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Hotel outsourcing under asset specificity: "The good, the bad and the ugly"

Glauco De Vita [a, *], Arafet Tekaya [b]

[a] Faculty of Business, Oxford Brookes University, Oxford, OX33 1HX, UK
[b] Independent Management Consultant, PLASTEKA s.a.r.l., Rue El Quods, Zone Industrielle Ezzahra, 2034, Tunisia

HIGHLIGHTS

- Three case studies investigating the performance of Tunisian hotel outsourcing.
- We apply TCE to examine hotel outsourcing relationships under asset specificity.
- Working within post-positivism, we find evidence of falsification value.
- Insights have important implications for the management of hotel outsourcing.

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ABSTRACT

This paper presents three case studies developed to investigate outsourcing outcomes in the Tunisian hotel industry. The paper applies a transaction cost economics (TCE) logic to examine potential contracting problems stemming from hotel outsourcing under asset specificity conditions. Working within the tradition of post-positivism, we find case study evidence of significant falsification value regarding TCE propositions on the performance consequences of unilateral and bilateral relation-specific investments and their holdup potential. Our insights have important practical implications for the management of hotel outsourcing relationships characterized by high asset specificity.

1. Introduction

Although outsourcing is a pervasive feature of inter-firm cooperation in the hospitality industry, research on hotel outsourcing is scant (e.g., Donada & Nogatchewsky, 2009; Espino-Rodríguez, Lai, & Baum, 2012; Espino-Rodríguez & Padrón-Robaina, 2004; Gonzalez, Llopis, & Gasco, 2011; Lamminmaki, 2011; Wan & Su, 2010). The limited research attention is striking also because of the theoretical importance of inter-firm contracting in the context of the firm's make-or-buy decision, "the canonical transaction for transaction cost economics (TCE)" (Williamson, 2008, p. 5).

According to TCE, transaction costs under alternative governance structures (market, hybrid or hierarchy) are at the heart of the firm's boundary choice. The key factors that influence transaction costs are uncertainty, frequency and, most especially, asset specificity (Williamson, 1985). Asset specificity emerges when, to transact with another party, one party makes a relation-specific investment, i.e., an investment the value of which is substantively lower in any use other than supporting the transaction. A core tenet of TCE is that under high specificity, the higher transaction costs to be incurred for safeguarding against opportunism make vertical integration, rather than market (e.g., outsourcing), the most efficient governance structure (Williamson, 1985).

Studies supporting this TCE proposition have flourished in past decades. As Roodhooft and Warlop (1999) spell out: "Managers do take into account transaction costs, at least when they are explicitly specified. Quite rationally, they [are] more reluctant to opt for outsourcing if the outsourcing option [is] associated with asset specific investments" (p. 367). Yet, existing research largely overlooks the question of what happens when firms do choose to outsource under asset specificity conditions (see De Vita & Wang, 2006).

* Corresponding author. Tel.: +44 (0)1865 485798.
E-mail addresses: gde-vita@brookes.ac.uk (G. De Vita), arafet79@yahoo.fr (A. Tekaya).

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With few exceptions (Espino-Rodríguez & Gil-Padilla, 2005; Espino-Rodríguez & Lai, 2014; Espino-Rodríguez, Lai, & Baum, 2008; Espino-Rodríguez & Padrón-Robaina, 2004; Hemmington & King, 2000; Lamminmaki, 2005, 2007) asset specific investments are neglected also in studies examining hotel outsourcing. As a result, several grey areas remain in scholars' knowledge of hotel outsourcing under asset specificity, and how related TCE propositions fare. As highlighted by Song, Dwyer, Li, and Cao (2012), despite the usefulness of TCE, to date this approach has not been widely used in analyzing the behavior of tourism firms. Song et al. (2012) call for future research to apply TCE to analyze inter-firm behavior "within a tourism supply chain, or in the context of service outsourcing" (p. 1663). The present study answers precisely this call.

We employ a case study methodology that, drawing from three outsourcing relationships with high asset specificity content in the Tunisian hospitality industry, offers illustrative evidence of particular theoretical significance. Far from aiming to shoot down one of the most influential theories of industrial organization with a silver "falsification bullet", let alone build an alternative theoretical framework, our attempt is circumscribed to highlighting particular TCE implications about unilateral and bilateral relation-specific investments, their holdup potential, and their consequences for hotel outsourcing, and subjecting these implications to observational scrutiny. Our contribution lies in evidencing performance consequences of managerial decisions that diverge from theoretical predictions thus enhancing understanding of hotel outsourcing relationships characterized by asset specificity.

