and company X acts opportunistically, there would be no hesitation on the trader’s part to switch the company with whom they trade. If, on the other hand, the trader has few or no alternative trading partners, the company X has more latitude to act opportunistically.

2.4. specific investments, opportunism and market forces

Transaction cost economists have identified the presence or absence of transaction-specific investments as an important factor influencing the power of market forces. Such investments lead to a weakening of market forces because the loss of the value of the transaction-specific investments a company has made if it takes its business elsewhere makes the threat it will actually do so less plausible. If the assets involved are non-specific, the trader has free range to choose the company that offers their services at the best price. When the assets involved become more specific, and the number of alternative providers decreases, then the threat of opportunistic behavior increases, because they know that the trader has very few if any other companies to turn to. Thus transaction-specific assets tend to lock trading partners into an exclusive relationship. Trader identity becomes much more important as the number of available trading partners decreases.

Thus the trick is to analyze a specific transaction’s complexity and agents involved, and create a governance structure that can best reduce the effects of incomplete information and protect against opportunistic behavior. Klein, Crawford and Alchian made the following assumption: In spot market contracting, transaction costs increase more rapidly as asset specificity, uncertainty and frequency increase, than they otherwise would under a vertically integrated governance structure\(^3\).
2.5. critical dimensions of a transaction: asset specificity, frequency and uncertainty

Williamson has explored the role of asset specificity, uncertainty and transaction frequency in governance structure choice in many papers and several books. The following passages are based heavily on his work and the work of his students. According to Williamson¹, the following are the critical dimensions influencing governance structure choice.

2.6. asset specificity

If an asset is highly transaction specific, it means there is a lack of transferability of that asset to another use or user other than the function for which is was originally intended. The transaction is not what is specific, but rather the assets that support or coordinate that transaction. As the specificity of the assets involved in a transaction increase, the risk for opportunism rises; this gives incentive to vertically integrate that transaction. Williamson identified six main types of asset specificity. They are: site specificity, physical asset specificity, human asset specificity, brand names, dedicated assets and temporal specificity. The four most relevant asset specificities related to the hotel transactions being analyzed are explained in detail below.

2.6.1. physical asset specificity

Physical asset specificity refers to a machine, tool or asset with the capabilities only to meet the needs for that which it was initially intended for. Joskow⁵ defines asset specificity as being “When one or both parties to the transaction make investments in equipment and machinery that involves design characteristics specific to the transaction and which have lower values in their alternative uses.” When physical assets become highly specific, they become “locked in” with the agents and transactions they are supporting. Palay’s paper regarding the governance of Rail Freight Contracting provides a look at the specificity of rail cars². Palay found that the most highly specific rail cars were those used in the transportation of finished automobiles. These finished automobiles required specialized rail car characteristics and design. Weight, size, material used and capacity were all designed based on the specification of the automobiles they would be transporting. This rail car is not necessary or usable for transporting alternative cars or products, making it a very specific physical asset; whose value rests in its ability to transport the cars it was originally designed to carry.

2.6.2. site specificity

Site specificity refers to the usability of a physical location. If a physical site is selected based on its geographic location or relative proximity to another dependent site, then the site is highly specific. Like the physical assets, when a location becomes highly site-specific, it becomes locked in to supporting only the transaction for which it was originally intended. Reasons for investing in specific sites may be to reduce transportation and labor costs. An example of site specificity comes from Joskow⁷. He discusses the governance structures of Electric Generating Plants based on varying degrees of asset specificity. In this case, the type, amount, design and procurement methods of coal are all plant specific. If a plant needs to be constructed in order to burn a specialized type of coal, in specific quantities and along on a specific time table, a “mine-mouth plant” needs to be constructed. This means building the plant literally at the mouth of the mine. The plant is intentionally built next to the mine to reduce both the cost of transporting the coal, and the time it takes to get the coal from the mine to the plant itself. The physical proximity of the plant to the mine is the most efficient way to reduce transaction costs in this situation, thus there is a high degree of site specificity.

