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De Vita, G. and Tekaya, A.

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

by Glauco De Vita and Arafet Tekaya

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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 (ibid).

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).

With few exceptions (Espino-Rodríguez & Gil-Padilla, 2005; Espino-Rodríguez & Padrón-Robaina, 2004; Espino-Rodríguez, Lai, & Baum, 2008; Espino-Rodríguez & Lai, 2014; 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.

Table 1 here

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; and 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 & 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, 2010) empirical tests have been typically undertaken using an aggregate specificity measure, with mixed evidence as to its moderating effect on buyer-supplier performance. Espino-Rodríguez & Lai (2014) also analyze asset specificity as a moderator variable in the relationship between an organization's competitive strategy and activity outsourcing. Our research design, on the other hand, allows us to look closer into the *direct influence*, if any, of *distinct types of relation-specific investments* on outsourcing outcomes.

Another aspect we aim to shed some light on, concerns the longstanding and still obscure issue surrounding *the nature of holdups and the holdup potential of relation-specific investments in outsourcing relationships*. A holdup is a lock-in situation highly susceptible to opportunistic exploitation by one party to the detriment of the relationship (Williamson, 1983). Theoretically, the debate over the nature of holdups revolves around two opposed hypotheses. The first purports that holdups are serendipitous events that, in the context of imperfect contracts and limited reputational capital, are governed by the probability that parties may be placed in a position where unanticipated events push the contractual relationship outside what Klein (1996) calls the "self-enforcing range". The second hypothesis postulates that holdups are the fruit of deliberately deceptive behavior. For example, Williamson's (1985, p. 47) view of opportunism as "calculated efforts to mislead, distort, obfuscate, or otherwise confuse" generates a notion of holdup that is tantamount to deception. Yet, next to nothing is known about how, in practice, holdups emerge in the first place since the mainstream TCE view is skeptical about the

significance of holdups. For example, Coase (2006) claims that contractual devices can be used to handle the problem. But it is still unclear whether contractual arrangements suffice in preventing the emergence of holdups.

The study also offers the opportunity to observe, up close, outsourcing relationships characterized by *reciprocal relation-specific investments*. Williamson (1983) argues that bilateral investments signal a credible commitment by both parties and that, through the creation of "a mutual reliance relation" (p. 528), deter opportunistic holdups:

> The offer of hostages poses a hazard of expropriation. One way to deter this is to expand the contracting relationship from one of unilateral to bilateral exchange [..] Reciprocity in these circumstances is thus a device by which the continuity of a specific trading relation is promoted with risk attenuation effects. (ibid, pp. 530-532)

Yet little is known on how such reciprocal investments come about, and how, in practice, they affect the "continuity" of the "mutual reliance relation" postulated by TCE.

4. Methodology

Our qualitative research is located within the tradition of post-positivism. Post-positivism purports that falsification, not verification, is the basic task of research:

> Well-developed postpositivist qualitative methods can uncover facts and compare facts to hypotheses or prior findings in an attempt to falsify prior hypotheses or to contradict previous knowledge. (Gephart, 2004, p. 456)

Indeed, our purpose is to unveil aspects of hotel outsourcing under specificity conditions that can be juxtaposed to related TCE propositions. Accordingly, an *illustrative* case study research design was devised as this method was the best suited for becoming intimately familiar with the phenomenon and for the generation of insight.

Our close ups are illustrative descriptions resulting from within-case analysis of three dyad-based outsourcing relationships. Table 2 provides an overview of the firms in our study, and relationship features. We use fictitious names to ensure anonymity. Purely to maintain consistency with the cinematographic analogy chosen to label the cases, the three hotels have been re-named *Blondie*, *Angel Eyes* and *Tuco*. Table 3 highlights the main specificity dimensions displayed and a summary of outsourcing outcomes.

Tables 2 and 3 here

Readers unfamiliar with this research tradition may "raise eyebrows" to the rigor of this approach. After all, the tales from which evidence is drawn may be said to be based upon "few cases", "non-randomly chosen" that are, as a result, "dubiously representative". However, subjecting these criticisms to scrutiny provides us with the opportunity to dispel these charges, and highlight the virtues of the methodology we adopt.

First, whilst in statistical sampling "sample size" has serious implications for reliability, our cases were selected following the logic of theoretical sampling (Glaser & Strauss, 1967). Hence, it is not the number of cases or firms that matters here but the extent to which they highlight aspects of theoretical significance.

With respect to the charge of a non-random sampling procedure, Eisenhardt (1989) notes that for research that relies on theoretical sampling, random selection "is neither necessary, nor even preferable" (p. 537) and cites several studies in which few illustrative cases underlined the sampling strategy. Analogously, our cases were chosen to highlight theoretical aspects related to asset specificity in outsourcing relationships. It should be added that the selection of the firms we ended up with, is not at all coincidental as it was inevitably guided by our quest for outsourcing relationships exhibiting particular theoretical (asset specificity) features which could provide valuable data to inform related theoretical predictions. As such, our sampling procedure was indeed one influenced by pre-established theoretical criteria of the relationships to be subjected to scrutiny.

