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A Principal-Agent View on International Hotel Branding and Empirical Evidence from China

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A thesis submitted in partial fulfillment of the requirements for the Doctor of Philosophy degree in Business

A PRINCIPAL-AGENT VIEW ON INTERNATIONAL HOTEL BRANDING AND EMPIRICAL EVIDENCE FROM CHINA

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by

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Abstract

This dissertation analyzes the branding status of international hotels, defined as those that combine software systems offered by foreign managers (e.g., business format, booking network, operation know-how, etc.) with hardware facilities provided by local developers (e.g., land, building, furniture, etc.) to serve travelers. When two specialist firms cooperate to set up an international hotel, they can each compete for the right to brand the software-hardware bundle. It is common to see an international hotel that carries the name of the foreign manager (manager branding), the name of the local developer (developer branding), or the names of both parties (manager/developer co-branding). Significantly, each branding option corresponds to a particular *contractual* format to coordinate manager-developer cooperation. An international hotel can also be transformed into a company-owned hotel bearing the brand of a single party that imposes *hierarchical* fiats to direct manager-developer cooperation internally (the fourth option that I call integrated branding).

The rise of international hotels has received attention from scholars who investigate the relative costs of using contract vs. hierarchy to govern manager-developer cooperation across borders. Regardless of the choice of contract vs. hierarchy, however, the focal hotel always bears the brand of the hotel chain and its branding status is *irrelevant* in the relative efficiency of contract vs. hierarchy. Other scholars also treat franchising as a mechanism for unknown local developers to borrow reputation from established foreign managers, based on the traditional role of branding in attracting customer patronage. This reputation-borrowing view does *not* consider the governance implications of hotel branding rights, where the right to brand the software-hardware bundle in an international hotel can be reassigned to promote manager-developer

cooperation, without altering hotel ownership rights as dictated by the contract vs. hierarchy paradigm.

In this dissertation, I adopt an agency approach to address the above literature gap. More precisely, I propose an agency view on international hotel branding to address two questions that have remained unanswered in prior studies: (1) what are the factors that influence the branding option for an international hotel and (2) what is the implication of each branding option for the room rates of the hotel?

Conceptually, my dissertation isolates the branding rights from the ownership rights to an international hotel to define an agency issue called *branding agency*, in which the branding party of the manager-developer dyad serves as a principal who is entitled to the reputation residuals of the hotel, but the non-branding party acts as an agent who receives a fee for its contributions to hotel reputation. Reallocations of hotel branding rights realign the incentives of the parties and thereby alter the costs of addressing the branding agency issue. Without resorting to integration, the right to brand a hotel can be reassigned to economize on the agency costs of governing manager-developer cooperation across borders. Once the incentives of the parties are properly aligned, they are self-motivated to invest in the reputation of the hotel, which in turn allows them to charge a premium room rate.

Empirically, I use a sample of 535 international hotels collected from China to verify the agency view of international hotel branding. Specifically, I predict the probability that foreign managers let local developers co-brand a hotel, i.e., the choice of manager branding vs. manager/developer co-branding. My findings reveal that the likelihood of manager branding will be higher if foreign managers contribute more to the reputation of the hotel and are better able to monitor shirking by local developers. The likelihood of manager/developer co-branding will be higher if the opposite holds. Furthermore, the closer the actual branding status of a hotel to its optimal branding status, the higher the premium that the hotel can command compared to other hotels in the same geographic location or in the overall Chinese market. These findings obtained from China are consistent with the agency view on international hotel branding.

To sum up, this dissertation treats international hotel branding as a governance decision that can be manipulated to save on the agency costs of regulating manager-developer cooperation across national borders. My agency view can be extended to all business settings, where the right to brand the joint output of two or even more specialists can be reassigned to facilitate inter-firm cooperation, which I consider a major contribution to organizational economics. This dissertation also contributes to branding practitioners, who can no longer see branding as a tactical decision made at the operational level, but instead must treat it as a strategic decision made at the corporate level. As the first study that defines the governance role of branding, this dissertation also points out several promising directions for future research to advance the agency view on international hotel branding.

Keywords:

International hotel branding, service sector, foreign entry mode, governance choice, internalization, agency theory, branding, organizational economics

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CHAPTER 1: INTRODUCTION

1.1 The Phenomenon

The past decades have witnessed a dramatic growth of international hotels worldwide, wherein physical facilities (e.g., land, building, furniture, etc.) controlled by local development companies have been combined with intangible systems (e.g., business format, booking network, operation know-how, etc.) provided by foreign management companies (Alexander & Lockwood, 1996; Contractor & Kundu, 1998a; Dunning & Kundu, 1995; Dunning & McQueen, 1981; Litteljohn, 1997). Many hotel chains, such as InterContinental, Hilton, and Marriott, have become household names to travelers outside their home markets. By 2012, the international hotel industry had approximately 27,820 international hotels, with over 4 million rooms, operating in more than 200 countries (Smith Travel Research).

The growth of international hotels is particularly significant in China, where international hotels account for almost two-thirds of total revenue and approximately half of all establishments in the high-end segment of hotels (IBISWorld, 2013). Between 1995 and 2012, the number of international hotels in China increased from 391 (with 102,424 rooms) to 1,696 (with 407,964 rooms; Smith Travel Research). According to IBISWorld (2013), over 50 hotel chains had entered the China market by 2012, and they operated more than 120 hotel brands in the country. The demand for international hotels is expected to continue to grow: by 2020, China is expected to surpass France as the world's top tourist destination, with a projected 130 million foreign visitors per year (IBISWorld, 2013).

International hotels are formed through the combination of two components that I call *hotel software* and *hotel hardware*. I borrow the terms "software" and "hardware" from the information technology (IT) industry and apply them to an international hotel setting. I define hotel software as the intangible systems provided by foreign managers (e.g., business format, booking network, operation know-how, etc.) and hotel hardware as the physical facilities offered by local developers (e.g., land, building, furniture, etc.). In order to serve guests, international hotels need to combine software systems and hardware facilities controlled by the two specialist firms (i.e., foreign managers and local developers).

When a management company wants to exploit hotel software internationally, it has to decide how to access hotel hardware in the local market, potentially through a two-stage process. In the first stage, the company must choose between acquiring hardware facilities through integration (i.e., the *equity mode* option to purchase hotel properties) or entering a contractual relationship with a local development company that owns hardware facilities (i.e., the *contractual mode* option to borrow hotel properties). The equity mode option is rarely pursued in the international hotel industry because integration requires large capital investment (Boddewyn, Halbrich, & Perry, 1986) and foreign acquisition of hotel hardware is often tightly regulated by the government (Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995). Consequently, most foreign management companies enter into a contractual relationship with local development firms to access hardware facilities in the host country.

In the second stage, if the foreign management company decides to pursue a contractual relationship with a local development firm, it must then choose a contractual format to organize its relationship with that firm. The most common contractual mode is a *franchise contract*, in which the foreign management company grants the local development firm (the franchisee) the right to use its hotel software to run a hotel. In the alternative, the two companies can sign a *management contract* that allows the foreign management company to deploy its hotel software to manage a hotel on behalf of the local development firm. In either case, the focal hotel bears the brand of a single party: while a franchised hotel carries the name of the foreign management company, and a contractually managed hotel carries the name of the development company. There are also cases where the two firms sign a *manager/developer co-branding contract*, under which the overall software-hardware bundle is sold to travelers using the brand names of both firms.

What is significant about the three contractual modes (i.e., franchise contract, management contract, and manager/developer co-branding contract) is that each option corresponds to a unique allocation of branding rights between the foreign management company and the local development firm. Shangri-La's expansion into China provides illustrative examples of each option. For instance, the franchised hotel in Haikou carries the Shangri-La brand name, while the local developer—Hainan First Investment Group—is kept anonymous to hotel guests. I call this a *manager-branded hotel*, and the practice *manager branding*. In contrast, when Shangri-La signed a contract to manage a hotel in Beijing that was developed and branded by the Beiao Group, the Shangri-La brand remained hidden from travelers. I call this a *developer-branded hotel*, and the practice *developer branding*. Finally, the Shangri-La Golden Flower in Xian is an international hotel developed by Xian Tourist Service Company but managed by Shangri-La. It provides an example of a manager/developer co-branding contract, where the manager and the developer have co-branded the hotel, making both firms identifiable to guests. I call this a *manager/developer co-branded hotel*, and the practice *manager/developer co-branding*. These three contractual formats and their corresponding branding options are summarized in Figure 1.1.

Stage One: **Equity vs. Contract**

Stage Two: **Contractual Format (or Branding Option)**

- Equity mode
- Contractual mode
  - Franchise contract (manager branding)
  - Management contract (developer branding)
  - Co-branding contract (manager/developer co-branding)

Figure 1.1: A two-stage decision process for hotel chain expansion

The three branding options are not limited to China, but rather can be seen worldwide. In Toronto and Vancouver, for instance, Shangri-La has branded its hotels under its franchise name, without showing the hotel developers' identity (i.e., manager branding). In New Delhi India, Shangri-La serves as an anonymous manager for a hotel developed by Eros International, which is branded under the developer's name (i.e., developer branding). In Taipei, Shangri-La's Far Eastern Plaza represents a case of manager/developer co-branding, where the hotel carries the brands of both Shangri-La and the hotel development firm, Far Eastern. These examples illustrate the pervasiveness of the three branding options in the international hotel industry.

1.2 Previous Research

Business scholars have adopted two theoretical perspectives to investigate the rise of international hotels. First, studies based on internalization theory have examined the motives for hotel chains to expand across borders and the corresponding modes of entry (Buckley & Casson, 1976; Dunning, 2000). These studies rely on the market (contractual mode)-vs.-integration (equity mode) paradigm, wherein a hotel chain can rent its specific advantages to a local company through the market of franchising. If the transaction costs in the franchising market are high, the hotel chain can avoid the use of the inefficient franchise market by integrating into hotel development in the host country (Anderson & Coughlan, 1987; Brickley & Dark, 1987; Buckley & Casson, 1976; Contractor & Kundu, 1998a).

Second, studies on agency theory—which also draw on the market-vs.-integration paradigm—consider the extra agency costs entailed in monitoring salaried employees, who are likely to shirk responsibilities when operating a company-owned hotel abroad. If the agency costs of integration are high, a hotel chain can turn a salaried employee into an owner-franchisee, who is entitled to the profits of the franchised hotel and therefore less motivated to shirk responsibilities (Anderson, 1985; Brickley, Dark, & Weisbach, 1991; Krueger, 1991; Thompson, 1992). Thus, the use of the franchise market can reduce the agency costs incurred by hotel chains in monitoring salaried employees under integration.

Both internalization theory and agency theory have made valuable contributions to our understanding of the choice made between market (i.e., franchising) and integration when hotel chains are expanding internationally. Simply put, integration saves on the transaction costs associated with franchising, whereas franchising economizes on the agency costs related to integration. As noted earlier, however, franchising is not the only contractual format that can be used to establish an international hotel. Studies on internalization theory and agency theory have overlooked the branding status of international hotels, and have therefore hindered scholars from analyzing decisions regarding the optimal contractual format for organizing cooperation between a foreign hotel manager and local hotel developer—or the optimal allocation of branding rights between the two parties.

Prior studies entailing internalization theory and agency theory have overlooked the branding status of international hotels for two reasons. First, the branding status of a hotel is irrelevant to the market-vs.-integration paradigm used in the two theories, since a hotel always bears the name of the hotel chain regardless of whether it uses franchising or integration to expand abroad (Lal, 1990). Second, both theories are sub-fields of organizational economics that emphasize the governance of business-to-business cooperation without involving consumers (Kim & Mahoney, 2005). In a business-to-business context, the branding status of an international hotel becomes irrelevant because the branding system traditionally serves to facilitate business-to-consumer transactions.

Without considering the branding status of an international hotel, prior studies have only focused on the first stage of the two-stage decision process described above (i.e., the choice of equity vs. contractual mode), while ignoring the second stage of the decision process (i.e., the choice of optimal contractual format for organizing cooperation between foreign hotel managers and local hotel developers). It turns out that integration is not the only option for hotel chains to expand internationally when franchise transactions are too costly to arrange—because the full right to brand an international hotel can be reassigned to accommodate other contractual formats (i.e., management contracts under developer branding or co-branding contracts under manager/developer co-branding). Integration is necessary only when all three contractual modes have been found to be infeasible. In such cases, both hotel hardware and hotel software bear the brand name of a single company that develops and manages an integrated hotel without a local partner—a fourth branding option that I call *integrated branding*.

1.3 Research Objective

The objective of this dissertation is to bridge the gaps in the existing literature and advance our understanding of the branding status of international hotels. Specifically, I aim to answer the following questions: What are the drivers behind the branding options for an international hotel? What performance implications can be drawn from the branding status of international hotels?