2.6.3. human asset specificity

This refers to the training or knowledge one is required to have in order to complete a task. If that task is no longer necessary, the individual would no longer have a need for that specific training or knowledge. Typically, this knowledge is gained from a “knowing by doing” fashion. The skills and knowledge are highly specific to a certain relationship in which the transaction’s completion is dependent on the presence of those skills. When the skills are highly specific they are not transferable, they becomes locked in to supporting only the transaction for which they were originally intended. James Acheson’s 1985 paper provides an example of a human specific asset⁶. Acheson
discusses the complex relationship between the fishermen, the dealers and the wholesalers. Many dealers start out as fishermen and establish themselves into dealers later on. As a dealer, responsibilities include hiring fishermen, providing most if not all of their equipment, paying for their services and holding the catch. Wholesalers, by nature of their position in the lobster market, can dictate price and quantity of lobster. Thus it can be frustrating for dealers who have already incurred fishing costs to not receive the price they originally wanted from the wholesalers. Knowing how to give and take from both the fishermen and wholesalers is a skill and knowledge base that can only be gained by being a dealer and living the life. The industry specific skills associated with being a lobster dealer are not transferable. If the lobster industry died out, dealers would need to learn a new trade, as their lobster specific knowledge is not nearly as valuable in an alternative industry. Dealers in the lobster market consequently possess a high degree of human asset specificity.

2.6.4. dedicated asset specificity

Joskow’s 1985 paper defines it as “general investments that would not take place but for the prospect of selling a significant amount of product to a particular customer.” An example can be drawn from Joskow. If a general electric plant is built solely for the purpose of processing coal based on a specific contract, that plant becomes a dedicated asset. The plant would not have otherwise been constructed, and have no alternative value, other than for its use in the contract for which it was originally created (plant is locked in). The plant’s location and capabilities to other mines would be irrelevant, as the investment has been made in the facility to meet the needs of that one specific mine, and the premises of the original contract. Thus, the plant would have a high degree of dedicated asset specificity.

2.7. dimension #2: frequency

In 1979, Williamson described frequency in his paper, Economic Organization. He stated “frequency can be characterized as one-time, occasional or recurrent.” When examining the frequency of a transaction, the rate of occurrence and the expected rate of occurrence of the exchange are noted. In the context of hotel laundry, linen and towels are used every single day; therefore, there is laundry to be washed every day on a continuous basis. This is an example of a transaction with high frequency. On the other hand, when the hotel requires interior decorating for the Christmas holidays, it happens once a year, and is a very infrequent transaction. Williamson came to the conclusion, that under the TCE theory, as a transaction’s frequency increases or promises to be held on a long-term basis, a vertically integrated governance structure can reduce long run transaction costs.

2.8. dimension #3: uncertainty

There is an element of uncertainty in every transaction. As discussed earlier, humans are subject to bounded rationality, leaving room for error. As the nature of the transaction becomes more complex, the chance of an individual acquiring all the knowledge and information surrounding the exchange becomes less likely. As the level of uncertainty increases, the ability to monitor and limit opportunistic behavior decreases. Klein, Crawford and Alchian explain that as a transaction becomes more specific and complex, each component of the transaction carries more independent importance. With a highly complex transaction, there will be more contingencies to consider, and consequently more potential outcomes. The inability to observe and monitor all of the outcomes of a complex transaction creates uncertainty. When there is uncertainty, there is an increased possibility for a party to act opportunistically. This forces costly, extensive contracts to be written in order to try to reduce the level of uncertainty.

An example of uncertainty can be drawn from Bell’s 1982 paper concerning the creation of the Lockheed L-1011 jet. Construction of the plane was subcontracted out to Rolls Royce. Many subcontractors were then employed to complete other components. All of them were initially designed to fit the specifications of a brand new, “cutting edge” engine that was being built by Rolls Royce. No one knew whether the engine would turn out the way its designer’s had originally intended, nor were they sure it was being built in the correct manner or time frame. There is no way for any one person or even Boeing to possibly keep tabs on every contractor all the time. This example shows a high degree of uncertainty and incomplete information. Williamson determined that as uncertainty increased, a vertically integrated governance structure would help reduce the communication errors and the incomplete information, similar to those found in the Lockheed L-1011 example.
Williamson determined that as levels of uncertainty increased, the expected frequency increased and the degree of asset specificity increased, a vertically integrated governance structure would be most effective in reducing transaction costs.

2.9. economies of scale (eos)

EOS is a condition that must be considered when analyzing the three critical dimensions of a transaction. “Economies of scale can be realized when production increases, and the cost of producing each additional unit falls.” The financial benefits of EOS may outweigh the benefits to vertically integrating a transaction. As the presence of EOS increases, the specificity of the asset will also need to increase, in order for a company to find financial advantages to vertically integrating.

The Lockheed L-1011 example from Bell’s 1982 paper shows the presence of EOS trumping TCE theory. The asset specificity and uncertainty involved with production of a jet are extremely high. Vertical integration would reduce transaction costs, information gaps and the risk of opportunistic behavior. So why would Boeing choose to subcontract the construction of plane? The answer is the presence of EOS. Production efficiency is key here. Boeing asked subcontractors who already produce similar types of products for other planes to produce a slightly modified version for theirs. The costs of these modifications are less than the cost of Boeing producing it themselves. The subcontractors already have the know-how, technology, employees, production design and machinery/tools. Evident by the governance structure used (relational contracting); the benefits of EOS outweighed the transaction costs incurred from the highly specific assets and uncertainty.