Finally, we make no claim of a "representative" sample, at least not in the positivist sense in which this nomenclature is usually employed. Consistent with our aim, the cases are not intended to prove a new theory but rather, present real-life examples of hotel outsourcing situations pointing to the fact that some TCE prescriptions concerning asset specificity are at odds with observed behavior. As Siggelkow (2007) points out "although it is true that individual cases cannot prove a theory ('A always leads to B'), individual cases can sometimes suffice to falsify theories, as a single counterexample is enough" (p. 21). In short, our cases are "representative" of the theory-practice discordances they unveil.

We should emphasize that our research design possesses most of the attributes the literature (e.g., Xiao & Smith, 2006) identifies as critical for evaluating rigor in case study research. The explicit derivation of a TCE-based conceptual framework, a clear rationale for context selection, data triangulation alongside our careful documentation of the research

procedures attest to the transparency (reliability) of a clear protocol that specifies how the cases were constructed. Accordingly, in discussing sampling choices and data collection and analysis procedures, we will now spell out how our study fares in terms of the two most important measures of case study research: internal and construct validity.

Three factors motivated our choice of the Tunisian hospitality industry as our setting. First, our choice of the Tunisian market answers recent calls to conduct research in countries with socio-cultural contexts very different from those of Western countries (Tsui, 2007).

Second, hospitality is the most developed industry in Tunisia, accounting for approximately 7% of GDP. Moreover, outsourcing is a widespread strategy in Tunisian hotels and just prior to the socio-political turmoil of 2010/11, Tunisia ranked in the top 20 world's destinations as an offshore location (AT Kearney, 2009).

Third, our research design required access to potentially sensitive information by probing perceptions on processes and outcomes of outsourcing relationships from the perspective of both, each hotel and its main supplier. The chosen setting offered better-than-average access to these difficult-to-obtain data. Indeed, the operators' concerns on the future of the industry, offered more favorable conditions to conduct the study than would have been the case otherwise.

Our three case studies are developed mainly on the basis of interviews, though observational evidence and supplementary documentary material were also used for confirmatory purposes. After piloting among industry experts, we contacted 11 hotels to conduct preliminary interviews. The semi-structured interviews generated conversations around outsourcing. Specific questions concerned the length of relevant relationships, their management, type of relation-specific investments undertaken and performance outcomes. Additionally, we

asked to identify their most representative supplier in light of asset specific investments undertaken and associated holdups, and focused the rest of the interview on that relationship.

Nine hotels had developed buyer-supplier relationships that involved relation-specific investments. Of these, two hotels did not wish to take further part given our necessity to engage also with suppliers for data collection. The approach of investigating both sides of the same relationship is quite rare in academic research, even in the field of outsourcing, despite the conceptual focus on dyadic relationships. However, we considered it essential to obtain a true reflection of the relationship. Hence, we undertook preliminary interviews with the relevant supplier identified by each hotel. Three suppliers agreed to participate, giving us three buyer-supplier dyads with asset specificity content.

During face-to-face interviews we questioned each hotel about aspects germane to asset specific investments undertaken and characteristics of the relationship under study, including longevity, commitment, trust, and perceived cooperation/opportunism. We also probed into supplier targets, monitoring procedures, transaction costs, and relationship satisfaction. In parallel, we interviewed the suppliers along similar lines. 40 interviews were conducted with 23 respondents (see Table 2 for an exact breakdown). Several rounds of interviews were held with key informants while multiple interviewees from each firm helped us triangulate across data sources in addition to, across methods (interviews, observation, and documentation).

To attenuate the well-known biases of pure “snowball sampling”, interviewees from the hotels were selected through the “respondent-driven” sampling technique (see Salganik & Heckathorn, 2004) on the basis of their knowledge of operational and management issues with respect to the focal services under study. Suppliers’ informants included, in the first instance, those identified by the respondents at the hotels as having direct involvement with the outsourced

activities but once interviews with suppliers got underway, we were introduced to additional informants who had business ownership or managerial responsibility. Interviews lasted up to two hours and ended at data saturation. Interviews were transcribed and translated, data reduced and preliminary conclusions drawn. The validity of the analysis of critical constructs, such as types of "asset specific investments" and "relationship satisfaction", was ensured by maintaining strict adherence to their typical conceptualization in relevant literature. We did not provide absolute values to these characteristics ("factor analytic approach"). Instead, we constructed relevant categories (alongside the theoretical grey areas identified) to draw out patterns of qualitative analysis which translated into the three cases. This procedure of systematic pattern matching between the theoretical and observational realms, avoided the use of subjective judgments in defining, observing and analyzing key theoretical concepts. Interpretive validity (verification) was sought by confirming unclear issues via summaries sent to the interviewees to ensure a common interpretation.