To address these questions, I build on an agency view to propose a general theory of international hotel branding with four branding options (i.e., three contractual mode options plus one equity mode choice). I first classify the property rights to an international hotel into two categories: *ownership rights* and *branding rights*. By isolating the branding rights from the ownership rights, I argue that franchising transfers only the ownership rights to a hotel from an integrated firm to an entrepreneur-owner. Hence, franchising addresses only one type of the agency problem that I call *ownership agency*. Holding only the ownership rights to a hotel, the entrepreneur-owner has no control over the branding rights and therefore lacks incentive to invest and protect the reputation of the franchise brand. The separation of ownership rights from branding rights isolates another agency issue that I call *branding agency*.

When the ownership rights to hotel software and hotel hardware are held separately by different members of the the manager-developer dyad under a contractual mode, I propose that the branding agency problem can be resolved through reallocations of branding rights between the two parties in three ways—to the manager, to the developer, or to both parties. Under the three branding options, I designate the *brander* of an international hotel as the principal who stands to claim the gains in hotel reputation directly from consumers, and the *non-brander* as the agent who sells its reputation contributions at a pre-determined fee without direct contact with consumers. The right to brand an international hotel can be allocated between the foreign manager and the local developer in an optimal way that economizes on the agency costs of contracting their cooperation. In cases where reallocations of branding rights fail to address the agency issue, the foreign manager can integrate into hardware facilities to evade high agency costs (i.e., integrated branding).

Following the agency framework, I have conducted two empirical studies to predict the branding status of an international hotel and the performance implications of hotel branding based on a sample of international hotels in China. Of the four branding options, my studies focus on the choice between manager branding vs. manager/developer co-branding of the focal hotel. I have chosen not to address integrated branding in the two tests because the equity mode is rarely seen in the international hotel industry. I have also chosen not to address developer branding because that branding option is difficult to identify in reality and the contractual relationship between the parties involved is less stable.

In the first empirical study, I have used a vector of hotel-, firm-, and city-level variables to predict whether a hotel should exclusively bear the brand name of the foreign manager, or whether the manager should let the local developer co-brand the hotel (i.e., manager branding vs. manager/developer co-branding). I hypothesize that a hotel should bear only the name of the foreign manager if the manager contributes more (relative to the developer) to the reputation of the hotel brand and/or the manager is better able (relative to the developer) to monitor and prevent the developer from shirking on reputation of hotel brand. Alternatively, the manager should allow the local developer to co-brand a hotel if the developer also contributes to the reputation of the hotel brand and is capable of monitoring the manager behaviour.

In the second empirical study, I have examined how the choice between manager branding and manager/developer co-branding affects the room rates that a hotel can command in the market. Based on the branding agency view, the branding status of an international hotel determines the incentives of the two specialist firms to invest in hotel reputation. If the branding status of a hotel is optimal, the two parties can more easily harmonize their joint actions to build and protect the hotel brand without incurring a high cost in addressing potential agency issues in branding. Due to the joint contributions made by the manager-developer dyad to the hotel reputation, the hotel can charge a higher rate. To probe the effect of branding status on hotel room rate, I have compared the actual branding status to the optimal branding status of a hotel (which I call the *branding gap*, i.e., the absolute value between a hotel's actual and optimal branding statuses) to predict the premium rate of the focal hotel. I hypothesize that the narrower the branding gap, the higher the premium rate of the hotel—because the manager-developer dyad is more motivated to build and protect the reputation of the hotel brand.

1.4 Implications

To the best of my knowledge, this dissertation is the first study that treats the branding status of an international hotel as a governance decision that can be deliberately made to facilitate inter-firm cooperation (business-to-business transactions), on top of its traditional role in facilitating business-to-consumer transactions. The empirical studies that I have conducted are also the first to operationalize and examine the factors behind different branding statuses of international hotels, as well as the first to predict the performance implications of the allocation of branding rights. In doing so, this dissertation yields important insights for academic scholars and hotel executives.

By taking into account the allocation of branding rights, my dissertation goes beyond the focus on ownership rights in conventional internalization theory. By considering the branding status of an international hotel, I demonstrate how the extant internalization literature is limited in its focus on the choice between franchising and integration. Specifically, the literature ignores other market mechanisms beyond franchising, which vary in the allocation of branding rights and can be used to govern the cooperation a foreign manager and a local developer without resorting to integration.

My dissertation also contributes to agency theory by isolating another agency problem, which I call *branding agency*. Branding agency occurs in manager-developer cooperation, in cases where the non-branding partner of a cooperative relationship lacks incentives to build or protect the reputation of the branding partner. I illustrate how the nature of this principal-agent relationship varies according to the allocation of branding rights between two hotel firms. This branding-focused perspective differs from conventional agency studies, which define the principal vs. agent roles based on the control of ownership rights.

Fundamentally, internalization and agency theory are both sub-fields of organizational economics that rely on the market-vs.-integration dichotomy to examine the governance of inter-firm cooperation (Kim & Mahoney, 2005). The market-vs.-integration dichotomy focuses on a one-dimensional continuum that captures the transaction costs for a local developer to sell its reputation contributions to a foreign manager. In reality, however, the foreign manager can also sell its reputation contributions to the local developer, which means that the manager-developer transaction can be conducted in two opposite directions (i.e., developer-to-manager vs. manager-to-developer). As such, organizational economics should be modeled through a two-dimensional space that captures the relative costs of using a developer-to-manager vs. manager-to-developer transaction to govern cooperation between the manager and developer in establishing an international hotel.

While branding is commonly considered a mechanism that facilitates business-to-consumer transactions, this dissertation also establishes the institutional role of branding in facilitating business-to-business transactions. I base my research on a triadic framework, in which two hotel specialist firms cooperate to serve their common guests. The allocation of branding rights between the two firms shapes their incentives to appeal to hotel guests and affects the costs of organizing their cooperation. Clearly, the branding status of an international hotel represents a governance choice that can be deliberately made to economize on the costs of conducting business-to-business transactions.

The branding agency view of hotel branding encourages business practitioners to re-examine branding decisions as governance tools for facilitating inter-firm cooperation. When expanding overseas, hotel chains have traditionally focused on entry mode choices based on the allocation of ownership rights, without considering the allocation of branding rights. In cases where branding rights allocation has been an issue, hotel chains have tended to rely on brand power to settle it. This dissertation offers new and useful guidelines that business practitioners can draw on to organize inter-firm cooperation in a global context. Specifically, branding rights of a hotel should be assigned to the party that is best suited to brand the joint output and claim the profit stream from the hotel guests (i.e., relatively greater reputation contribution to the hotel brand and/or stronger ability to monitor the other's shirking behaviour)—rather than the party that has stronger brand power. Business practitioners may reconsider branding as a strategic decision that can be made at the corporate level to promote inter-firm cooperation.

1.5 Dissertation Structure

The dissertation consists of six chapters. Following the introduction in Chapter 1, I review three streams of literature in Chapter 2 related to the theory of franchising (manager branding), which form the starting point of my research. I begin by reviewing the literature on the market-vs.-integration paradigm in internalization theory and the literature on agency theory, both of which focus on business-to-business relationships. Next, I review the literature on branding, which emphasizes the function of hotel brands in attracting client patronage in a business-to-consumer setting. At the end of Chapter 2, I summarize my research agenda to bridge the gaps in prior studies related to the branding status of international hotels.

In Chapter 3, I propose an agency view to theorize the four branding options in the international hotel industry, including three contractual modes (i.e., manager branding, developer branding, and manager/developer co-branding) and one equity mode (i.e., integrated branding). In particular, I discuss the agency problems associated with each of the four branding options. I focus on how the control of branding rights affects the incentives of the manager and developer to build and protect the reputation of the hotel brands, which in turn alters the agency costs incurred by the parties in regulating their cooperation. Furthermore, I present a two-dimensional branding framework, which compares the relative branding agency costs across the four branding options. I conclude this chapter by offering a rule for branding rights allocation: The right to brand an international hotel should be allocated in an optimal manner that economizes on the agency costs of organizing manager-developer cooperation.

In Chapter 4, I test this agency view by presenting the empirical study I have conducted on a sample of international hotels in China, which has been the largest receiving country of international hotels in the past decade. I probe the factors at the hotel-, firm-, and city-level to predict whether a hotel should exclusively bear the brand name of the foreign manager, or whether the manager should allow the local developer to co-brand the hotel (i.e., the choice of manager branding vs. manager/developer co-branding). These factors alter the relative contributions made by each party to the reputation of the hotel brand, as well as their relative ability to monitor each other's behaviours. Consequently, these factors also affect the agency costs incurred in governing the manager-developer relationship. My premise is that the choice between manager branding and manager/developer co-branding should be made deliberately to save on the agency costs incurred to harmonize the two parties' cooperation.

In Chapter 5, I use the same sample of international hotels in China to empirically demonstrate how the choice between manager branding and manager/developer co-branding affects the premium rate that a focal hotel can command in the market. To do so, I compare the predicted branding status of a hotel from the first study (described in Chapter 4) with the actual branding status of the same hotel, labelling the gap between them the *branding gap*. I further hypothesize that the narrower the branding gap of a hotel, the higher the premium rate of the hotel because the manager and the developer are more motivated to build and protect the reputation of the hotel brand. Specifically, I probe the premium rate of a hotel in three settings—within the franchise network, within the geographic location, and within the overall market of China.

This dissertation concludes with Chapter 6, where I review the agency view of international hotel branding and describe the contributions of my study to two unanswered questions: What are the drivers behind the branding options for an international hotel? And what performance implications can be drawn from the branding status of international hotels? Furthermore, I discuss how my research addresses gaps in the literature on internalization theory, agency theory, branding, and organizational economics overall. Finally, I discuss the managerial implications and possible directions for future research.

CHAPTER 2: LITERATURE REVIEW

When it comes to hotel chains that want to expand globally, most research in the business literature has focused on the choice of franchising vs. integration. Franchising refers to the case in which a foreign manager enters a contractual relationship with a local developer that owns hotel hardware. In a franchised hotel, the franchisor-manager brands the hotel while the franchisee-developer is anonymous to hotel guests. In contrast, integration occurs when a foreign manager directly acquires the hotel hardware in the host country without having to collaborate with a local developer. In such cases, the owner-manager also brands the focal hotel exclusively.

In this chapter, I review three literature streams related to the choice between franchising and integration. First, I examine the market-vs.-integration paradigm in internalization theory, which states that a hotel chain should integrate into hotel ownership overseas if the transaction costs of using the franchising market are deemed to be too high. Second, I review the agency theory literature, which proposes that franchising reduces the agency costs incurred by a hotel chain in monitoring salaried employees of company-owned hotels by converting those employees into owner-franchisees. The two literature streams are sub-fields of organizational economics that focus on business-to-business transactions. Hence, I investigate a third literature stream that defines the traditional functions of branding in facilitating business-to-consumer transactions (i.e., the function of a hotel brand in attracting client patronage). Based on my review of the extant literature, I conclude the chapter by identifying the research gaps that my dissertation will address.

2.1 Internalization Theory of International Hotels

2.1.1 Conceptualization

Internalization theory suggests that hotel chains will expand outside their national boundaries when they have ownership advantages in hotel software systems over firms from other countries and it is economical to combine their software advantages with hardware facilities endowed in indigenous countries (Buckley & Casson, 1976; Dunning, 2000). When expanding abroad, hotel chains can use franchise contracts to licence the rights to their software systems—on which their brand reputations are based—to indigenous hotel development firms. Alternatively, hotel chains can exploit their software advantages in the host market by integrating into hardware development through direct investment (Hennart, 1986; John & Weitz, 1988; Teece, 1986; Williamson, 1981).

The choice between franchising and integration depends on the contracting costs incurred by foreign hotel chains and local hotel developers in organizing their franchise relationships (Anderson, 1988; Brouthers & Brouthers, 2003; Klein, Crawford, & Alchian, 1978). Franchising is preferred when the software advantages held by foreign hotel chains can be efficiently transferred to local hotel developers through franchise contracts. When the costs of writing and enforcing franchise contracts are too high, it becomes cost efficient for foreign hotel chains to withdraw the franchise transaction from the market and organize the transaction within a hierarchy structure through vertical integration (Davidson & McFetridge, 1986; Hennart, 1986). Regardless of the choice they make between franchising and integration, foreign hotel chains exploit their competitive advantages overseas in attracting home-country travelers who are familiar with their brand name. This is called *reputation spillovers,* a phenomenon that prompts a hotel chain to follow its customers abroad (Dunning & McQueen, 1981).

2.1.2 Empirical evidence

A large number of internalization studies have contributed to our current understanding of the factors that lead to the failure of the contractual market. These studies suggest that the costs of using the contractual market depend on the characteristics of the product or service transferred (e.g., intangibility, tacitness, etc.; see Brouthers & Brouthers, 2003; Caves, Crookell, & Killing, 1983; Terpstra & Yu, 1988), the degree of asset specificity (Anderson, 1985; Gatignon & Anderson, 1988; John & Weitz, 1988), and the ability of firms to enforce contractual relationships abroad (Erramilli & Rao, 1993; Fladmoe-Lindquist & Jacque, 1995; Murray & Kotabe, 1999).