3. Hotels: Nature and Specifications

3.1. hotel #1: the chanler

The Chanler is the first mansion on the famous “Cliffwalk” in historic Newport, Rhode Island. This hotel features twenty uniquely decorated guestrooms, a casual grill and a fine dining restaurant (The Spiced Pear). The Chanler does not offer many extra-curricular services that traditional hotels might, though its prime location on the cliff walk and relative proximity to the beach highlight the hotel’s marketability. The fine dining restaurant was given the “Award of Excellence” by Wine and Spectator Magazine. The Chanler is one of the finest hotels in the State of Rhode Island, and ranks among the top resorts in New England (Boston Magazine, 2007). There are 80 employees and only 20 rooms; at capacity, the employee to guest ration is 2:1.

3.2. hotel #2: meadowood resort

Meadowood Resort is located in the heart of wine country, in St. Helena, California. Meadowood, relative to the other hotels in this comparison, is the largest most developed property. Set on 250 acres of land, the hotel features championship croquet lawns, eight tennis courts, a nine-hole walking golf course, hiking trails, swimming, a full-service health spa and an on-site wine educator. Meadowood not only caters to its guests, but the 900 members that pay top dollar to make use of the property’s facilities year round. Meadowood is considered one of the finer hotels in the country (Relais Chateaux, 2007, Andrew Harper Hideaway Report, 2007). With 300 employees and 99 rooms, the employee to guest ratio at capacity is 1.5:1.

3.3. hotel #3: nisbet plantation

Nisbet Plantation is located on the Caribbean island of Nevis. Located on 30 beachfront acres, Nisbet has 16 Caribbean style cottages that harbor a total of 36 elegant guest rooms. The hotel has two full service bars, two casual grills and a formal dining restaurant. Tennis, croquet and an array of water/beach sports are available onsite; ready to help you are 87 staff members. At capacity, the employee to guest ratio is about 1:1. This hotel ranks as the second largest on the island, behind the 150 room Four Seasons Resort. In 2003, Nisbet was ranked the third best resort in the Caribbean (Reader’s Choice Awards, 2007)
3.4. hotel #4: the point

The Point is the last standing Great Camp of William Rockefeller; located in Saranac Lake, New York. It has been maintained to resemble the original design and feel the property offered in the late 1800’s. There are 12 guest rooms, accommodating up to 24 people on the 75 acre property. At capacity, with 40 employees, the employee to guest ratio is almost 2:1. Fine and causal dining are offered on-site. Hiking, water sports, tennis, croquet and all winter sports (season permitting) are among the many activities available to guests at The Point. The Point has been rated as high as number 1 in North America and number 2 worldwide. (Condenaste, 2002)12

3.5. hotel #5: waterloo house

Waterloo House is located on four acres along Hamilton Harbor on the island of Bermuda. There are 30 rooms and seven suites in this well known and respected hotel. Water sports, tennis, croquet and putting greens keep guests entertained, should the island of Bermuda and its busy capital of Hamilton fail to do so. The restaurant at the Waterloo House in known worldwide to be one of the best on Bermuda, while the hotel itself was rated the ninth best small hotel (Travel and Leisure, 2006). At capacity, the employee to guest ratio is a little less than 1:1.13

4. Hotel Transactions

There are dozens of transactions that occur within the operation of a hotel. The fifteen specific transactions that will be analyzed in the complete version of this paper are: laundry, accounting, security, office equipment, vehicles, sales dept., website, public relations, sewage, interior decorating, events/catering, guest services, payroll, human resources and purchasing. For the purposes of this paper, Laundry and Public Relations will be discussed. Analyses of these two transactions relative to their governance structure will provide insight into the effectiveness of the TCE framework.

4.1. laundry

As a transaction, laundry refers to the washing, drying and pressing of guest room, restaurant and spa linens.

4.2. public relations

As a transaction, a hotel will hire a public relations agent or firm, whose responsibility is to attract the attention of travel agents and writers. The agent or firm coordinates meetings, visits, phone calls and media appearances to allow the travel writer an opportunity to report on the hotel and expose the hotel name/reputation.