Visits to the hotels and their suppliers were also conducted to gain valuable contextual information. Documentary evidence (contracts, SLAs, KPI performance spreadsheets, press releases, etc.) was also analyzed. Reliability was further ensured by keeping an "audit trail" to avoid the risk of inadvertently dropping disconfirming evidence. Internal validity was sought through detail-rich description in our within–case close ups.

5. Close ups

5.1. "The Good": Blondie and its laundry service provider

Blondie is a business hotel located near to the capital's city centre. The hotel benefits from one business centre and nine conference rooms, all fitted with the latest audiovisual

equipment. The hotel also offers spa facilities. Nearly 70% of *Blondie*'s turnover stems from repeated business with an expanding portfolio of regionally-based clients whose commercial activities include banking, internet services, and telecommunication.

In 2006, *Blondie* underwent a major expansion, nearly doubling its capacity from 43 to 84 rooms. Prior to 2006 *Blondie* sub-contracted dry cleaning services (spa towels as well as guests' private dry cleaning orders) to three locally-based operators, while laundry operations of bed linen and room towels were kept in-house. One of the dry cleaning service providers (referred to as "*S1*") also provided *Blondie* with occasional maintenance for laundry machinery as *Blondie* often required urgent mechanical repairs. *S1* is a family business offering laundry services as well as "on-premises" laundry equipment maintenance.

In recalling the in-house laundry operations, one of *Blondie*'s managers commented:

> We were constantly confronted with problems stemming from our inability to react to machine breakdowns and consequent shortages. Bringing in a specialized provider became indispensable to avoid putting our reputation under further threat. Although we recognized the importance our guests place upon the freshness and cleanliness of bed linen, laundry operations often slipped to the bottom of our priorities. Yet any delays in room readiness or a shortfall in laundry quality had a lasting impression on guests.

During the second half of 2005 *Blondie* obtained further assistance from *S1* in the form of 24/7 "on-call" maintenance. However, difficulties in maintaining standards when at full occupancy meant that large quantities of spare linen had to be purchased to compensate for temporary shortfalls. The cost of such inventory, alongside the additional investments needed to satisfy the laundry volume to be faced post-expansion led to the decision to outsource fully

laundry and dry cleaning operations to one specialized supplier. *Blondie*'s general manager summarized the drivers of the outsourcing decision as follows:

> The decision was motivated by our desire to free up time to focus on our guests, reduce labor costs, eliminate laundry-related capital investment and the risk of over/under-capacity, and remove the costs of dealing with environmental issues such as the disposal of used water and chemicals.

At the end of 2005, *Blondie* tendered for a three-year contract, renewable for another five upon satisfactory performance (as per SLA conditions). A critical clause of the invitation to tender entailed a compulsory supplier's site-specific investment in the form of a 10 year lease on *Blondie*-owned premises adjacent to the hotel, where laundry and dry cleaning operations "had to be located". *Blondie* saw this clause as "crucial to ensure the timely delivery of linen".

The lease offered a redemption option on the site after 10 years, so as to provide a long-term incentive for a co-operative relationship. Out of two bidders, *S1* won the contract. As noted by *S1* owner-manager: "The 10 year lease for a site that could have served only the needs of a short-term outsourcing contract constituted a major risk". When probed on this issue, the son of the owner-manager stated:

> Our decision carried the high risk of ending up with unsustainable fixed costs if this relationship came to a premature end, potentially compromising our whole business. Yet we believed we could deliver the SLA targets for contract renewal. Our previous experiences with [*Blondie's*] encouraged us to take such a risk.

To safeguard against costly delays and unsatisfactory standards, *Blondie* specified a detailed SLA that included the schedule of daily pickups and deliveries. The contract also

stipulated a pre-established price indexation, with future annual adjustments to be based on the official Consumer Price Index (CPI). Process controls were left within the responsibility of *S1* whilst output controls, upon which the KPIs of the SLA targets are based, were set by *Blondie*, also responsible for sharing with *S1* the scores of its monitoring of "timeliness of delivery" for both linen and dry-cleaning items, and of the inspections on the "cleanliness of laundered linen".

Despite a few teething problems, mutual understanding and full information sharing to fine tune daily operations allowed sound routines to be quickly embedded. The prior collaboration between the parties also helped attenuate the few, early critical incidents:

> The past opportunity we had in giving [*Blondie*] maintenance assistance, and the knowledge gained about their operations, helped us in providing them with a high quality service. (*S1* owner-manager)

As per the records made available to us, over the first three years, *S1* achieved a 97% score against KPIs. To *S1* great satisfaction, the contract was renewed in 2010. *Blondie*'s general manager summarized the current relationship status as follows:

> Eight years on, we are very satisfied with [*S1*]. Outsourcing allowed us to avoid further capital investment and eradicate the maintenance issues faced when the activity was in-house. It also freed some of our time as managers. We are very happy with our decision... much better now!