Studies have further shown that the costs of using the contractual market depend on the level of uncertainty of the environment within which the focal transaction is to take place. Such uncertainties may include legal restraints in the market (Huszagh, Huszagh, & McIntyre, 1992), the degree of economic development (Davidson, 1980), and the stability of the institutional environment (John & Weitz, 1988; Klein, Frazier, & Roth, 1990). When environmental uncertainties are higher, the costs of conducting the focal transaction through the contractual market increase. In such cases, integration serves to evade the high transaction costs in the contractual market.

While most internalization scholars place emphasis on the manufacturing industry, a few studies have attempted to investigate the choice between franchising and integration in the international expansion of hotel chains. One of the first field studies of international hotels was completed by Dunning and Kundu (1995), who conducted surveys among 110 multinational enterprise (MNE) hotel chains based in 18 countries to identify the competitive advantages that are particularly significant in the hotel industry. They found that the choice of franchising vs. integration is influenced by three transaction cost factors: the capability of a hotel chain to ensure quality control in the international hotel; the ability of a hotel chain to coordinate its global hotel network; and the economic and financial conditions of the host country.

In another study, Contractor and Kundu (1998a) used a sample of 1,131 international hotel properties in 112 countries to empirically test the factors that favour franchising over integration. They found that the choice of franchising over integration reflects a mix of internalization theory factors related to characteristics of the hotel chain (e.g., size, international experience, extent of global coverage, etc.), as well as host-country variables that affect the transaction costs of renting the hotel software to local hotel developers (e.g., level of economic development, etc.). These results supported the predictions of internalization theory.

2.1.3 Comments

The market-vs.-integration dichotomy in internalization theory is strictly based on ownership rights. In franchising, a foreign hotel chain and a local development company hold separate ownership rights on software systems and hardware facilities. In contrast, integration combines the ownership rights to hotel software and hotel hardware in a single firm that consists of two divisions: hotel management and hotel development. This approach overlooks the fact that when ownership rights to hotel hardware and hotel software are split between two firms, the rights to brand the software-hardware bundle can be allocated between the parties in more than one manner. With its emphasis on ownership rights and no consideration of branding status, internalization theory is limited in its focus on the choice between franchising and integration; it fails to address market modes beyond franchising that can be used to organize cooperation between two specialist firms in the global setting.

In addition to a franchise contract (wherein the focal hotel carries the name of the foreign manager), software systems and hardware facilities can be combined to serve customers through a management contract (wherein the hotel bears the brand of the local developer). The two parties can also appeal simultaneously to hotel guests by co-branding their software systems and hardware facilities, such that manager-developer cooperation is structured through a manager/developer co-branding contract. While the ownership rights to the software-hardware bundle remain the same across all three contractual formats (i.e., the foreign manager controls hotel software, the local developer owns hotel hardware), the status of hotel branding differs. Without considering all three branding options available under the market mode, internalization theory does not address how one contract may be superior to another in governing inter-firm cooperation.

2.2 Agency Theory of International Hotels

2.2.1 Conceptualization

Agency theory probes the same choice of franchising vs. integration by examining the agency costs incurred by an integrated company to monitor salaried employees. The theory defines a principal-agent relationship as one in which an integrated hotel chain (a principal) delegates actions to its employee (an agent), who takes actions on behalf of the chain to operate company-owned hotels (Jensen & Meckling, 1976). As a principal, the chain claims the hotel profit as owner and is motivated to optimize its efforts for higher profits. As an agent, the employee receives a fixed wage for its efforts and bears no direct consequences from its own actions to build the hotel's business. Agency issues therefore arise when the salaried employee lacks incentives to contribute to the profitability of the company-owned hotel (Bergen, Dutta, & Walker, 1992; Eisenhardt, 1989; Fama & Jensen, 1983; Krueger, 1991; Sappington, 1991). To address this agency issue, the integrated chain must spend extra resources (i.e., agency costs) to monitor and prevent the salaried employee from harming the profitability of the hotel business through shirking.

According to agency theory, franchising is the preferred option if agency costs are deemed to be high in an integrated company (Carney & Gedajlovic, 1991; Caves & Murphy, 1976; Rubin, 1978). Under franchising, the hotel business is no longer operated by salaried employees who act on the chain's behalf, but instead by owner-franchisees who are entitled to the residual returns of the franchised hotel. Franchising therefore saves on the agency costs incurred by an integrated company in monitoring salaried employees because the owner-franchisee is self-motivated to enhance the profitability of the franchised hotel (Brickley, Dark, & Weisbach, 1991; Lafontaine, 1992; Mathewson & Winter, 1985).

2.2.2 Empirical evidence

Most empirical studies have aimed to identify the factors that result in high agency costs incurred in organizing the principal-agent relationship under integration. Previous literature has found that agency costs are likely to increase when the salaried employees are located in geographically removed locations, where the opportunity for employee shirking is higher (Carney & Gedajlovic, 1991; Fladmoe-Lindquist & Jacque, 1995). Agency costs may rise in these situations because cultural differences constitute barriers for an integrated company to monitor and regulate salaried employees, whose language, values, and behaviours are different from those espoused by the company (Davidson, 1980; Gatignon & Anderson, 1988; Roth & O'Donnell, 1996).

To reduce the likelihood of agent shirking, many studies have supported the idea that the principal should stipulate a scheme of profit sharing with the agent in the contract (Basu, Lal, Srinivasan, & Staelin, 1985; John, Weiss, & Weitz, 1987; Lal & Staelin, 1986). For example, using data collected from 54 specialty stores, Eisenhardt (1988) found that performance-contingent compensation is more likely to exist when task programmability is low, when the company cannot easily control its employee, and when outcome uncertainty is high. She has found that agents compensated based on performance outcome are more motivated to devote efforts and resources to improve the profitability of the principal's business. This study was further extended by Conlon and Parks (1990), who used experimental tests to examine the relationship between a principal's monitoring ability and the compensation arrangement of the principal-agent dyad. Their results supported the agency view that performance-contingent compensation is negatively associated with the principal's monitoring ability. Under this profit-sharing scheme, the agent is more motivated to act in the interest of the principal—and is therefore less likely to shirk.

2.2.3 Comments

Similar to internalization theory, agency theory examines the choice of franchising vs. integration that corresponds to the allocation of hotel ownership rights to an owner-franchisee (franchising) or an integrated hotel chain (integration), where franchising serves to alleviate the agency problem found in integration. In reality, however, hotel franchising is not exempted from agency problems. When claiming the profits of franchised hotels, owner-franchisees have incentives to minimize their operational costs—sometimes to a point that harms the reputation of the franchise network. Although owner-franchisees can act to affect the reputation of the franchise brand, they do not bear the full consequences of their actions because their identities remain unknown in the market. This is known as the "free-riding" problem, wherein owner-franchisees are motivated to shirk their responsibilities to build and protect the franchise brand, even though they control the ownership rights to a franchised hotel (Kidwell, Nygaard, & Silkoset, 2007; Mathewson & Winter, 1985). To protect the reputation of the franchise network, the hotel chain must regulate the behaviours of owner-franchisees through various contractual restraints, such as exclusive dealing promises (Dutta, Heide, & Bergen, 1999; Klein & Murphy, 1988; Marvel, 1982), compensation terms (i.e., franchise fee vs. royalty payment; see Gallini & Lutz, 1992; Lafontaine, 1993; Lal, 1990; Shepard, 1993), or tying agreements (Klein & Saft, 1985).

Conventional agency theory does not address the persistence of agency problems after the ownership rights to a hotel have been shifted to a self-motivated owner-franchisee. It overlooks the fact that branding rights represent one type of property rights that allows hotel branders to charge a premium rate. The concentration of hotel branding rights in a single party of the manager-developer dyad (i.e., the hotel chain in franchising) can potentially trigger another type of agency issue, wherein the brander must incur extra costs to assure that the non-brander does not shirk their responsibilities in building and protecting the reputation of the hotel. Without considering the branding status of a hotel, agency theory does not explain why free-riding problems are inevitable in franchising.

Agency theory and internalization theory are in fact two sides of the same coin in predicting the choice of franchising vs. integration: one focuses on hierarchy bureaucracy costs, and the other on market transaction costs. According to internalization theory, a fundamental motive for integration is the failure of the franchising market to cheaply facilitate the cooperation between foreign hotel chains and local hotel developers (Caves, Crookell, & Killing, 1983; Williamson, 1981). However, when the shift is made from franchising to integration, the focal hotel is no longer operated by self-motivated owner-franchisees, but rather by salaried employees who must abide by the chain's managerial directives. According to agency theory, agency issues arise because salaried employees lack incentives to contribute to the profitability of an integrated hotel (Jensen & Meckling, 1976). The hotel chain must therefore spend extra resources to impose managerial fiats to regulate the behaviours of the salaried employee. By focusing on the assignment of hotel ownership rights alone, both theories overlook the allocation of hotel branding rights as a potential tool to facilitate manager-developer cooperation in the international hotel industry.

2.3 Branding Theory of International Hotels

Researchers have also addressed branding in relation to hotel franchising. On the one hand, unknown hotel developers use franchising to borrow reputations from hotel chains without having to build a new brand to attract guest patronage (Hunt, 1977; Roberts & Dowling, 2002; Tadelis, 1999; Wernerfelt, 1988). On the other hand, franchising allows multiple owner-franchisees to share an established hotel brand, which helps the hotel chain to spread the costs of reputation and image-building across a large number of hotels without having to invest in hotel properties (Choi, 1998; Erdem, 1998). This research addresses two transactional functions of branding that facilitate business-to-consumer transactions: quality signalling and social symbolizing.

2.3.1 Brand names as quality signals

Hotel services are characterized by information asymmetry, wherein the hotel operator knows more about its service quality than its guests do (Akerlof, 1970). Because service quality can only be revealed through a hotel stay, hotel guests must incur significant costs to search for information on the hotel's quality prior to booking (i.e., hotel services are a so-called experience good; see Nelson, 1970).

To fill the information gap, the owner of a hotel can invest in the reputation of the hotel brand to reduce quality uncertainty for customers. Brand reputation is a credible quality signal to hotel guests because only high quality hotel owners are willing to invest in hotel reputation. Low quality hotel owners would fail to generate enough repeat business to recover their reputation investments, which are sunk and specific in nature (Kirmani & Wright, 1989; Nelson, 1974). Guests can therefore rely on brand reputation as a guide to quality and save on search costs. As a result, they are willing to pay a higher price to stay at a hotel that bears a reputable brand, which in turn allows the owner to recover its reputation investment in the hotel brand (Anselmsson, Johansson, & Persson, 2007; Klein & Leffler, 1981).

Sunk and specific investments in hotel reputation further serve as a bond to guarantee service quality received by guests (Telser, 1980). To preserve its ability to charge a higher rate, a hotel with a reputable brand is less likely to cheat on quality because doing so would forfeit the premium rate that guests are willing to pay (Krouse, 1984). Brand reputation becomes even more credible when a higher premium rate is charged, because potential losses on future profits will be greater (Klein & Leffler, 1981; Landes & Posner, 1987; Mitchell, 1989; Tellis & Wernerfelt, 1987). The reputation enjoyed by the hotel serves as a hostage that restrains the hotel owner from cutting its service quality—which makes the hotel brand even more credible to travelers as a guide to service quality (Kuksov, 2007; Shapiro, 1983).

Previous studies have used experiments to test the proposition that brand reputation serves as a signal for product or service quality. An early study by Jacoby, Olson, and Haddock (1971) found that brand reputation has a more significant impact than price on consumers' quality perceptions. Similarly, using college students as experimental subjects, Raju (1977) found that brands with stronger reputations receive better quality evaluations from customers than less reputable counterparts. He further argued that brand reputation has a greater impact on quality evaluations for high-price items than low-price items. In a meta-analysis of 36 experiments, Rao and Monroe (1989) confirmed that the relationship between brand name and perceived quality is positive and statistically significant. This positive relationship has been tested further in the international context, where brand reputation produces stronger quality signalling effects in those cultures that feature a tendency for high uncertainty avoidance (Erdem, Swait, & Valenzuela, 2006).

2.3.2 Brand names as social symbols

Most brand names contain social meanings that can help consumers signal their self-image to others. In doing so, consumers can derive symbolic value from those products or services that are sold under brand names with attractive social meanings. Such psychological satisfaction arises whenever consumers use trademarks as a symbol to identify (Bearden & Etzel, 1982; Belk, 1988), enhance (Batra, Ahuvia, & Bagozzi, 2012; Berger & Heath, 2007; Han, Nunes, & Dreze, 2010), and/or signal their self-image (Escalas & Bettman, 2003; Kleine, Kleine, & Kernan, 1993). Hotel owners can invest in such symbolic meanings to enhance the appeal of their brand name to travelers. Those guests who value the symbolic meanings embedded in the hotel brand can generate more psychological satisfaction from their hotel stay and thereafter are more willing to pay a premium price (Fournier, 1998). Accordingly, hotel owners can use the premium rate to recover their image investments in brand name (Stahl, Heitmann, Lehmann, & Neslin, 2012).