5. Implementation

The following section will provide a look at two transactions. The level of asset specificity, frequency, uncertainty and presence of EOS will be determined. These findings will then be compared to the actual governance structure employed by the hotel. Williamson determined asset specificity to be the most important dimension on which governance structures are based1. For this reason, the raw asset specificity value (1-3) will be multiplied by two, to carry more weight. More important than their totals, are the patterns existent amongst the governance structures in each hotel. Actual Governance (Spot Market, relational tie or vertical integration), refers to the actual governance structure implemented at the respective hotels for the given transaction. The rows will be headed by each of the five hotels in discussion. The following premises should be noted: 1. The value in the “Row Totals” column is simply a numerical characterization of the degree of relative asset specificity, frequency and uncertainty of each hotel’s transaction. 2. A relational tie can have traits more similar to spot market contracting than vertical integration and vice versa (continuum). 3. Patterns are expected to emerge; as the Row Totals value increases, the actual governance should tend to be vertical integration. 4. A high degree of one characteristic may make up for weaker values in the other two, or vise versa. 5. “Industry norms” are not provable facts, but rather the educated opinion of Tim Thuell; a manager in the small hotel industry for over twenty years14.
Asset Specificity is rated on a scale of (1-3) 1 is non specific and easily transferable. 2 is somewhat specific and relatively transferable. 3 is high specific and not transferable. Frequency is rated on a scale of (1-4). 1 is one or two times per year. 2 is once a month. 3 is once a week. 4 is on a daily basis. Uncertainty is rated on a scale of (1-3). 1 indicates a low level of uncertainty. 2 is a moderate level of uncertainty. 3 is highly uncertain.

Table 1. values of the critical dimensions for ‘laundry’ versus actual governance

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Asset Specificity (2-6)</th>
<th>Frequency (1-4)</th>
<th>Uncertainty (1-3)</th>
<th>Row Totals (4-13)</th>
<th>Actual Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chanler</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>9</td>
<td>Spot Market</td>
</tr>
<tr>
<td>Meadowood</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>10</td>
<td>Relational Tie</td>
</tr>
<tr>
<td>The Point</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>9</td>
<td>Vertical Integration</td>
</tr>
<tr>
<td>Nisbet</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>12</td>
<td>Vertical Integration</td>
</tr>
<tr>
<td>Waterloo</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>10</td>
<td>Vertical Integration</td>
</tr>
</tbody>
</table>

The industry norm for laundry is relational contracting. Table 1 shows the Chanler uses spot market contracting; Meadowood uses relational ties, while The Point, Nisbet, and Waterloo all vertically integrated. Looking at asset specificity, all of the hotels have values of 4, except for Nisbet which has a 6. The machines used in this transaction are not your average washing machines. They are specifically designed for larger quantities of sheets, towels, and delicate cloths. Although they are specialized assets, these machines can be used by spas and other hotels. Essentially if any of these hotels went out of business, the machines could be used by another hotel or facility. In the case of Nisbet, the machines were customized to fit the physical specifications of the room in which they were kept. It is important to keep in mind that the demand for customized industrial grade washing machines on an underdeveloped Caribbean island in the early 1990’s was not that great. Had Nisbet gone out of business, there would have been no alternative use for the assets.

Notice the frequency at all the hotels was valued at 4; at least once a day. There is a constant need for laundry to be done. Uncertainty varied from none to moderate across the five hotels. The Chanler has a good standing relationship with the company it hires to wash its laundry. Inventory is well monitored and accounted for, and they are confident with the quality of the service offered by the laundry company; uncertainty at The Chanler is low. The Point owns an offsite laundry facility. The chance for opportunistic behavior is low, due to the fact that it is owned by the Point, and the employees are hired internally. With Meadowood, the moderate uncertainty is based on the size of the operation. While inventory is kept, the laundry is transferred from hotel to truck, to processing, to washing/drying/pressing, to truck back to hotel. The transaction is more complex...leading to greater uncertainty. Nisbet and Waterloo face an interesting dilemma. They utilize a vertically integrated governance structure. The problem is the absence of an alternative or a solution if they experience internal problems. Bermuda and Nevis lack the technological wherewithal to quickly remedy any issues they may have. Additionally, there are no external laundry services on either island to support the transaction should they experience problems.

EOS is an important factor in the laundry transaction. The Chanler experiences positive effects from EOS. The company they hire is responsible for several other institutions. When their machines are being used efficiently, they can offer reduced per unit prices to The Chanler (lower price per pound). With no physical space to build a laundry facility onsite, the cost of building, running and maintaining an offsite laundry facility for the Chanler is greater than the cost of hiring an outside company. Nisbet and Waterloo do not have access to laundry facilities that might offer financial benefits from EOS. Meadowood certainly gains from hiring a large outside laundry service due to their large quantities. EOS provides incentive for Meadowood to not vertically integrate. Currently they have limited onsite capabilities to handle immediate issues and emergencies.