5.2. "The Bad": Angel Eyes and its nautical activities provider

Angel Eyes is a privately-owned luxury hotel situated just 250 meters from one of the most beautiful beaches of the Tunisian coastline. The hotel serves predominantly a tourist clientele, offering a variety of leisure activities including a gym, tennis courts, and an outdoor

swimming pool where several water-based activities take place. In 2008, *Angel Eyes* obtained ISO 9001 accreditation (international standard for quality management systems) and as part of its continuous quality improvement, decided to expand the provision of water-based activities:

> Although we were already offering water polo and aqua aerobics, we became convinced that offering our guests additional activities such as water-skiing and scuba diving would enhance their holiday experience and strengthen our competitive advantage. (*Angel Eyes*' manager)

However, offering nautical activities would entail investments in equipment, the burden of stocking and ensuring the maintenance of such equipment, and hiring qualified personnel. These considerations led *Angel Eyes* to the decision to outsource. In March 2009, the hotel tendered for a five-month contract, for the season May-September 2009. *S2* won the contract. The outsourced activities were water/jet skiing, parasailing, and scuba diving. The contract stipulated a fixed amount to be paid in two installments; at the beginning and at the end of the contractual period. An additional percentage premium based on the number of guests using the services on offer (to be paid weekly) was also stipulated. The decision to opt for a season-based contract was seen as critical by *Angel Eyes* in light of the reputation embedded into outsourcing the hotel's nautical activities. *Angel Eyes* sought to exercise greater control over the relationship thus ensuring that any under-performance from *S2* would result in the non-renewal of the contract: "A longer-term agreement would have released the pressure the season-based contract allowed us to exert on them". (*Angel Eyes'* floor manager)

Nevertheless, disagreements emerged early in the relationship. *Angel Eyes'* strict internal ISO standards meant that *S2* had to customize its routines. This procedural investment was seen by *Angel Eyes* as a crucial requirement while in the words of *S2* owner:

> We were shocked by the sheer volume of bureaucracy imposed upon us. Apart from the time we had to spend in familiarizing ourselves with their internal software system (billing system for each client), [*Angel Eyes*] expected us to assist all clients in filling in a health questionnaire and obtaining their signature for a safety/responsibility disclaimer. These procedures were neither brought to our attention at the contract stage nor were they stated in it.

Angel Eyes perceived things very differently: "From the outset we found it difficult to make [*S2*] adhere to our procedures. They displayed resistance".

As the contractual relationship reached its mid-stage, elements of mutual deceit began to emerge. An unexpected request from *S2* for a higher percentage premium due to a sudden rise in fuel prices triggered *Angel Eyes'* request for *S2* to include fishing trips to the range of activities. As gathered from both parties:

> [*S2*'s] sudden demand for a higher premium half way through the season, accompanied by their threat to terminate the service, was a clear manifestation of opportunism. (*Angel Eyes*' general manager)

> [*Angel Eyes*'] request to add fishing trips in response to our call for a sensible adjustment to the financial agreement given the unforeseen rise in fuel costs, was a retaliatory measure to exploit the situation. (*S2* owner)

Discord exacerbated when it was found that *S2* accepted clients from neighboring hotels. While *S2* argued that the contract did not prohibit them from doing so, *Angel Eyes* regarded this

as a breach of the moral contract. Following yet another dispute, *S2* granted exclusivity to *Angel Eyes*' guests but not without resentment:

> After our investment for adding fishing trips, and the costs incurred as a result of procedural customization, accepting guests from neighboring hotels at times of low demand could only help our financial situation with no consequence for the service level. (*S2* owner)

As reported by the hotel's assistant manager: "[*S2*'s] service level kept deteriorating. We received several complaints, and one incident had serious repercussions". This incident relates to injuries sustained by one guest during a scuba diving session. The injured guest had to be flown back to his country under intensive care. The incident received substantial media coverage: "[*S2*] failed to ensure the guest had signed the relevant documents, safety disclaimer included. The incident badly affected our reputation, our most important asset". (*Angel Eyes'* manager)

The insurance company of the injured guest took *Angel Eyes* to court for negligence. In turn, *Angel Eyes* sued *S2* and later won the court case. The final settlement allowed for both reputation damages and legal costs.

5.3. "The Ugly": Tuco and its catering provider

Tuco is a business hotel. Conveniently located in close proximity to both the airport and the capital's city centre, the hotel is considered to be a popular choice among businessmen looking for a comfortable stay with easy access to the financial district of Tunis. While *Tuco*'s ordinary meal service runs smoothly and profitably, the provision of a 24-hour room service

represents a problem. For years issues germane to food quality, the speed of delivering the service, labor costs and the level of food waste incurred, have remained unresolved.

Given the importance accorded to this service, *Tuco* chose to outsource solely the food menu provision whilst keeping in-house the delivery of the round-the-clock room service. This approach was expected to allow for a wider menu, a reduction in food waste through a system of portion control at the point of purchase, savings from labor efficiencies, and greater focus on room service without the risk of compromising the quality of the food itself.