Earlier studies in marketing and consumer research have largely confirmed that reference groups can be a critical source of brand meanings (Bearden, Netemeyer, & Teel, 1989; Childers & Rao, 1992; Escalas & Bettman, 2003). For example, Han, Nunes, and Dreze (2010) conducted experiments on brand decisions for three categories of luxury goods: designer handbags, luxury cars, and men's shoes. They found that consumer preferences for conspicuously luxury brands derive from their wish to identify themselves with a reference group that represents a desirable social meaning (i.e., high social status based on high income).

The significance of brand meaning can differ depending on product categories. Based on their evaluation of brand decisions surrounding 16 products, Bearden and Etzel (1982) proposed that publicly consumed (vs. privately consumed) and luxury (vs. necessity) brands convey more social symbolic meanings about the consumer. In a similar experiment, Berger and Heath (2007) found strong support for the idea that the impact of brand meaning is more significant in products that are seen as symbolic of identity (e.g., music or hairstyle, rather than backpacks or stereos). Research has also suggested that more symbolic brands tend to elicit stronger consumer satisfaction than less symbolic brands (Amaldoss & Jain, 2005; Escalas & Bettman, 2005). In addition, other studies have found that the psychological value that customers can extract from a brand varies according to culture (e.g., tendency towards self-independency; see Aaker & Schmitt, 2001) and out-group preferences (Escalas & Bettman, 2005).

2.3.3 Comments

The branding theory of international hotels emphasizes the role of branding in facilitating business-to-consumer transactions. A weakness of this literature stream, however, is that most chains started with an unknown brand name that lent little reputation to their owner-franchisees. The theory is even less applicable in the global setting, where a hotel chain—no matter its reputation at home—may be unknown in a foreign country to which it is newly expanding.

The aforementioned gaps in the literature on organizational economics highlight another limitation of the branding literature. Traditionally, the branding system facilitates transactions in the consumer market under the presumption that the seller of a product is also the brander. However, in the hotel industry the software systems provided by a foreign manager can be sold under the brand of a local developer. Conversely, the hardware facilities controlled by a developer can be sold under the name of a manager. Reallocations of hotel branding rights between the two parties inevitably affect their incentives and thereby alter the costs of harmonizing their cooperation. The allocation of branding rights in this business-to-business context represents a governance issue that is neglected in the branding literature, which focuses only on the business-to-consumer relationship.

2.4 Summary

While the rise of international hotels has attracted much research attention, previous studies have largely overlooked the status of hotel branding—and particularly the fact that branding rights can be assigned between two cooperating hotel firms in more than one way. My review of the literature demonstrates that internalization theory and agency theory both focus on business-to-business transactions without examining the allocation of branding rights between the parties involved. This gap in the research exists because branding is irrelevant to the choice of franchising vs. integration, since both franchised and integrated hotels bear the brand name of the hotel chain.

Focusing on the choice of franchising vs. integration, internalization theory overlooks other market modes that can also be used to organize the cooperation between two specialist firms in the international hotel industry. Depending on the branding status of an international hotel (i.e., manager branding, developer branding, manager/developer co-branding), manager-developer cooperation can be arranged through two more contractual modes other than franchising. As such, the failure of the franchising market does not always lead to integration, since the branding rights of a hotel can be reassigned to save on market transaction costs. In proposing the integration of hotel management and development as a solution to market failure, internalization theory does not address the option of choosing one contractual mode over another.

Focusing on the transfer of hotel ownership rights from one party to the other, agency theory does not explain why agency issues persist in hotel franchising. In addition to hotel ownership rights, hotel branding rights can also be reallocated between foreign managers and local developers. Reallocations of hotel branding rights inevitably alter each party's incentives and thereby affect the agency costs that must be incurred in organizing their cooperation. Based on the traditional ownership agency problem, the choice between franchising and integration does not address the branding agency issues that may arise under three distinct branding statuses of an international hotel.

At the same time, the branding literature focuses on the role of brand names in promoting business-to-consumer transactions without considering cases in which two businesses cooperate to serve their common customers. While a hotel requires the cooperation between a manager with hotel software and a developer with hotel hardware, the two specialist firms can compete for the right to brand the hotel. The branding literature overlooks the fact that branding rights can be assigned to the manager, the developer, or even both. The governance implications of hotel branding therefore remain unaddressed.

Based on my review of the literature related to international hotel branding (i.e., internalization theory, agency theory, and branding), I unveil the need to incorporate both a business-to-business relationship and a business-to-consumer relationship into a triadic framework, in which two hotel specialists cooperate to serve travelers and each can compete for the right to brand the software-hardware bundle (see Figure 2.1). Under this triadic relationship, the foreign manager and the local developer can each minimize their operation costs in order to increase the profit stream derived from the ownership rights to their respective software systems and hardware facilities. At the same time, the parties can invest in reputation-building and image-making to increase the prices that travelers are willing to pay for their respective brand name. The breakdown of the two profit streams (which I call *operation residuals* and *reputation residuals* later in the dissertation) implies the need to separate the branding rights from the ownership rights of an international hotel, as demonstrated by my review of literature above.

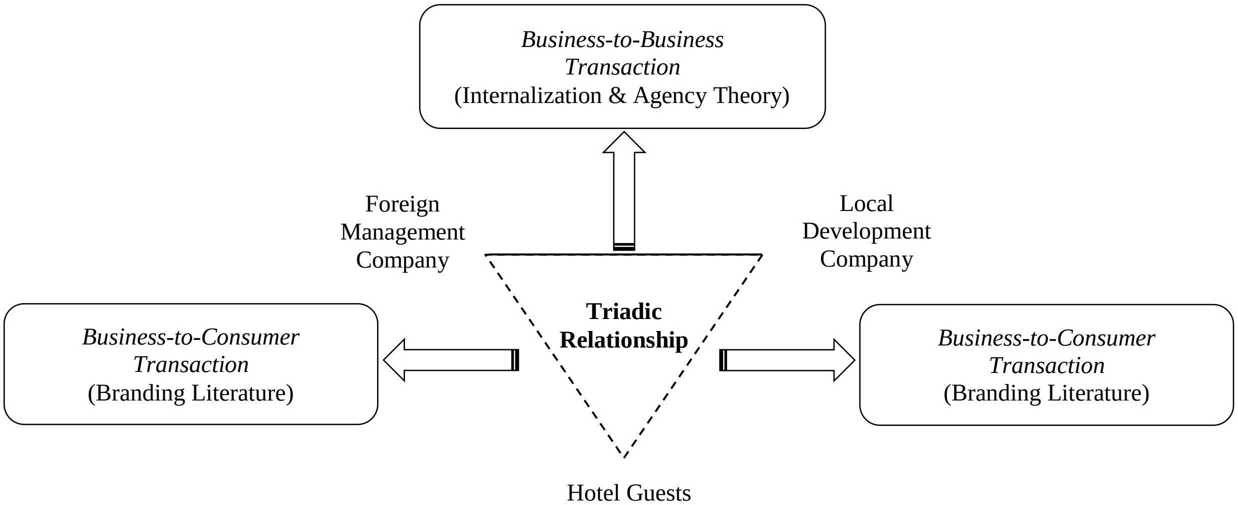

Figure 2.1: The triadic relationship of international hotel branding

In the next chapter, I build on an agency perspective to analyze the drivers behind the three contractual modes (i.e., three distinct branding options) that can be used to support an international hotel. By isolating the branding rights to a hotel from its ownership rights, I define a new category of agency issue in the international hotel industry called *branding agency*, wherein the non-brander partner lacks the incentives to build and protect the reputation of the brander partner. Building on this branding agency view, I reframe the principal-agent relationship between a foreign hotel manager and a local hotel developer across four branding options. By comparing the four branding options, I propose a new principal-agent framework to predict the optimal branding status of an international hotel. The fundamental argument in this dissertation is that the full rights to brand the software-hardware bundle of an international hotel can be reassigned to align with the incentives of the foreign manager and the local developer. As such, the branding status of an international hotel represents a governance decision that can be deliberately made to save on the agency costs of organizing manager-developer cooperation in the international hotel industry.

CHAPTER 3: AN AGENCY VIEW ON INTERNATIONAL HOTEL BRANDING

In this chapter, I adopt an agency view to examine how different branding options of an international hotel affect the incentives of the foreign manager and the local developer, which in turn alters the agency costs of governing their cooperation. I isolate an agency issue that I call *branding agency*, wherein the non-brander partner of a cooperative venture lacks the incentive to build and protect the reputation of the venture. Based on the allocation of branding rights, I also construct a principal-agent relationship in order to investigate the agency problems posed by different branding options. As the principal-agent roles of the foreign manager and the local developer change under different branding options, the costs of solving the agency issue also vary. In this chapter, I argue that the branding status of an international hotel is essentially a governance decision that can be adjusted to economize on the agency costs of governing manager-developer cooperation in delivering a software-hardware bundle to hotel guests.

3.1 Branding Rights Allocation in International Hotels

When a foreign manager and a local developer pool software systems and hardware facilities to create an international hotel, the two specialist firms can negotiate for the rights to brand the hotel. The default option in the literature is franchising, wherein the branding rights are assigned to the manager but the developer remains anonymous to guests (manager branding). Alternately, I posit that the branding rights can also be allocated to the developer (developer branding) or split between both parties (manager/developer co-branding). Regardless of the branding status of an international hotel, the issue of branding agency is likely to impede manager-developer cooperation, and the costs of addressing that agency issue vary across the three branding options. If the agency costs are deemed high for all three options, the provision of software systems and hardware facilities should be internalized through direct investment, wherein the focal hotel bears the brand of an integrated company (integrated branding). The allocation of hotel branding rights between two specialist firms thus corresponds to the choice of an optimal governance structure to organize manager-developer cooperation.

3.1.1 Manager branding

Manager branding, or franchising, refers to cases when a franchisor-manager (i.e., hotel chain) grants a local franchisee-developer the permission to operate an international hotel under its established franchise brand based on its standardized software systems at a predetermined fee (Hunt, 1977). In such instances, the software systems and hardware facilities provided by the two parties are sold to guests exclusively under the manager brand. As illustrated in Figure 3.1, franchising represents a contractual arrangement in which the anonymous developer supplies its hardware facilities to the manager for resale to the hotel guest under the franchise name.

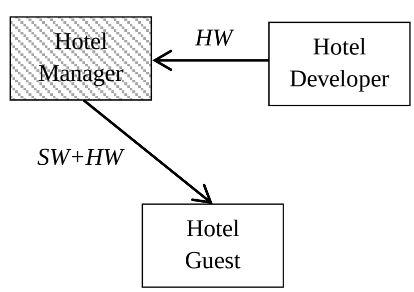

Figure 3.1: Conceptualization of manager branding

(SW: software; HW: hardware; : brander)

In franchising, the developer is entitled to the hotel profit, and thus lacks incentives to shirk its responsibilities in providing hardware facilities to guests. This perspective is commonly addressed in the agency literature, which argues that franchising alleviates the agency problems found at an integrated hotel, where the non-owner employee of a business lacks incentives to maximize company profits. In this study, I call such agency issues *ownership agency*. Based on agency theory, ownership agency can be addressed through franchising, which shifts the ownership rights of the hotel from a hotel chain to a self-motivated hotel franchisee (Anderson, 1985; Fama & Jensen, 1983). Ownership rights confer upon the franchisee the right to claim all economic benefits associated with the use of its property, a profit stream that I term *operation residuals* (Grossman & Hart, 1986; Klein, 1995; Lutz, 1995). Claiming the profit stream associated with the ownership rights to hotel hardware, the franchisee is self-motivated to increase the profit of the hotel by driving down its operational costs.

In most industries (e.g., fast food, car dealership, etc.), the franchisor grants the franchisee the right to deliver a product or service to shoppers using the franchise format (e.g., brand name, operation know-how, training, etc.). The franchisor only supplies the business format, and the franchisee is responsible for operating the franchised business. However, in the international hotel industry, the software systems involved in hotel operation are too complex to pass from the manager-franchisor to the developer-franchisee. In addition to the franchise contract that allows the developer to put the franchise brand on its hardware facilities, the two parties also enter into a contract that allows the manager to operate the franchised hotel at a fee. This differs from the franchising setup in other industries, where franchisees operate the business themselves.

From this perspective, hotel franchising is not exempted from the agency issue of employee shirking posed by integration. For a hotel chain to establish a company-owned hotel abroad, it must first send a team of employees to develop hardware facilities, before deploying another team to operate the hotel with its proprietary software systems. Thus, the hotel chain faces agency problems in both hotel development and hotel management because its salaried employees do not hold the ownership rights to the software-hardware package. In the international hotel industry, franchising typically assigns only the ownership rights of hotel hardware to the local developer; the franchised hotel is still operated by salaried employees deployed by the foreign manager. Clearly, franchising only addresses the agency problem in hotel development, and the agency issue remains unsolved in hotel management. The issue is further exacerbated by the fact that—in addition to the foreign manager—the local developer must also monitor the behaviours of on-site employees to assure the service quality guaranteed by the franchised brand.