"The Good, the Bad and the Ugly" is a 1966 Italian "spaghetti western" film that gained critical acclaim in later years, and which is now widely considered as one of the greatest films of its genre of all time. Unlike the homonymous movie, the infamous trio named in the title is not intended to reflect human impersonations nor the character that the eponymous protagonists of the legendary film embodied (*Blondie*, "the good" bounty hunter; *Angel Eyes*, "the bad" sociopathic mercenary, and *Tuco*, "the ugly" bandit). We use the phrase "The Good, the Bad and the Ugly" as the idiomatic expression it has come to signify in some countries' popular culture, i.e., the upsides, downsides and the parts which could have been done better (in this context "The Bad" holds considerably more negative connotations than "The Ugly"). They are, therefore, figurative labels that to preserve the anonymity of the firms involved, have been given to three distinct outcomes of hotel outsourcing under asset specificity.

The case of the "The Good" portrays a very successful outcome that outperforms that which could have been attained by keeping the outsourced activity "in-house". The case of "The Bad" illustrates a devastating outcome characterized by mutual dissatisfaction, significant damage for both parties and, inevitably, contract termination. Finally, the case of "The Ugly" exhibits a somewhat troubled yet still on-going outsourcing relationship in which the parties continue to work together with increasing levels of relationship satisfaction stemming from the adoption of corrective measures that entail systematic relationship appraisal and regular fine tuning of operations.

However, analogously to the legendary "spaghetti western", the plots - which in the movie revolve around the story of a compelling treasure hunt - offer unexpected twists and turns in the dynamics of outsourcing relationships under asset specificity conditions. Moreover, just like the movie director's striking visual approach to his cinematographic epic, the cases allow for the opportunity to zoom in and out; with moments of dramatic "close ups", to search for meaning in the detail of the cases, followed by "widescreen shots", aimed at theoretical contextualization.

2. Asset specificity

Williamson (1985) defines asset specificity as:

> Durable investments that are undertaken in support of particular transactions, the opportunity cost of which investments is much lower in best alternative uses or by alternative users should the original transaction be prematurely terminated. (p. 55)

De Vita, Tekaya, and Wang (2011) recently engaged in a systematic review of "the many faces" of asset specificity. They propose a blended definitional framework that, by categorizing various interpretative patterns of specificity into six focal themes (customization, uniqueness, transferability, asset value outside the relationship, value tied in the continuance of the relationship, and importance of the identity of the transactional parties), highlights their inter-relatedness to aid a fuller appreciation of this multifaceted construct.

The complexity of asset specificity is augmented by the fact that different dimensions have been recognized. The limited yet insightful tourism and hospitality literature on asset specificity (e.g., Espino-Rodríguez & Gil-Padilla, 2005; Espino-Rodríguez et al., 2008; Espino-Rodríguez & Padrón-Robaina, 2004; Lamminmaki, 2005, 2007; Promsivapallop, Jones, & Roper, 2012) has shown that differentiation of these dimensions is highly valuable in empirical application. Hence, it is instructive to treat each category distinctly. Table 1 provides a taxonomy of asset specificity.

3. Theoretical context

Although the methodology we adopt does not entail the formulation of specific hypotheses to be tested, it is still opportune to frame clearly the theoretical areas and related TCE precepts this study focuses on.

The first theoretical grey area relates to the very *existence — and performance of — outsourcing relationships under asset specificity conditions*. According to TCE, high specificity levels are expected to lead to the adoption of internal governance (hierarchy). The very presence of outsourcing under high specificity, therefore, would in itself constitute a deviation from TCE. It is, of course, true that TCE does not categorically (deterministically) exclude the possibility that some companies would still choose to outsource under asset specificity conditions (see, for example, Williamson, 1985; Holcomb & Hitt, 2007; Lui, Wong, & Liu, 2009), but not without adding that this would come at a high cost. Indeed, TCE does categorically postulate that, under asset specificity, the governance performance of outsourcing transactions will be invariably inferior to that of a hierarchy. This may explain why Espino-Rodríguez and Lai (2014) find that the higher the level of specificity, the lower the likelihood of hotel activity outsourcing. While some previous research related to the manufacturing industry is also relevant in this respect, our cases of asset specificity are all the more informative when considering that they pertain to hotel outsourcing services and, for the most part, to softer capital investments (reputation, customization processes, temporal specificity) that — notwithstanding the notable exceptions cited earlier - are severely overlooked in the literature and would not normally be associated with high risk.

Another prominent gap relates to *the moderating or direct role of asset specificity*. Although TCE treats specific investments as value enhancing within a hierarchy, empirical application of TCE ordinarily leads to the formulation of hypotheses in which specificity merely *moderates* the "inter-firm governance — performance" relationship. With few exceptions (e.g. De Vita, Tekaya, & Wang,