



Discussion paper

What matters for hotel executives? An examination of major theories in non-equity entry mode research

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ABSTRACT

This study examines the non-equity entry mode decisions of high-level executives in the international hotel industry, specifically the choice between franchising and management contracts. This quantitative study is based on a self-selected scenario-based online survey of 110 hotel executives. The primary objective of the study was to develop and test hypotheses through the combined theoretical lenses of transaction cost economics and the resource-based view. The hypotheses were tested through a logistic regression and the findings show that intangible assets and resources are the most important consideration in deciding between franchising and management contracts when internationalising hotels, generally prompting the use of management contracts. It was also found that uncertainties in the host market may lead hotel executives to choose franchising over management contracts, and finally, that asset specificity may prompt the use of management contracts over franchising.

1. Introduction

The mode used to enter a foreign market is a central consideration in the internationalisation process of multinational corporations (Quer et al., 2007). It determines the future of the operations in the host country and constitutes one of the most critical factors for success (Anderson and Gatignon, 1986; Leon-Darder et al., 2011). The importance of this decision is reflected in the literature, where considerable attention is paid to the phenomenon by scholars in the field (Agarwal and Ramaswami, 1992; Anderson and Gatignon, 1986; Brouthers and Brouthers, 2003; Brouthers et al., 2008; Brouthers and Hennart, 2007; Canabal and White, 2008; Dev et al., 2007; Werner, 2002).

Non-equity entry modes have become increasingly popular with hotel organisations (Contractor and Kundu, 1998b; Erramilli et al., 2002; Martorell-Cunill et al., 2012), the restaurant industry (Enz, 2008) and the broader tourism industry (Nowak et al., 2010). The hotel industry is characterised as being capital intensive in the ownership of physical assets such as real estate. It is therefore common to separate industry knowledge and managerial expertise from the ownership of these physical assets in the form of non-equity entry modes (Brown et al., 2003; Contractor and Kundu, 1998a; Gannon et al., 2010; Martorell-Martorell-Cunill and Forteza, 2010; Rodríguez, 2002). According to Martorell-Cunill and Forteza (2010), Erramilli and Rao

(1990) and Pla-Barber et al. (2010), control does not necessarily need to be sacrificed when non-equity entry modes are used, despite the fact that the investment commitment is generally lower in such modes. This allows firms to expand more rapidly (Pine et al., 2000) and allows for market concentration (Martorell-Martorell-Cunill and Forteza, 2010). It is likely that for these reasons Contractor and Kundu (1998b) found that hotel properties that have used non-equity entry modes constitute 65.4% of all multinational hotel organisations worldwide—a trend that has increased greatly since the publication of Contractor and Kundu's study in 1998 (Alon et al., 2012; Martorell-Martorell-Cunill and Forteza, 2010).

It is surprising to find in the literature that the idiosyncrasies of different non-equity entry modes in the hotel industry seem to have been generally overlooked or understated by many researchers, apart from some notable exceptions (see the literature review). There are several forms of non-equity entry mode, ranging from exporting to various types of contractual agreements, including licensing, franchising and management contracts, all of which have their own idiosyncrasies (Anderson and Gatignon, 1986; Erramilli and Rao, 1990; Pan and Tse, 2000). However, the majority of previous research considers all non-equity modes as one category and compares this with equity entry modes as a second category. By doing so, these studies disregard the complexity, heterogeneity and relationships between non-equity modes (Contractor and Kundu, 1998b; Villar et al., 2012). Finally, and

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most importantly, although there has been previous research examining factors that influence a hotel organisation's entry mode decisions, it has generally been conducted employing samples that are not actually in charge of these strategic level decisions (e.g., Erramilli et al., 2002; Martorell-Cunill et al., 2013a, 2013b; Villar et al., 2012).

An exploratory study conducted by Kruesi et al. (2017) aimed to begin filling this gap through qualitative interviews with a group of experts including hotel executives, who are directly involved in decision between different non-equity entry modes. The aim of the study was to understand, which theories of new institutional economics would be most appropriate further analyses in this context. Kruesi et al. (2017) suggest that transaction cost economics (TCE) and the resource-based view (RBV) would be the most suitable new institutional economics theories to understand hotel's non-equity entry-mode decisions.

This study, which builds on Kruesi et al. (2017), further investigates the views of decision making level hotel executives with respect to what factors impact most on their non-equity entry mode decisions, based the theoretical foundation of TCE and the RBV through quantitative survey methods. To the best of our knowledge, this study is the first quantitative research to examine the critical factors that influence the entry mode choice between management contracts and franchising using a sample of high-level hotel executives. The remainder of the present study is structured as follows: Initially the literature on entry mode research is briefly reviewed, followed by a review of TCE and the RBV. The hypotheses of this study are then presented followed by an outline of the methodology. Finally the findings of the study are presented followed by a discussion linked in the findings to previous literature before concluding the paper.