While franchising assigns the ownership rights of hotel hardware to the local developer, the foreign manager retains the branding rights to both hotel software and hotel hardware. In addition to the operation residuals conferred by the ownership rights of an international hotel, another profit stream can be derived from the branding rights of the hotel. As discussed in the branding literature, a reputable brand adds value to hotel services and allows the hotel chain to charge a premium room rate (Klein & Leffler, 1981; Telser, 1980). The commonly adopted concept of brand equity measures the size of the premium that travelers are willing to pay for branded hotel services in relation to unbranded alternatives (Rindova, Williamson, Petkova, & Sever, 2005; Stahl, Heitmann, Lehmann, & Neslin, 2012). On the other hand, a notorious brand reduces the value of hotel services and forces the hotel chain to offer a discount price, in relation to the same services offered unbranded. The brander of a hotel is thus entitled to the profit stream above or below the normal room rate of a comparable unbranded hotel. I call this profit stream the *reputation residuals*, which are derived from the branding rights of the focal hotel.

In cases of franchising, travelers patronize an international hotel based on the software systems and hardware facilities provided by two specialist firms—but the overall software-hardware package bears only the brand of the software manager, while the hardware developer remains anonymous in the market. As such, the brander manager claims not only the reputation residuals of its software systems, but also the reputation residuals of the hardware facilities of the non-brander developer. Therefore, the manager is highly motivated to build up and safeguard the reputation of the hotel brand in order to gain higher reputation residuals from travelers (e.g., by raising its franchise fee or opening more outlets in the designated area). In comparison, the developer-franchisee is an anonymous provider of hardware facilities for resale to travelers under the brand of the manager-franchisor. Claiming only the operation residuals of its hardware facilities, the developer-franchisee has incentives to minimize its operational costs to an extent that could potentially harm the reputation of the franchise network. Although the developer-franchisee can act to affect the reputation of the hotel brand, it bears no direct consequences for those actions, a behaviour pattern that has been labelled "free-riding" in previous studies (Eisenhardt, 1989; Minker & Park, 1994).

Free-riding behaviour poses a new type of agency problem that I call *branding agency*. While franchising in the hotel industry allows two specialist firms to control the ownership rights to their respective software systems and hardware facilities, the branding rights to the software-hardware bundle are concentrated in the foreign manager. The separation of ownership rights and branding rights to hotel hardware thus leads to branding agency issues, wherein the non-brander developer lacks incentives to build or protect the reputation of the franchise brand.

Although they are based on two different types of property rights (ownership rights vs. branding rights), branding agency and ownership agency are similar in nature. In a traditional principal-agent relationship, the owner-employer claims the operation residuals in a business by paying a fixed salary for the contributions of the non-owner-employee. In the case of branding agency, the brander can be treated as a principal who claims the reputation residuals in a business from consumers, and the non-brander serves as an agent who sells its reputation contributions at a fee. Franchising addresses the agency issue associated with the ownership rights to hotel hardware—but it triggers the issue of branding agency because the owner of hotel hardware does not control its branding rights.

To protect its brand reputation from being harmed, the manager can specify a variety of contractual restraints to prevent faulty hardware facilities. For example, the franchisor can stipulate the standards of hardware quality provided by the franchisee and reserve the right to inspect the premises (Mathewson & Winter, 1985). In addition, the manager can also offer territorial protection to encourage the developer to invest in hardware quality and thereby improve the popularity of the franchise brand in the designated territory (Dutta, Heide, & Bergen, 1999). To assure that the developer can fully recover its investment in hardware quality, the manager can even promise not to raise its franchise fee or open new outlets as a way for the developer to split the reputation residuals in the hotel brand in the designated area. More directly, the manager can make a payment to buy out the contributions made by the developer to the reputation of the franchise brand (Klein, 1995; Krueger, 1991).

My analysis has identified a special agency issue, called *branding agency*, that arises when a foreign manager and a local developer contribute their respective software systems and hardware facilities to establish a franchised hotel—but the software-hardware bundle only bears the manager's brand name. As the brander, the manager incurs extra contractual costs in preventing the anonymous developer from shirking its responsibilities to provide and maintain hardware facilities in ways that could potentially harm the reputation of the franchise network. If the costs of addressing this branding agency issue are too high, a potential solution is to reassign the branding rights to the developer (i.e., developer branding, as presented in the next section), without the integration of hotel management and hotel development within a single firm.

3.1.2 Developer branding

When a foreign manager and local developer partner to establish an international hotel, the right to brand the software-hardware bundle can also be assigned to the developer alone, where the hotel is governed through a management contract (Contractor & Kundu, 1998b). The ownership rights to a contractually managed hotel are assigned in the same manner as those to a franchised hotel. The difference between the two lies in the assignment of branding rights: while the manager holds the branding rights to a franchised hotel, the developer holds the branding rights to a contractually managed hotel. As conceptualized in Figure 3.2, the manager of a contractually managed hotel supplies its software systems to be bundled with the hardware facilities for resale to the hotel guests under the developer brand.

As discussed above, the branding agency problem in franchising occurs because the hardware facilities owned by the local developer are sold under the brand of the manager. To address this problem, the branding rights to the software-hardware package can be reassigned from the manager to the developer. As the brander of a contractually managed hotel, the developer claims the reputation residuals of the hotel and thus has full incentives to enhance the quality of its hardware facilities; in turn, this releases the manager from having to monitor the behaviour of the developer. Developer branding is the mirror image of manager branding, in that it helps to resolve the branding agency issue by reassigning the full branding rights of the hotel from the manager to the developer.

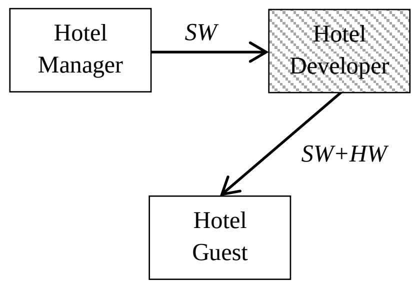

Figure 3.2: Conceptualization of developer branding
(SW: software; HW: hardware; : brander)

However, developer branding does not fully eliminate the issue of branding agency. As the anonymous supplier of the software systems, the manager claims only the residuals of its software operations; however, it can still act to alter the reputation of the hotel. Hence, the manager does not have the same motivations to build and protect the reputation of the hotel. In some instances, it may even find it attractive to downgrade software quality to maximize its operation residuals, since inferior services would only harm the reputation of the developer. For a contractually managed hotel to work, contractual restraints are still needed to enable the developer to monitor the operations of the manager.

To protect its reputation from being damaged by faulty software systems, the developer must stipulate quality standards for hotel software and retain the right to return low-quality software systems to the anonymous manager (Mathewson & Winter, 1985). It can recoup the reputation losses caused by faulty software systems through a punitive payment collected from a manager who violates the agreed-upon quality standards. Conversely, in cases where the manager upgrades its software systems and enhances the reputation of the focal hotel, the developer can make a direct payment to the manager to help recover the manager's investment in hotel reputation. The costs of writing and enforcing such contractual restraints are the agency costs of developer branding.

As long as the agency costs of manager branding and developer branding are both reasonable, the software-hardware bundle can be sold to travelers through a franchised hotel branded by the manager or through a contractually managed hotel branded by the developer. The distinction between the two lies in the relative agency costs incurred by the manager vs. the developer to build and protect the reputation of the focal hotel. In cases where the agency costs of both branding options are high, the two parties can retain the right to brand their respective software systems and hardware facilities through a setup that I call manager/developer co-branding.

3.1.3 Manager/developer co-branding

When the contractual solutions to the branding agency issues posed by manager branding and developer branding are costly, the manager and the developer can retain their respective branding rights and appeal directly to travelers through two separate business-to-consumer transactions—a relationship that can be called *manager/developer co-branding*. In such cases, the two parties sell their software systems and hardware facilities to travelers under their respective names (see Figure 3.3).

Similar to the branding options discussed above, the ownership rights to the software systems and hardware facilities of a manager/developer co-branded hotel are assigned to the manager and the developer. The two parties claim the operation residuals generated by their respective software and hardware, and both invest in the reputations of their brands to claim subsequent reputation residuals from travelers. Hence, ownership and branding agency issues should be absent in a manager/developer co-branded hotel.

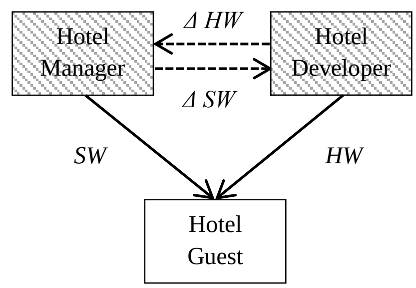

Figure 3.3: Conceptualization of manager/developer co-branding

(SW: software; HW: hardware; ▨: brander; ---- reputation interaction)

Under manager/developer co-branding, the two parties are motivated to maximize the joint value of their software systems and hardware facilities. The manager, for instance, can make its booking network widely accessible to travelers and provide more sophisticated on-site services. Likewise, the developer can add more amenities for travelers and update its facilities on a regular basis. In a multiple-manager/multiple-developer setting, travelers can choose the best software-hardware package available in the market to maximize their overall satisfaction with the manager/developer co-branded hotel. By appealing to travelers through two brand names, the manager-developer dyad can automatically maximize the value of their joint output, without having to impose contractual restraints on each other.

Manager/developer co-branding also allows the two parties to claim a fair share of their joint profits, be it operation residuals or reputation residuals. Because the manager and the developer of a manager/developer co-branded hotel are both identifiable, travelers can hold them directly responsible for the values of their input components (Landes & Posner, 1987). Irrespective of the hardware facilities in which the software systems are embedded, travelers can pay a premium or a discount price to reward or punish the manager for the quality of the software systems sold under its brand. The same can be said for developers who provide high- or low-quality hardware facilities. By appropriating the residual streams based on their ownership rights and branding rights, the co-branding parties can automatically claim a fair share of their joint profits without direct settlements with each other (Chen, 2005; Grossman & Stiglitz, 1980).

Manager/developer co-branding will be possible if the reputation of one party is independent from the actions of the other. As long as travelers can separate the performance of one brander from that of the other, they can reward or penalize the two parties directly and separately for their respective contributions to the hotel. Hypothetically, the co-branders of the focal hotel can maintain an arm's length distance from one another—that is, the two parties need not impose contractual restraints on each other to assure that they maximize the value of their joint output and claim a fair share of their joint profits. This setup can be called *arm's-length co-branding*, where ownership- and branding-related agency issues are absent in the manager-developer dyad.

However, when hotel software and hotel hardware are sold as a package under separate brands, travelers do not always possess sufficient information to separate the performance of one party from that of the other. In such cases, the actions of one co-brander affect not only its own reputation, but also the reputation of the other co-brander. For instance, the quality of check-in services at a manager/developer co-branded hotel depends on the manager's software systems (e.g., training standards) and the developer's hardware facilities (e.g., computer stations). Accidentally or deliberately, the developer can offer superior or defective hardware components to alter the quality of check-in services and thereby impact the reputation of the manager brand among travelers. It is also possible for the manager to enhance or reduce the quality of its contributions to boost or degrade the reputation of the developer. I call this situation *reputation interaction*, a challenge that occurs when a co-brander of an international hotel claims a stream of reputation residuals that depends not only on its own actions, but also on the actions of the other co-brander.

The presence of reputation interaction between the two parties who co-brand a hotel calls for the imposition of contractual restraints for them to maximize the value of their joint output and claim a fair share of their joint profits—a governance structure that can be called *contractual co-branding* (Chen, 2005). Under contractual co-branding, the manager and developer each claim a portion of their reputation residuals directly from hotel guests through two separate business-to-consumer transactions. At the same time, they also claim the remaining portion of their reputation residuals from each other through two separate business-to-business transactions: the manager buys out the developer's reputation contribution on hotel software, and the developer buys out the manager's reputation contribution on hotel hardware (see Figure 3.3). When the agency costs of conducting those two business-to-business transactions are low, the parties can still co-brand the hotel, but they must rely on contractual restraints to settle potential reputational disputes.

I have argued that manager-developer cooperation can be organized through different market contracts, in which the right to brand the software-hardware bundle for an international hotel can be assigned in three ways, even when the ownership rights to software systems and hardware facilities remain the same. The three contractual-mode branding options pose different branding agency issues that differ in nature. The manager-developer dyad can choose between the branding options to select one that saves on the agency costs of organizing their cooperation. In cases where all three contractual-mode branding options involve high agency costs, integration becomes the only solution. In such cases, the international hotel bears the brand name of a single firm that controls both the ownership rights and branding rights of the focal hotel—a branding option that I call *integrated branding*.

3.1.4 Integrated branding

Following the market-vs.-integration paradigm in internalization theory, when all contractual-mode branding options involve high agency costs, the software-hardware in an international hotel can be integrated within a single firm (Hennart, 1986; Williamson, 1979). I call this setup *integrated branding*, whereby a hotel chain invests in foreign countries to develop its own hotel hardware to be combined with its hotel software (Figure 3.4).