In June 2007, *Tuco* invited to tender for a three-year outsourcing contract, renewable for another three. One of the clauses of the invitation required applicants to employ Hazard Analysis Critical Control Point (HACCP) procedures in their operations. Given the sensitivity of the focal service and its potential threat to the hotel's image, *Tuco* saw the HACCP condition as paramount "to bring a level of assurance about food safety at the supplier level". *S3* won the contract, which entailed daily delivery of the agreed menu with the quantity detailed as per the hotel's daily order. In an attempt to safeguard against delivery shortages or delays, *Tuco* set out a detailed SLA which stipulated the daily range of minimum-maximum quantities of orders.

The relationship went smoothly during the three years. In the words of *Tuco*'s purchasing director: "objectives were achieved with noticeable improvement in room service quality and cost minimization. Overall, we calculated cost savings from outsourcing in the region of 20% compared to when the 24-hour room service was operated in-house". However, lurking under the surface, were *Tuco*'s fears about delivery shortages and delays given their sole reliance on *S3*'s supplies, and *S3*'s concerns about the increasing pressure with low/high orders and the consequent risk of shortage/surplus of stock. As summarized by *Tuco*'s purchasing director:

> As the relationship unfolded it became clear we had to widen the range of minimum-maximum quantities since we were not always meeting guests' exact demand. Occasionally we had to place a minimum order although we did not have enough demand to justify it. When demand was high, we had to stick to the maximum order of the SLA range, hence limiting menu choices. This wasn't sustainable since the timeliness of this service and the reputation associated with it are key resources underpinned by years of investments.

Despite tensions stemming from *Tuco's* request to expand the range of daily orders, and *S3's* consequent request to extend delivery lead times, in 2010 the contract was renewed:

> We were happy about the renewal but disappointed over the condition to widen the daily range. This made managing our stock of ingredients more difficult, especially given the very short delivery time. (*S3* owner-manager)

Just after the renewal of the contract several complaints concerning sandwiches ordered via room service brought into question the solidity of the relationship. Some related to the freshness of the salad, and in another instance the wrong ingredient had been used, with the guest ending up with herb cheese instead of blue cheese. As stated by *Tuco*'s floor manager:

> Complaints about the freshness of sandwiches made us suspect they had been prepared a day earlier - issues that could seriously harm our reputation, which is our most valuable asset.

S3's director justified the incident about the salad as follows:

> At delivery, the salad was fresh. It is [*Tuco*] who should be responsible for storing and refrigerating food from delivery onwards. Besides, it was [*Tuco*] who insisted that daily delivery should take place early in the morning.

The incident of the different sandwich ingredient caused greater controversy:

> If blue cheese is shown as a menu ingredient and one guest asks for it, that's what the guest must get! The incident was a wake-up call. Our room-service management team placed too much trust on [*S3*] based on their previous clean records. I suspect [*S3*] exploited the situation. By that time both parties had become too complacent. (*Tuco*'s floor manager)

S3 owner-manager's view of this incident was rather different:

> On several occasions we asked [*Tuco*] to communicate their order early. We import blue cheese and experienced delays from our supplier. We replaced blue cheese with herb cheese just to fulfill the order, which by the way, exceeded the agreed maximum range and came at very short notice.

Corrective mechanisms were adopted in the second year of the new contract term, leading to increasing levels of relationship satisfaction. Delivery would occur twice a day so as to preserve food freshness and achieve better order management. Regular appraisal meetings were also put in place to aid effective communication.

6. Widescreen shots

In this section we draw patterns across cases to highlight the key findings. The three cases offer clear illustrations of the contrasting outcomes that hotel outsourcing under high specificity can provide, from mainly benefits to mainly devastating costs (see summary of

outcomes in Table 3) but pulling together the contrasting patterns can help explain why such patterns occur and cast light on the theoretical grey areas in question.

As noted earlier, according to TCE, high specificity conditions are positively related to the adoption of internal governance. Yet, all the three cases confirm that even in the presence of high asset specificity, outsourcing transactions do take place. This is consistent with evidence from Espino-Rodríguez & Lai (2014), Lamminmaki (2005), and Hemmington and King (2000), which also highlights conditions conducive to hotels choosing to outsource under asset specificity. Most importantly, however, we also find that though - as suggested by TCE - market transactions under high specificity can generate devastating costs (as in the case of “The Bad”), our evidence also illustrates instances whereby outsourcing under high specificity can work, bringing hoped–for benefits without the costs of keeping the activity “in–house”. This is certainly the case for *Blondie* (as evidenced by cost savings quantified in the region of 20%, and high relationship satisfaction), and to some extent for *Tuco* (which maintains an on-going relationship with its supplier after successful negotiations), though the level of transaction–specific risk pertaining to the relationship forged by the latter was, albeit high in its own terms, limited to the buyer’s temporal and reputational capital (unilateral specificity).