2. Literature review

2.1. Entry mode research review

Since the inception of international business research, entry mode choice has been considered one of the most critical decisions in the internationalisation process (Anderson and Gatignon, 1986; Brouthers and Hennart, 2007; Hill et al., 1990; Quer et al., 2007; Wind and Perlmutter, 1977). Entry modes directly relate to the international activity of firms and are defined as:

a structural agreement that allows a firm to implement its product market strategy in a host country either by carrying out only the marketing operations (i.e., via export modes), or both production and marketing operations there by itself or in partnership with others (contractual modes, joint ventures, wholly owned operations). (Sharma and Erramilli, 2004, p. 2)

The literature on international entry modes is vast, as can be seen in the reviews conducted by Brouthers and Hennart (2007), Canabal and White (2008), Sarkar and Cavusgil (1996) and literature meta-analyses conducted by Morschett et al., (2010), Tihanyi et al. (2005) and Zhao et al. (2004). This vast body of literature has come about because of the importance of entry mode decisions in the internationalisation process, arising from the effect they have on the performance of the entering firm (Brouthers, 2002). Moreover, the entry mode choice is critical because, as pointed out by Brouthers and Hennart (2007), it is challenging, and perhaps even impossible, to change once a firm has entered a foreign market. This has significant long-term consequences for the entering firm. However, from an industry perspective, there is still confusion as to what entry mode works best. According to Morschett et al. (2010), while there has been substantial research done on international entry modes over the past decades, there is still no clear consensus from empirical studies regarding the effect of the variables commonly put forward to determine entry mode choice.

2.2. Non-equity entry modes in the hotel industry

This study is focused on the two most widely used non-equity entry modes in the hospitality industry: franchising and management service contracts, or branded management contracts (management contracts) (Contractor and Kundu, 1998a, 1998b; DeRoos, 2010; Pla and Leon, 2002; Sandman, 2003; Zeng, 2010). These entry modes are referred to as 'asset-light' modes by industry practitioners. The key difference between franchising and management contracts is that, although both are collaborative modes, franchising is an inter-firm transaction that crosses firm boundaries, while a management contract is an intra-firm transaction that remains within the firm boundaries (Contractor and Kundu, 1998a; Dev et al., 2002; Erramilli et al., 2002; Fladmoe-Lindquist and Jacque, 1995). Although both franchising and management contracts are non-equity modes, the management contract offers more strategic and operational control for the entering firm than franchising, but at the cost of being more resource intensive (Contractor and Kundu, 1998a, 1998b; Pla and Leon, 2002). The degree to which the control is shared between the parties involved in the contract is referred to as the governance structure (Argyres et al., 2012; Brouthers and Brouthers, 2003; Contractor and Kundu, 1998a; Dev et al., 2002; Erramilli et al., 2002; Erramilli and Rao, 1993; Madhok, 1996; Williamson, 1979, 1996). It should be noted that there is one other non-equity entry mode used by hotel organisations, namely leasing. In leasing, the hotel organisation rents a building and runs the entire operation independently (Gee et al., 2008). Therefore, by not owning the building, it is also by definition a non-equity mode. However, leases are not a focus of this study. Firstly, leases are not very popular and quite rarely used in the hotel industry because they are risky and costly (Hotel Innovations and Technologies, 2013). Secondly, while leases are technically non-equity modes, they are closer to the ownership model and therefore are an 'asset-heavy' way to develop. Besides the risk, the reason leases are not as popular as management contracts and franchising is that companies cannot develop a large number of properties with lease agreements because the balance sheet would become too heavy (Hotel Innovations and Technologies, 2013). In other words, while leases are technically not owned by the hotel organisation, the lease payments or 'rent' for the property becomes a continual fixed expense, regardless of the profit or loss the hotel organisation experiences. The adverse effects of this were highlighted in the last financial crisis, when hotel organisations heavily leveraged with leases had significant losses while still having to pay the same rent (Hotel Innovations and Technologies, 2013). Finally from the hotel owners perspective, it was found that hotels under management contracts sell at a higher premium than those under lease agreements (Hodari et al., 2017).

2.3. Theoretical foundation

Transaction cost economics (TCE) and the resource-based view (RBV) were chosen as the theoretical foundation for this study based on the findings of Kruesi et al. (2017). TCE views firms as governance structures and is fundamentally concerned with the 'make or buy' decision, that is, evaluating the governance structure that will incur the least amount of transaction costs. TCE weighs up the cost of market procurement over the cost of internalisation and involves the comparative assessment of planning, monitoring, enforcing and adapting the costs involved in a transaction and the alternative organisational forms available (Williamson, 1985). Conversely, From the RBV, the basis of every firm's competitive advantage is posited to rest in its heterogeneous resources or capabilities. A resource can be thought of as an asset that is tangible or intangible, such as capital or machinery and brand names or production/operational knowledge respectively, moreover, it can be human or non-human (Barney, 1991). As will be outlined in the review below, TCE and the RBV can be used to support the choice between different entry modes based on the findings of several entry mode studies. Moreover, TCE and the RBV are especially

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