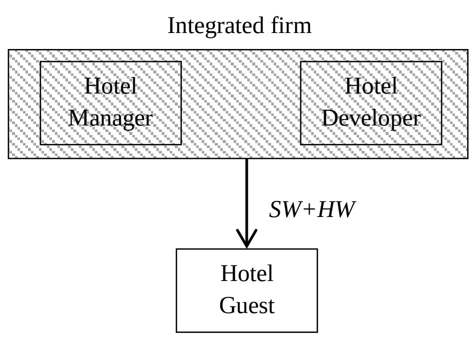

Figure 3.4: Conceptualization of integrated branding
(SW: software; HW: hardware; ▨: brander)

Integrated branding provides a solution to the agency problems posed by the three contractual-mode branding options described above. Under integrated branding, the overall software-hardware bundle bears the name of an integrated firm that claims the operation and reputation residuals of both hotel software and hotel hardware (i.e., four residual streams in all). As such, it does not need to buy out reputation contributions from any cooperative partner, which alleviates the branding agency issues posed by the other three branding options. Integrated branding thus saves the agency costs incurred by two specialist firms in coordinating their joint efforts to build hotel reputation.

Along with branding rights, the ownership rights of hotel software and hotel hardware are also concentrated in an integrated firm that is entitled to all residual profits of the joint software-hardware operation. Salaried employees from two specialist divisions in the firm are deployed overseas to develop hardware facilities and manage software systems for a company-owned hotel. Hence, integration triggers the traditional agency problem, in which salaried employees are motivated to shirk responsibilities. Unlike the earlier branding options, integrated branding requires the use of hierarchical directives to regulate the interactions between the two specialist divisions within the integrated firm. On top of the agency costs of monitoring the salaried employees deployed overseas, the integrated firm also incurs extra bureaucratic costs to coordinate the manager-developer interaction internally. Integrated branding works if the bureaucratic costs related to the use of hierarchical directives to regulate the interaction between the two specialist divisions are lower than the transaction costs associated with the use of market contracts to govern the cooperation between two specialist firms.

3.2 Branding Principal-Agent Relationships

I have argued that a hotel chain can choose from four different modes for overseas expansions, including three contractual modes and one equity mode. Under the three contractual modes, the respective ownership rights to the software systems and hardware facilities of an international hotel are assigned to two specialist firms, while the full rights to brand the hotel can be assigned between those firms in three different ways. A hotel chain can also use the equity mode to expand abroad, by concentrating the ownership rights and branding rights to the overall software-hardware bundle in a single integrated firm that consists of two specialist divisions.

In treating the right to brand a hotel as the right to claim the reputation residuals of the hotel brand, I identify an agency issue called *branding agency*—which differs from the conventional agency problem based on ownership rights. The nature of the branding agency issues and the principal-agent roles of a manager and developer vary across the four branding options (i.e., three contractual mode options plus one equity mode choice).

In the cases of manager branding and developer branding (Figure 3.5 and 3.6), a single brander claims all of the reputation residuals of the software-hardware bundle and hence can be seen as the *full principal*. The non-brander sells all its reputation contributions at a fee without claiming any reputation residuals and thus can be seen as the *full agent*.

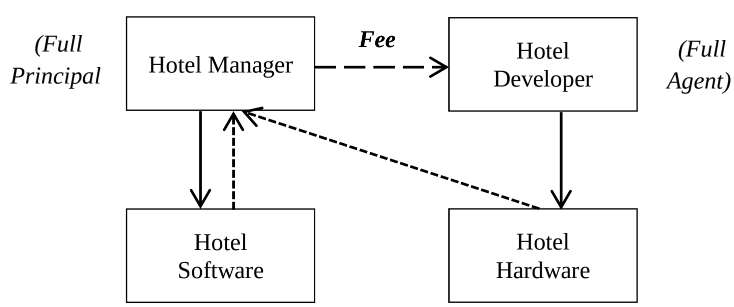

Figure 3.5: Branding principal-agent relationship in manager branding
(— reputation contribution;----- reputation residual)

In these two branding options, the full principal must incur positive agency costs to monitor the actions of the full agent in building and protecting the reputation of the hotel brand. The choice of manager vs. developer branding is determined by the relative agency costs that would be incurred by each party in the role of full principal to monitor the full agent.

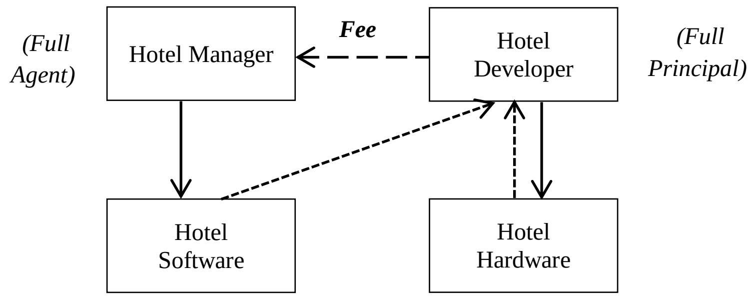

Figure 3.6: Branding principal-agent relationship in developer branding (— reputation contribution; ----- reputation residual)

If the agency costs of manager branding and developer branding are both high, the two parties can retain their rights to brand the software systems and hardware facilities of the focal hotel through manager/developer co-branding (Figure 3.7). In the absence of reputation interaction (that is, the action of one party does not alter the reputation of the other), the two hotel specialists both act as full principals who claim separate streams of reputation residuals based on their brands. As a result, they are fully motivated to build and protect the reputation of the manager/developer co-branded hotel and do not need to incur any costs to address the issue of brand agency that occurs when one party (agent) sells its reputation contributions to the other party (principal) at a fee.

However, the presence of reputation interaction means that the action of one co-brander affects the reputation of the other. In such cases, the two co-branders claim a stream of reputation residual that depends in part on each other's actions. As such, their reputation contributions to the manager/developer co-branded hotel can be divided into two portions—one that they can claim as *a principal* directly from hotel guests, and the other that they must sell as *an agent* to the cooperating partner at a fee. Because the two co-branders are not rewarded solely by reputation residuals claimed from guests, they are both *partial principals*. Because the two co-branders sell only a portion of their reputation contributions to each other, they are both *partial agents*. Therefore, under manager/developer co-branding, brand agency occurs in a two-way manner—where both parties are principals and agents at the same time. This differs from the one-way brand agency in manager branding and developer branding—where one party is a principal, and the other is an agent. Owing to the presence of reputation interaction, the two co-branders still have to incur positive agency costs to coordinate their joint efforts in building and protecting the brand reputation of the focal hotel.

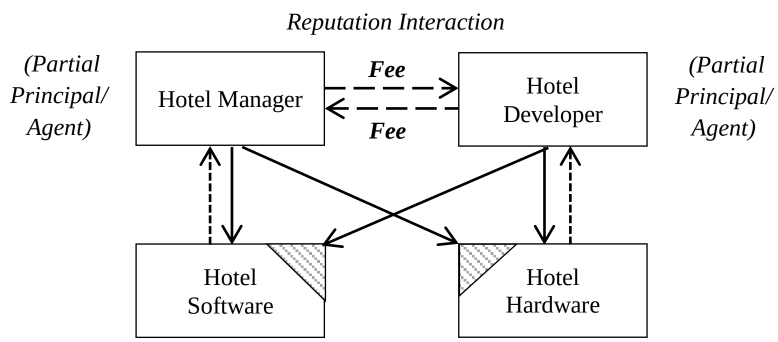

Figure 3.7: Branding principal-agent relationship in manager/developer co-branding (— reputation contribution; ----- reputation residual)

When the three contractual-mode branding options (i.e., manager branding, developer branding, and manager/developer co-branding) all fail due to high agency costs, the full right to brand the software systems and hardware facilities can be concentrated in a single firm that integrates hotel management and hotel development, as shown in Figure 3.8. In such cases, the integrated company is the full principal that claims all reputation residuals in the focal hotel directly from guests. The integrated company consists of two specialist divisions, hotel management and hotel development, that abide by hierarchical fiats from their common boss. All salaried employees in the two specialist divisions are agents who do not claim residual profits from guests.

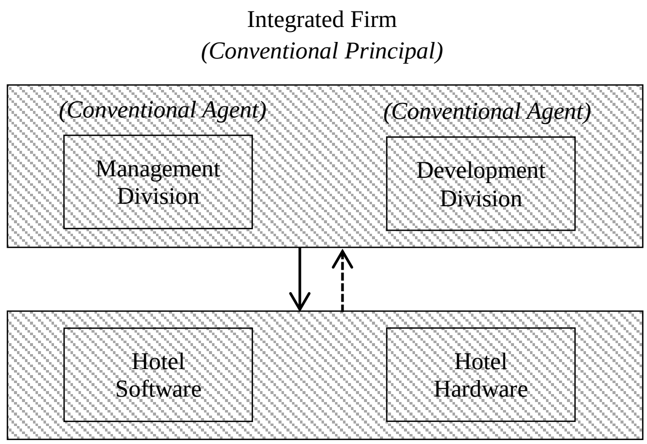

Figure 3.8: Branding principal-agent relationship in integrated branding (—— reputation contribution; ----- reputation residual)

A comparison of the four branding options is summarized in Table 3.1. To begin with, each of the branding options corresponds to a particular governance mode for organizing manager-developer cooperation. The ownership rights to hotel software and hardware remain the same across all three contractual modes, but the branding rights are allocated in different ways. Under the three contractual modes, the allocation of branding rights also determines the nature of the principal-agent relationship between the two hotel specialist firms. All else remaining constant, the selection of the optimal contractual mode to govern manager-developer cooperation thus depends on two types of agency costs incurred by the parties to harmonize their joint efforts to build and protect the hotel brand: the agency costs of manager branding represent the costs of addressing branding agency when the manager is identifiable to hotel guests, and the agency costs of developer branding represent the costs of addressing branding agency when the developer is identifiable to guests. When the agency costs are high under all three branding options, the integration of hotel management and hotel development becomes the only feasible option for establishing an international hotel.

Table 3.1: Comparison of international hotel branding options

	Manager Branding	**Developer Branding**	**Co-branding**	**Integrated Branding**
Governance mode	Franchise contract	Management contract	Co-brand Contract	Hierarchy
Allocation of ownership rights				
- Software	Manager	Manager	Manager	Integrated firm
- Hardware	Developer	Developer	Developer	Integrated firm
Allocation of branding rights				
- Software	Manager	Developer	Manager	Integrated firm
- Hardware	Manager	Developer	Developer	Integrated firm
Role of manager	Full branding principal	Full branding agent	Partial branding principal & partial branding agent	Conventional agent
Role of developer	Full branding agent	Full branding principal	Partial branding principal & partial branding agent	Conventional agent
Control of manager	Consumer market	Contractual restraints	Consumer market & contractual restraints	Hierarchical directives
Control of developer	Contractual restraints	Consumer market	Consumer market & contractual restraints	Hierarchical directives
Agency costs of manager branding	Low	High	Low	High
Agency costs of developer branding	High	Low	Low	High

3.3 The Optimal Branding Status of International Hotels

My analysis has suggested that, as the branding rights of a hotel shift between the manager and developer, the roles of the two parties also change (i.e., full branding principal, full branding agent, partial branding principal, partial branding agent). As a result, their incentives to build and protect the reputation of the focal hotel differ across the three contractual modes. Accordingly, the costs of solving the branding agency issue also vary with the three branding options.

Fundamentally, different allocations of branding rights imply two types of agency costs. First, the agency costs of manager branding are the costs incurred to address branding agency issues when the manager pays a fee to buy out the reputation contributions made by the developer to the hotel. Second, the agency costs of developer branding are the costs incurred to deal with branding agency problems when the developer pays a fee to buy out the reputation contributions made by the manager to the hotel. These costs occur because the reputation residuals accrued to one party depend in part on the actions of the other, so contractual restraints must be imposed to harmonize the parties' joint efforts to build and protect the reputation of the hotel brand. The presence of these two types of agency costs suggest that the branding status of an international hotel is determined by the relative agency costs of manager branding vs. developer branding, which can be captured through a two-dimensional branding space. As illustrated in Figure 3.9, the vertical axis in the two-dimensional space measures the agency costs of manager branding, and the horizontal axis measures the agency costs of developer branding.

The origin point in Figure 3.9 represents the option of arm's-length co-branding, which denotes the hypothetical case in which two specialist firms co-brand a hotel and appeal directly to travelers through two separate business-to-consumer transactions. In the absence of reputation interaction, the two co-branders need not settle misplaced reputation gains or reputation losses through any business-to-business transactions. As such, they can maintain an arm's length distance from each other and incur zero agency costs—because neither party needs to buy out the reputation contributions of the other. I call this governance mode *arm's-length co-branding*.