In analyzing the reasons for the different outcomes, the cases are particularly informative about the role of contractual features in minimizing the likelihood of holdups. The possibility of future business is a case in point. In “The Good”, the contract renewal clause acted as an enforcement device to constrain opportunism. But it is evident that this clause signaled, concurrently, the buyer’s commitment to invest in a lasting relationship of mutual benefit, giving the supplier confidence in being able to amortize the relation-specific investment over time. The additional clause of exclusive dealing (on the buyer’s side), alongside the parties’ agreement to

adjust prices annually on the basis of the official CPI also reduced uncertainty, providing further reassurances on the buyer's intention to develop a mutually satisfactory relationship.

On the other hand, in the case of "The Bad", the relationship's time horizon was limited from the outset since the contract length was designed deliberately to serve the seasonal term. Rather than acting as an enforcement device, the season-based contract increased the supplier's sense of vulnerability, thus incentivizing further the potential one off gain from opportunism. This suggests that short-term contracts with no obvious opportunity for renewal, by limiting the time-span over which the relation-specific investment must pay off, increase the supplier's vulnerability thus deterring the development of trust in support of a cooperative relationship.

The tale of "The Bad" also acts as a powerful reminder of the holdup potential and economic cost of asset specific investments. TCE suggests that because the parties may factor in that they may lose a share of the return on their specific investments when a holdup occurs, one of the economic costs associated with holdups involves the reduced incentive to make relation-specific investments in the first place. Furthermore, these costs could be reduced because the parties, aware of the risks, may stipulate contractual terms that, as shown above, avoid the likelihood of holdups. Nevertheless, we find that although, in principle, holdup problems could be handled with a combination of contract terms and parties' reputations, this does not mean that in practice holdups do not occur.

The evidence of the case of "The Bad" also sheds light on the issue of why holdups emerge as it reconciles the two opposing views on the nature of holdups. Here a holdup initially borne out of inadequate contracting to safeguard against unanticipated changes in environmental conditions (the sudden rises in fuel costs which prompted a sudden demand for a higher premium), and insufficient reputational capital (on the supplier's side), quickly degenerated into

a pattern of deliberate and mutual deceit. This pattern is evidenced by *Angel Eyes*' attempt to exploit the situation by requesting an extension of the range of services to be provided by *S2*, and by *S2's* retaliatory and opportunistic threat to terminate the service half way through the season (a typical holdup scenario).

Consistent with the prediction of TCE, "The Good" supports the proposition that bilateral relation-specific investments can promote the "continuity" of the "mutual reliance relationship". Here the "hostage" of the buyer's reputational and temporal specificity was more than balanced by the high risk of the site specific investment the supplier undertook in the form of the 10 year lease on the laundry premises. Significantly, however, the case of "The Bad" illustrates that holdups are not necessarily "deterred" by bilateral specificity as suggested by TCE. Whilst the supplier's investments in equipment were "generic" rather than "relation-specific", the supplier's *procedural investments* reciprocated the exposure of the hotel's reputation. Nevertheless, the value the two parties accorded to such investments differed considerably, creating the paradox of dominant positions susceptible to opportunistic exploitation in spite of reciprocal specificity.

In illustrating the dynamics of hotel outsourcing under high specificity, our tales also shed light on the mediating role that factors developed outside TCE play in increasing cooperation, reducing opportunism, and enhancing relationship performance.

Although since the pioneering work by Macneil (1980) the relevance of individual variables such as trust and norms of solidarity in limiting opportunism has received considerable attention in the literature, the case of "The Good" in particular portrays the most vivid illustration of how these factors can help deter opportunism in outsourcing relationships under specificity conditions. It is evident that cordial relational norms played an important part in the coordination of activities governing the exchange, possibly also owing to the familiarity and learning content

embedded in the previous collaboration between the parties, helping them to achieve mutual satisfaction and competitive outsourcing performance.

Moreover, much trust underpinned this relationship. Trust in inter-firm relationships refers to the confidence that a partner will not exploit the vulnerabilities of the other. Although it is well known that the introduction of trust in the TCE model can alter the efficient boundaries of the firm by decreasing ex-ante and ex-post contracting costs, "The Good" additionally reveals an insightful interplay between trust and control. Although *Blondie*'s vulnerability with respect to its "temporal specificity" and "reputational capital" were partly safeguarded by the SLA, a fair amount of "calculative trust" is evidenced by *Blondie*'s decision to release fully "process controls". In turn, the supplier displays considerable "goodwill trust" in taking on the risk of a site specific investment on premises that would have much lower value in any use other than supporting this relationship. In contrast, in "The Bad", problems were not attenuated by counter effects stemming from a trusting relationship.