TCE theory succeeded in explaining the results from analyzing the laundry transaction. High frequency and asset specificity values, along with the absence of EOS resulted in Nisbet, Waterloo and The Point vertically integrating. The presence of EOS has kept The Chanler satisfied with spot market contracting, while Meadowood enjoys some financial benefits with its relational contract.
Table 2. values of the critical dimensions for ‘public relations’ versus actual governance

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Asset Specificity (2-6)</th>
<th>Frequency (1-4)</th>
<th>Uncertainty (1-3)</th>
<th>Row Totals (4-13)</th>
<th>Actual Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chanler</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>8</td>
<td>Spot Market</td>
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<tr>
<td>Meadowood</td>
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<td>Spot Market</td>
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<td>Nisbet</td>
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<td>Waterloo</td>
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The industry norm for public relations (PR) spot market contracting. Table 2 shows all of the hotels except for Waterloo would hire a PR firm, which would be responsible for getting travel writers to write about the hotel. The asset specificity is low here. While there are some PR firms that are more reputable than others, they all have the ability to perform the job to the same capacity. If the hotel went out of business, the PR firm would have no problem finding another institution in need of PR management.

Frequency values were high across the board. PR is a daily, ongoing process that never stops or slows down. Waterloo did not feel the need to pay for an outside company to do its PR. They hired someone within the company, whom had other responsibilities; for this reason, the frequency value was not 4 (daily). Uncertainty was moderate in all cases. When you have little to no control over the actions of the company providing the service, there is no way to monitor how much effort and time they are putting into the PR. There is no control over what is advertised, and which travel writers they attract. Even though the purpose of the PR firm is to get travel writers, there are no guarantees positive reviews will come about. Opportunistic behavior on the part of the PR firm is limited due to the presence of competition. A hotel that is displeased with their PR firm could easily find an alternative company.

EOS should be taken into consideration when deciding between doing your own PR or hiring an outside company. The outside companies that specialize in coordinating travel agents and writers will definitely have a much more effective method for finding them. They have the specific skills required to attract travel writers, and the tools they need to arrange visits, trips, phone calls and media sessions. Since PR firms will have a multitude of clients, the cost to a single firm will likely be lower than the cost of a firm vertically integrating their own PR.

TCE explains this transaction well. The values were lower across the board (with the exception of frequency). The non specific assets and the moderate uncertainty were combined with the positive effects of EOS to direct four of the five hotels towards spot market contracting.

6. Results

Table 3. raw score of transactions (4-13) versus actual governance structure employed

<table>
<thead>
<tr>
<th>Governance Structure</th>
<th>4</th>
<th>5</th>
<th>6</th>
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<th>9</th>
<th>10</th>
<th>11</th>
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<th>13</th>
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<tbody>
<tr>
<td>Spot Market</td>
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<td>Relational Tie</td>
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<tr>
<td>Vertical Integration</td>
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</table>

Table 3 represents the number of transactions assigned to each governance structure relative to its raw score. The numbers in the table represent the number of transactions that fell into each governance structure relative to their ‘raw score.’ A pattern is evident, though not well distinguished. TCE theory hypothesized that as the raw score increased, the preferred governance structure would tend towards vertical integration. There were no spot market contracts used for transactions which had raw scores greater than 9. There were no relational ties for transactions with a raw score greater than 11. For the four transactions that received raw scores of 12, only vertical integration was used. For the most part, TCE theory proved to be correct; in that as values of frequency, uncertainty and asset specificity increase, the tendency of the governance structure was to shift from spot market, to relational ties to vertical integration. There is a downward slop evident from in Table 1 implying validity to the TCE hypothesis.
7. Conclusions/Suggestions for Future Research

TCE proved to be a helpful and accurate tool when applied to hotel management. The hypothesis suggests that when the value of the transaction’s critical dimensions increase, vertical integration becomes the most efficient governance structure. Should further research on this topic be conducted, it would be advisable to select transactions with more governance structure variety. Of the 75 transactions analyzed, 40 assumed a vertically integrated governance structure, 26 assumed relational contracts and only 9 used spot market contracts. Since the nature of the transactions selected favored vertical integration, the theory was not able to efficiently evaluate the other end of the governance structure continuum (spot market contracting). It should also be noted that this was a small case study on 5 small hotels and 15 transactions. Larger more in-depth studies would surely provide further evidence as to the validity of the TCE theory.

8. Acknowledgements

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9. References

14. Interview with Tim Thuell, General Manager, October 6th, 2007