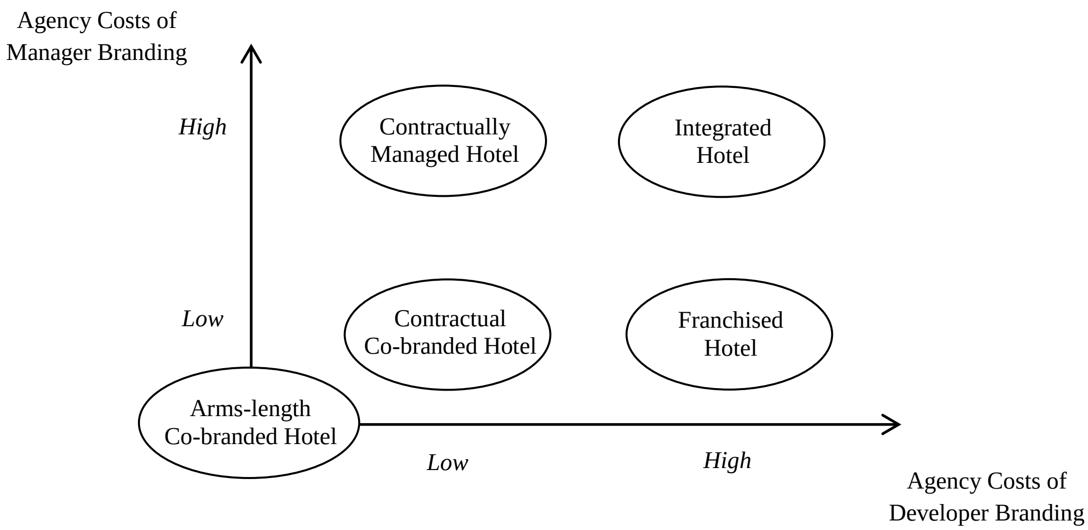

Figure 3.9: A two-dimensional branding agency model

In the presence of reputation interaction, the two specialist firms can still co-brand an international hotel, but they must settle misplaced reputation gains or losses with each other. Such settlements involve the use of two-way business-to-business transactions to buy out each other's reputation contributions. As long as the costs of solving the problem of two-way branding agency are low (i.e., the agency costs of both manager branding and developer branding are low), the two co-branders can rely on contractual restraints to harmonize their joint efforts to build and protect the reputation of the hotel brands, a governance setup that I call *contractual co-branding*—which is shown in the lower-left corner of Figure 3.9.

If the agency costs of manager branding are low, but the agency costs of developer branding are high, the manager should be the single brander of an international hotel, and the developer of the hotel must remain anonymous to travelers. This is the case for the franchised hotel shown at the lower-right corner of Figure 3.9. Under manager branding, the manager must pay a fee to buy out the reputation contributions made by the anonymous developer to the hotel brand. This one-way business-to-business transaction can be easily negotiated and enforced because the agency costs of manager branding are relatively low.

Conversely, if the agency costs of manager branding are high, but the agency costs of developer branding are low, the developer should hold the full rights to brand the software-hardware bundle of the hotel, and the manager must remain anonymous to travelers. This is the case for the contractually managed hotel shown at the upper-left corner of Figure 3.9. Under developer branding, the developer claims the reputation residuals in the hotel by paying a fee to buy out the reputation contributions of the anonymous manager. Again, this one-way business-to-business transaction is efficient because the agency costs of developer branding are relatively low.

When the agency costs of manager branding and developer branding are both high, the international hotel must bear the name of an integrated firm. This is shown at the upper-right corner of Figure 3.9. Integrated branding means that the integrated firm claims all reputation residuals from hotel guests, without the use of costly business-to-business transactions to govern manager-developer cooperation. Nonetheless, the integrated firm must still impose hierarchical fiats to coordinate cooperation between its two specialist divisions—hotel development and hotel management. Integrated branding works if the savings on two-way agency costs are higher than the bureaucratic costs of using hierarchical fiats to govern manager-developer cooperation within the firm, including the costs to monitor salaried employees deployed overseas to develop and manage a company-owned hotel.

3.4 Summary

In this chapter, I adopt an agency view to examine how different hotel branding options alter the incentives of the manager and developer in building and protecting the hotel brand—and therefore affect the agency costs of governing the cooperation between both parties. I isolate the branding rights from the ownership rights to an international hotel. In doing so, I draw attention to a new agency issue called *branding agency*, wherein the non-brander (the agent) lacks the incentives to contribute to the reputation of the brander (the principal).

While the ownership rights to the software-hardware bundle of an international hotel remain the same under all three contractual-mode options (i.e., the foreign manager controls hotel software, and the local developer owns hotel hardware), the issue of branding agency is addressed in different ways: the branding rights can be allocated to the manager alone (manager branding), to the developer alone (developer branding), or to both members of the manager-developer dyad (manager/developer co-branding). Under the three branding statuses of a hotel, the brander serves as a principal (full or partial), while the non-brander acts as an agent (full or partial). As the roles of the manager and developer change, the costs of solving the branding agency issue also vary. In cases where the costs of solving the issue of branding agency are too high in all three contractual-mode branding options, the right to brand the software-hardware bundle of the focal hotel should be concentrated in a single firm that integrates hotel management and hotel development—which I call *integrated branding*.

My rule for international hotel branding is therefore based on the costs of solving the issue of branding agency across each branding option. Depending on the relative costs of manager branding vs. developer branding, the right to brand an international hotel can be reassigned between the two specialist firms to harmonize their incentives and therefore save on the costs of solving the branding agency issue. The concentration of hotel ownership rights to both software systems and hardware facilities in an integrated firm is necessary only when the agency costs of solving the issue of branding agency are high under all three contractual-mode branding options. Simply put, the branding status of an international hotel is fundamentally a governance decision that can be deliberately made to economize on the agency costs of harmonizing manager-developer cooperation in delivering the software-hardware bundle to hotel guests.

CHAPTER 4: WHEN SHOULD FOREIGN MANAGERS LET LOCAL DEVELOPERS CO-BRAND AN INTERNATIONAL HOTEL? AN EMPIRICAL TEST IN CHINA

When a foreign manager collaborates with a local developer to establish an international hotel, as described in Chapter 3, the two parties can brand the hotel in three ways: *manager branding*, *developer branding*, or *manager/developer co-branding*. In cases where all three branding options are too costly to contract, the hotel should bear the name of a single firm that integrates hotel development and hotel management—a fourth branding option that I call *integrated branding*. Among the four branding options, manager branding is the most common choice in the international hotel industry (IBISWorld, 2013). In contrast, integrated branding is rarely seen due to the barriers (financial and regulatory) that international chains face in acquiring properties for hotel development in host countries. Casual observations reveal that sometimes, foreign managers allow local developers to co-brand a focal hotel and hence transform a manager-branded hotel into a manager/developer co-branded hotel. There are also cases where a foreign manager operates an international hotel that bears the name of the local developer. However, such hotels are harder to identify by an outside observer, and the contractual relationship between the manager and developer is often less stable.

Because manager branding and manager/developer co-branding are the two most popular choices, one critical question arises: when should foreign managers (which are often big and reputable) let local developers (which are often small and unknown) co-brand an international hotel? Drawing on a sample of international hotels collected from China, I use a vector of agency factors to predict the choice of manager branding vs. manager/developer co-branding for an international hotel. I start this chapter by reasoning that the costs incurred by a manager-developer dyad to address the branding agency problem are contingent upon the two hotel specialists' relative contributions to the reputation of the hotel brand and their relative ability to monitor each other's behaviour. As such, the branding rights of an international hotel should be assigned between the parties in a manner that aligns their incentives and thereafter economizes on the agency costs of governing their cooperation. Drawing on a set of variables that measure or proxy for the costs of solving the branding agency problem, I hypothesize that the branding status of an international hotel is determined by the costs incurred by the two parties to optimize their joint efforts in building and protecting the hotel brand.

4.1 The Choice of Manager Branding vs. Manager/developer Co-branding

In this section, I build upon the agency view presented in Chapter 3 to predict the choice between manager branding and manager/developer co-branding for an international hotel. Consistent with my earlier analysis, *manager branding* refers to cases in which a hotel carries only the brand of the foreign manager, while the local developer remains anonymous to travelers. *Manager/developer co-branding* occurs when a hotel bears the brand names of both the foreign manager and the local developer in appealing to a common customer. According to Chapter 3, the branding status of a hotel affects the respective incentives of the two parties and alters the agency costs of governing their joint contributions to the reputation of the hotel brand. The choice between manager branding and manager/developer co-branding should thus be made deliberately to minimize the agency costs of organizing manager-developer cooperation.

In this chapter, I explore why agency costs to govern the manager-developer dyad vary under different branding decisions. Specifically, the decision as to whether or not a foreign manager should let a local developer co-brand a focal hotel depends on two factors: (1) the relative contributions that each party can potentially make to the reputation of the hotel brand; and (2) the relative ability of each party to monitor the other's shirking of responsibility in building and protecting the hotel brand. My analysis suggests that the branding rights of a hotel should be allocated to the party that can contribute more to the hotel brand and/or is better able to monitor the action of the other party. This would allow the two parties to minimize the costs incurred to address the problem of branding agency.

4.1.1 Relative contributions of manager vs. developer to hotel reputation

When the foreign manager and the local developer of an international hotel both contribute to the reputation of the hotel brand, the branding status of the hotel determines the payoffs to each party for its reputation contributions. The brander(s) serve as a principal who claims the reputation residuals of the hotel from guests, and the non-brander (if any) serves as an agent who sells its reputation contributions to the principal at a pre-determined fee. Therefore, the branding status of a hotel defines the nature of the principal-agent relationship in the manager-developer dyad, whereby the principal pays a fee to buy out the reputation contributions of the agent. Expectedly, the relative contributions made by each party to hotel reputation can affect the agency costs incurred to organize their joint efforts in building and protecting the hotel brand. Hence, the right to brand a hotel should be assigned to the party that contributes relatively more to the hotel brand in order to reduce the agency costs of governing manager-developer cooperation.

Depending on the nature of the principal-agent relationship between the manager and developer, the parties get paid for their reputation contributions in different ways. In manager branding, the manager is the sole principal who claims the reputation residuals of the hotel brand from guests, and the developer is the sole agent who receives a pre-determined fee from the principal for its reputation contributions. Manager branding thus involves two payoffs: one through a business-to-consumer transaction, in which the manager claims the reputation residuals of the focal hotel from guests, and the other through a business-to-business transaction, in which the developer sells its reputation contributions to the manager.

In manager/developer co-branding, the foreign manager and local developer co-brand an international hotel together and earn reputation residuals from guests through two business-to-consumer transactions. Hypothetically, if the reputation residuals accrued to one party did not depend upon the actions of the other (i.e., there was no reputation interaction), the two co-branders would not need to settle misplaced reputation gains or losses with each other through any business-to-business transactions. In the absence of reputation interaction, it would take only two business-to-consumer transactions for both members of the manager-developer dyad to receive from their guests the compensations for their respective contributions to the reputation of the manager/developer co-branded hotel.

In reality, the actions of the manager and the developer affect not only their own brand reputations—but also the reputation of the other party's trademark. Even when such reputation interaction exists, the manager and the developer can still co-brand a hotel and claim reputation residuals from hotel guests through two business-to-consumer transactions. At the same time, they must also conduct two-way business-to-business transactions to settle misplaced reputation gains or losses resulting from reputation interaction. In such cases, it takes two business-to-consumer transactions and two business-to-business transactions to fully reward both members of the manager-developer dyad for their respective contributions to the reputation of the manager/developer co-branded hotel.

A *branding principal-agent relationship* exists when one party buys out the reputation contributions of the other (in full or in part) at a pre-determined fee. In such cases, the buyer is the branding principal, and the seller is the branding agent. In manager branding, the manager alone claims the full profit stream of the hotel brand, which consists of the reputation residuals of both its own software systems and the hardware facilities provided by the developer. A manager that buys out the full contributions of the developer to the hotel reputation is called a *full principal*, and this manager is made identifiable to hotel guests through branding. A developer that sells its full reputation contributions to the manager at a pre-determined fee is called a *full agent*, and this developer remains anonymous to hotel guests. Therefore, manager branding involves a one-way principal-agent relationship embedded in a single business-to-business transaction: the manager is the full branding principal and the sole buyer, and the developer is the full branding agent and the only seller.

In cases of manager/developer co-branding where reputation interaction exists, each party claims a stream of reputation residuals that depends not only on its own actions, but also on the actions of the other co-branding partner. In such cases, the manager serves as a *partial principal* and claims only a portion of its reputation contributions from hotel guests. At the same time, the manager also acts as a *partial agent* who sells the remaining portion of its reputation contributions to the developer. The same holds true for the developer, who serves as both a *partial principal* who claims a portion of its reputation contributions from hotel guests, and a *partial agent* who sells the remaining portion of its reputation contributions to the manager. Thus, manager/developer co-branding involves a two-way principal-agent relationship embedded in two business-to-business transactions: the manager and the developer are both buyers and sellers of reputation contributions. Without serving a singular role in the principal-agent relationship (i.e., either a full principal or a full agent), each co-brander now plays two roles: a partial principal, who claims partial reputation residuals from hotel guests, and a partial agent, who sells partial reputation contributions at a pre-determined fee.