7. Further discussion

7.1. Theoretical implications

So, to return to the grey areas we started with: How do our findings contribute to theory? A fervent TCE advocate might argue that the finding that asset specificity is more prevalent than theory would predict is not enough to falsify TCE, and go on to suggest that whilst it is true that an implication of TCE is that high specificity should result in a hierarchy, this does not necessarily mean that we could not find the unlikely cases of market transactions (as also found in other literature cited earlier). Nevertheless, TCE does postulate that, in the presence of high specificity, a hierarchy will "outperform" non-hierarchical forms of governance since TCE

expects high specificity to damage the performance of market transactions such as outsourcing (Espino-Rodríguez et al., 2008). Yet only the case of "The Bad" supports this TCE prediction. Furthermore, for *Blondie*, outsourcing under high specificity works better than a hierarchy as evinced by *Blondie*'s own comparison made with respect to when the outsourced activity was performed "in-house". This is an important aspect of our evidence since it allows for an appreciation of the proverbial "counter-factual", which is often lacking in studies examining the outcomes of make-or-buy decisions.

Another implication relates to the question of the *moderating* or *direct* role of asset specificity. The cases attest to the direct role of particular relation-specific investments in influencing inter-firm dynamics and, ultimately, outsourcing performance. Specifically, the cases demonstrate that by influencing directly parties' bargaining power, the likelihood of holdups, the one off gain from opportunism, and the way contracts are written, relation-specific investments can make or break outsourcing relationships.

Moreover, the evidence reveals that the influence of asset specificity on outsourcing performance, though direct, is indeterminate. Meaning that relation-specific investments are not always value enhancing and may lead to a variety of outcomes in inter-firm relationships, with their influence also being dependent upon contextual factors that are not contemplated by TCE but that can alter the way relational dynamics actually play out.

The findings also shed light on the role of bilateral specificity. Our evidence shows that consistent with TCE, bilateral relation-specific investments can produce "risk attenuation effects". Yet the evidence also highlights that "reciprocity" is neither a necessary nor a sufficient condition for promoting the "continuity" of the relationship postulated by theory. When bilateral investments are not supported by coordinated efforts to build a cooperative, trust-based

relationship, they do not, by themselves, guarantee a positive influence on performance and do not preclude the possibility of holdups arising. Much appears to depend also upon the perceived value of the non redeployability content embedded in each of the parties' reciprocal investments. Specifically, we find that differences in the perceived value of the two parties' specific investments can still give rise to dominant positions and hence promote conditions conducive to opportunistic exploitation.

In this respect, this evidence indicates that an outsourcing relationship characterized by bilateral yet asymmetric asset specificity, with one party in a dominant position, is no different from one displaying unilateral specificity as they are both susceptible to holdups. The core implication is that even in the case of reciprocal investments, transacting parties' reputations and contractual arrangements do not necessarily suffice in preventing holdups.

Finally, additional contingent factors pertaining to the characteristics of the relationship rather than the transaction (relationships' learning content, their longevity, and the relational norms that govern such relationships) are shown to exert a significant influence on the way in which asset specificity affects hotel outsourcing. The term of an investment, of the underlying contract and the opportunity for renewal, seem to play a particularly important role in determining parties' bargaining power, the potential to trigger opportunism, and the development of self enforcing safeguards such as relational trust.

The above implications constitute a significant contribution to both relevant theory and the literature on inter-firm behavior in the context of tourism/hospitality service outsourcing under asset specificity conditions. Specifically, our main findings enhance existing knowledge by demonstrating that: (i) hotel outsourcing can work better than a hierarchy even at high levels of asset specificity, in spite of the TCE prediction suggesting otherwise; (ii) particular relation-

specific investments can play a *direct* rather than merely *moderating* role in influencing inter-firm dynamics and outsourcing relationship performance; (iii) "reciprocity" (bilateral asset specificity) is neither a necessary nor a sufficient condition for deterring holdups and promoting the "continuity" of the relationship as postulated by TCE. Hotel managers are advised to reflect on these findings when making outsourcing decisions involving relation-specific investments.

7.2. Practical implications

Clearly, hotels that develop effective outsourcing relationships can reap many benefits. But are these benefits also available under high specificity conditions? TCE would suggest not. As the cases indicate, outsourcing under high asset specificity can indeed detract from a hotel's effectiveness and seriously damage its reputation. But the evidence also suggests that this need not necessarily be the case as it can also serve as a basis for added strength. For hotel management practice, the key questions then become: (i) When does hotel outsourcing under specificity conditions yield primarily benefits? and (ii) What should hotel managers engaging in such relationships do, to create conditions more conducive to a successful outcome?

Our findings indicate that conditions underpinned by a mutuality of trust expectations and commitment, familiarity with the transactional party, and a future time horizon (particularly with respect to the opportunity for contract renewal) appear all the more important in hotel outsourcing relationships under asset specificity. Furthermore, contractual safeguards or incentivizing premiums should account specifically for the value at stake from the relationship (e.g., reputational capital). This recommendation applies irrespective of whether the relation-specific investments are unilateral or bilateral as we have shown that even reciprocal specificity can give rise to dominant positions that render the relationship susceptible to holdups. To ensure

greater alignment of the value both parties attribute to relation-specific investments, KPIs set by hotel managers should account explicitly for the realization of buyer-supplier context-dependent benefits given the specificity invested in the relationship. This, in turn, requires a redefinition of outsourcing performance that goes beyond the measurement of strictly defined transaction costs to quantify governance efficiency.

7.3. Limitations and future directions

First, we cannot claim generalizability, though the evidence presented serves our falsification purpose well. Second, several data nuances relating to the inevitable interactions between asset specificity and the other two determinants of transaction costs, uncertainty and frequency, were left outside the scope of our investigation. Yet, our focus was primarily that of generating insights for a better understanding of hotel outsourcing under asset specificity rather than on building TCE. Third, we cannot exclude the possibility that the Tunisian context may have influenced the relationships considered and that, particularly in terms of trust connotations, they may display different dynamics to those of buyer-supplier dyads from the West. Hence, case study research in different countries would offer a profitable avenue for further investigation.

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Table 1
Taxonomy of asset specificity

Dimension	Definition	Typical construct operationalization
Human specificity	Job skills specific to transactional requirements (Walker & Poppo, 1991). Knowledge-specific assets arising from "learning-by-doing".	Supplier's access to buyer's knowledge or hours spent by supplier interacting with buyer.
Physical specificity	Investments in equipment tailored to a specific task with limited alternative use/value (Joskow, 1988).	Uniqueness of physical equipment/tools required by the transactional relationship.
Site specificity	Investments made to relocate operations within physical proximity of each other to save on transportation, inventory or other processing costs (Williamson 1983).	Physical proximity, using distance between the supplier and buyer's premises as the proxy of choice (e.g., Joskow, 1988).
Dedicated specificity	Investments made for a particular long-term transactional agreement. Should this relationship end prematurely, excess capacity will emerge (Williamson, 1983).	Typically measured exclusively with respect to the supplier's relation-specific investments.
Reputational specificity	When one party can harm the brand/reputation of the other (Gatignon & Anderson, 1988; Williamson, 1985).	Often measured by extent of advertising expenditure (e.g., Gatignon & Anderson, 1988).
Temporal specificity	It applies to inter-firm relationships where timely performance is vital to retain transactional value (Lohtia et al., 1994).	Importance of precise scheduling and punctual delivery (e.g., De Vita et al., 2010).
Procedural specificity	Degree of customization of supplier's routines to buyer's requirements (Zaheer & Venkatraman, 1995).	Adaptation of processes/systems or customization of supplier's workflows/routines.

Table 2
Sample firms and outsourcing relationships

Case	Buyer	Supplier	Activity outsourced	Specificity dimension	Key relationship features	No. of interviews (ees) with buyer	No. of interviews (ees) with supplier
"The Good"	Business hotel: *Blondie*	*S1*: Laundry and dry cleaning services	Laundry and dry cleaning services	- Buyer's temporal and reputational specificity - Supplier's site specificity	- Bilateral specificity - Renewable short-term contract - Detailed contract, adequate safeguards and flexible SLA - Familiarity and prior learning	7(4)	3(2)
"The Bad"	Tourist hotel: *Angel Eyes*	*S2*: Nautical activities	Nautical activities (water-skiing, scuba-diving, etc.)	- Buyer's reputational capital - Supplier's procedural specificity	- Bilateral specificity - Season-based contract - Inadequate contractual safeguards - Holdup and opportunistic behavior	10(5)	5(3)
"The Ugly"	Business hotel: *Tuco*	*S3*: Catering	24-hour catering service	- Buyer's temporal and reputational specificity (unilateral)	- Unilateral specificity - Renewable short-term contract - Incomplete contract and inflexible SLA	9(6)	6(3)

Table 3
Case-specific features and outcomes

Case	Buyer / supplier	Specificity dimension	Features observed	Outsourcing outcome
The Good	*Blondie*	Temporal and reputational specificity	*Blondie*'s need for punctual delivery of laundry. Failure could result in reputational damage and costly purchases of additional linen. Also, high reputational specificity since much of the hotel's turnover is based upon "repeated business with regionally-based clients".	Significant benefits. Mutual satisfaction. More successful than when activity was performed in-house.
	S1	Site specificity	*S1* site specific investment in the form of a "10 year lease on hotel –owned premises" constitutes a high risk and the most uncontroversial example of high asset specificity giving rise to an outsourcing transaction.	
The Bad	*Angel Eyes*	Reputational specificity	As stated by *Angel Eyes'* manager in reporting on a serious incident: "badly affected our reputation, our most important asset".	Devastating outcomes in spite of bilateral specificity: holdup; buyer's reputational damage; contract termination; legal dispute.
	S2	Procedural specificity	*S2* services to *Angel Eyes* were highly customized as evidenced by "the sheer volume of bureaucracy" associated with providing nautical services to each client, and customization connected to hotel's billing system.	
The Ugly	*Tuco*	Temporal and reputational specificity	"The timeliness of this service and the reputation associated with it, are key resources underpinned by years of investments" (*Tuco*'s purchasing director)	Increasing levels of mutual satisfaction achieved as a result of systematic appraisal and on-going fine tuning of operations.
	S3	N/A		