The principal relies in part on the agent's efforts to build and safeguard its own brand; therefore, any shirking of responsibility by the agent can harm the reputation of the principal's brand. To protect its brand and the resulting reputation residuals, the principal needs to stipulate contractual restraints to prevent or discourage the agent from shirking responsibility in ways that could damage the reputation of the principal brand (Gatignon & Anderson, 1988). The contractual costs of solving the branding agency issue therefore trigger extra agency costs to govern the business-to-business transactions used by the principal and agent to settle misplaced reputation gains or losses.

The size of the contributions made by an agent to the reputation of a principal brand affects the costs of governing the principal-agent relationship. When the agent contributes more towards the reputation of the principal brand, it can take more actions to alter the reputation residuals that the principal claims from hotel guests. The complexity of the agent's actions requires the principal to stipulate a more comprehensive contract to regulate their cooperation. In turn, this will result in higher agency costs between the two parties. Conversely, when the agent contributes less towards the principal's brand, it will be easier for one party to buy out the reputation contributions of the other. The business-to-business transaction that the parties use to settle reputation gains or losses will be less complicated and hence cheaper to write and enforce. As a result, the size of the reputation contributions made by the agent to the principal's brand is a key factor affecting the agency costs of organizing manager-developer cooperation.

The branding status of a hotel further determines the nature of the principal-agent relationship. In manager branding, the manager is the only principal and the developer is the only agent in a one-way business-to-business transaction, in which the developer sells its reputation contributions to the manager. Thus, the agency costs in manager branding depend solely on the contributions made by the developer (a full agent) to the brand name of the manager (a full principal). The less the developer contributes to the hotel brand (e.g., the fewer the actions that the developer can take to alter the reputation of the hotel), the easier it is for the manager to buy out the developer’s contributions to the hotel brand. Under this scenario, manager branding is a more optimal branding option, due to the lower agency costs entailed in governing the one-way business-to-business transaction in which the manager buys out the contributions of the developer to the hotel brand.

Conversely, when the developer contributes more to the reputation of a manager-branded hotel, it will cost more to govern the business-to-business transaction used by the brander principal to buy out the reputation contributions of the non-brander agent. Should this be the case, the manager can let the developer co-brand the focal hotel to save on agency costs. Manager/developer co-branding allows the developer to act as a principal and claim the rewards of its reputation contributions from hotel guests, rather than sell them to the manager as an agent. In the absence of reputation interaction, the manager and the developer can each claim their respective stream of reputation residuals from the manager/developer co-branded hotel, without having to conduct business-to-business transactions to settle misplaced reputation gains or losses with each other. In such hypothetical cases, there would be zero agency costs incurred because neither party acts as an agent on behalf of a principal to build and protect the reputation of the manager/developer co-branded hotel.

However, when the actions of one co-brander affect not only its own reputation but also the reputation of the other co-brander (i.e., with reputation interaction), the manager has to buy out the reputation contributions made by the developer to its software brand, and the developer has to buy out the reputation contributions made by the manager to its hardware brand. In other words, the two co-branders are rewarded partly by the reputation residuals claimed from guests and are both partial principals. At the same time, the two co-branders are rewarded partly by selling a portion of their reputation contributions to each other and are both partial agents. In this regard, branding agency under manager/developer co-branding (with reputation interaction) occurs in a two-way manner where the manager and the developer act as partial principals and partial agents at the same time. With the shift from full branding agency to partial branding agency, the agency costs of regulating the business-to-business transaction used by the manager to buy out the reputation contributions of the developer will be lower. Manager/developer co-branding can therefore save on agency costs if the developer contributes more to the reputation of the hotel relative to the manager. If the manager's contributions to the reputation of hotel hardware remain constant, higher contributions made by the developer to the reputation of hotel software will result in greater savings on agency costs in the shift from manager branding to manager/developer co-branding.

In manager/developer co-branding, the presence of reputation interaction implies a shift from one-way branding agency to two-way branding agency, wherein the developer also has to buy out a portion of the manager's reputation contributions to the manager/developer co-branded hotel—a transaction that is unnecessary in manager branding. As a result, the parties must incur extra agency costs to regulate one more business-to-business transaction used by the developer to buy out the reputation contributions of the manager. Those extra agency costs will be less significant in cases where the manager contributes less to the reputation of hotel hardware. In other words, if the developer's contributions to the reputation of hotel software remain constant, lower contributions made by the manager to the hardware brand will result in greater savings on agency costs in manager/developer co-branding. In line with my earlier argument, manager/developer co-branding is thus a more optimal branding status to save on agency costs when the developer contributes relatively more to the reputation of hotel software, while the manager contributes relatively less to the reputation of hotel hardware.

My analysis has shown that the branding status of a hotel will alter the nature of the principal-agent relationship between the manager and developer, and thereafter affect the agency costs of harmonizing their joint contributions to the reputation of the hotel brand. The branding status of a hotel can be selected to minimize agency costs based on the relative contributions of the manager and the developer to hotel reputation. The manager should solely brand the hotel if the developer contributes relatively less to the reputation of the hotel brand. Alternatively, the manager should let the developer co-brand a hotel if the developer makes relatively more contributions to the reputation of the hotel brand. In the latter case, the costs of solving the problem of two-way partial branding agency will be lower.

4.1.2 Relative ability of manager vs. developer to monitor each other

When the agent sells its reputation contributions to a hotel at a pre-determined fee to the principal, the agent has an incentive to shirk its responsibilities—because shirking would harm only the reputation of the principal, who claims the reputation residuals of the hotel brand from guests. This branding agency issue creates a need for the principal to monitor the behaviour of the agent. As noted earlier, the branding status of a hotel (i.e., manager branding or manager/developer co-branding) defines the nature of the principal-agent relationship between the manager and the developer, which also determines the need for them to monitor each other's behaviour. Depending on their relative ability to monitor each other's behaviour, the choice of manager branding or manager/developer co-branding can be made to minimize the costs of solving the branding agency issue. To put it more precisely, the right to brand a hotel should be allocated to the party who is better able to serve the principal's role in monitoring the behaviour of the agent.

To start with, the branding status of a hotel determines the need for the manager and the developer to monitor each other's behaviour. In manager branding, the manager is the sole brander and the full branding principal. The manager claims a stream of reputation residuals from the hotel that also depends on the actions of the developer, who serves as a full branding agent. As such, the manager has to monitor the behaviour of the developer. In turn, the developer remains anonymous to hotel guests and bears no direct consequences for its own actions or the actions taken by the manager to alter the reputation of the hotel brand. Claiming only a pre-determined fee for its reputation contributions, the developer has incentives to shirk responsibility, without having to worry about the behaviour of the manager.

In manager/developer co-branding, both parties are identifiable in the market, both serve as branding principals, and both claim the reputation residuals of their respective brands from hotel guests. In the hypothetical scenario where there is no reputation interaction, each party claims a stream of reputation residuals that depends solely on its own actions, and therefore the parties do not need to settle misplaced reputation gains or losses with each other. Because no one plays the role of a branding agent, they appeal directly and separately to hotel guests without the need to monitor each other's behaviour.

However, in the presence of reputation interaction, travelers cannot correctly reward or fault the manager and the developer for their respective reputation contributions to the manager/developer co-branded hotel, and some of the credit or blame for their branding efforts will be misplaced. In this case, both parties act as partial principals and claim a portion of their reputation contributions from hotel guests. Both parties also act as partial agents and sell the remaining portions of their reputation contributions to each other. Compared to manager branding, where only the manager needs to monitor the actions of the developer (i.e., one-way monitoring), manager/developer co-branding involves two-way monitoring, where both co-branders must monitor each other's behaviour. This two-way monitoring is partial in nature, since the parties also have incentives to self-monitor their own actions.

Clearly, the monitoring ability of a principal is highly relevant to the agency costs of governing manager-developer cooperation, but the monitoring ability of an agent is not. A principal with stronger monitoring ability requires less effort to stipulate a contract to identify and prevent shirking behaviour on the agent's part. As the shirking problem can be easily ironed out by a contract, the agency costs incurred to build and protect the hotel brand will be lower. In contrast, a principal with weaker monitoring ability must incur additional efforts to stipulate a contract that can effectively monitor the agent's behaviour, and higher agency costs will result.

As the branding status of a hotel defines the nature of the principal-agent relationship between the two parties, the choice of manager branding vs. manager/developer co-branding depends on the relative abilities of the manager and the developer to monitor each other's behaviour. In manager branding, the ability of the anonymous developer to monitor the manager does not affect the agency costs between the parties. If the manager is better able to monitor the shirking behaviour of the developer, the right to brand the hotel should be assigned to the manager—because in such cases, the costs of solving the issue of one-way full branding agency are lower. The stronger the ability of the manager to monitor the behaviour of the developer, the lower the agency costs incurred by the parties to harmonize their joint contributions to the reputation of a manager-branded hotel.

Conversely, when the manager's ability to monitor the actions of the developer is weaker, the agency costs incurred to address the one-way monitoring in manager branding will be higher. In such cases, the manager should let the developer co-brand the hotel to reduce the need for the manager to monitor the developer. As a hotel co-brander, the developer bears the direct consequences of its own actions (i.e., reputation residuals) and is highly motivated to invest and develop the reputation of the manager/developer co-branded hotel. In a hypothetical scenario without reputation interaction, the manager and the developer do not need to buy out each other's reputation contributions, and the ability of the manager to monitor the action of the developer becomes irrelevant to the agency costs of governing their cooperation.

However, with the presence of reputation interaction, the manager has to monitor the developer to protect its software reputation, and the developer has to monitor the manager to safeguard its hardware reputation. The monitoring effort required from the manager in manager/developer co-branding is less than the effort required in manager branding, due to the shift from full branding agency to partial branding agency. Since the manager's monitoring ability is less relevant to the agency costs in manager/developer co-branding (i.e., compared to manager branding), it makes sense for the manager to allow a developer to co-brand the hotel if the manager is weak in its ability to monitor the behaviour of the developer; in such cases, manager/developer co-branding provides more significant savings on agency costs. In contrast, if the manager's monitoring ability is strong, the savings on agency costs will be less significant under manager/developer co-branding.

In manager/developer co-branding, the developer also needs to monitor the action of the manager—which is unnecessary in manager branding. In this case, the ability of the developer to monitor the behaviour of the manager becomes critical to the agency costs of governing their cooperation. If a developer has a strong monitoring ability (i.e., the developer can negotiate a contract that prevents the manager from shirking responsibility at a lower cost), it can more easily prevent manager shirking, resulting in a smaller increase in agency costs arising from manager/developer co-branding. As noted earlier, manager/developer co-branding is an optimal branding status to economize on agency costs if the manager is less able to monitor the developer, and the developer is more able to monitor the manager.

Therefore, the branding status of a hotel determines the nature of the principal-agent relationship, and it thereafter affects the need for the parties to monitor each other's shirking behaviour. Depending on the relative monitoring ability of each party, the right to brand a hotel should be assigned between them in a manner that minimizes the agency costs of harmonizing their joint contributions to hotel reputation. The manager should solely brand the hotel if its ability to monitor the behaviour of the developer is strong, and the ability of the developer to monitor the manager is weak. Conversely, the manager should let the developer co-brand a hotel if the developer has a relatively stronger ability to monitor the behaviour of the manager. Therefore, the branding status of an international hotel depends on the relative ability of the manager-developer dyad to monitor each other's behaviour in building and protecting the reputation of the hotel brand.

4.2 Hypotheses Development

Thus far, my analysis has shown that the choice of manager branding vs. manager/developer co-branding should be guided by the relative contributions made by the manager and the developer to the reputation of a hotel brand, as well as their relative ability to monitor each other's behaviours. I argue that the manager is more likely to brand the international hotel exclusively if it contributes more to the reputation of the hotel brand and/or if it has stronger ability to monitor the shirking behaviours of the developer. On the other hand, the two parties should co-brand the hotel if the developer makes larger contributions to the hotel brand and/or is fully capable of monitoring the shirking behaviours of the manager.

The parties' relative contributions and monitoring abilities are affected by a number of factors. In the following section, I hypothesize how these factors can alter the relative reputation contributions and monitoring abilities of the two parties, and hence affect the agency costs incurred by them to govern manager-developer cooperation. Since the parties will optimally opt for a branding status that minimizes agency costs, the factors that affect agency costs will determine the choice between manager branding and manager/developer co-branding in the hotel.

4.2.1 Manager reputation

As discussed earlier, the branding rights of a hotel should be allocated exclusively to the manager if the manager can contribute more, relative to the developer, to the reputation of the hotel. Manager branding allows the manager to claim its reward directly from guests without the need to settle its reputation contributions with the developer. At the same time, if the developer contributes less to the reputation of a manager-branded hotel, such reputation contributions can be easily settled between the parties through a business-to-business transaction. This suggests that manager branding can better save on agency costs when the manager contributes more, relative to the developer, to hotel reputation.

Strong contributions made by a foreign manager to hotel reputation are important for two reasons. The reputation of the manager dictates its ability: (1) to send reliable signals to reduce quality uncertainty for customers (Akerlof, 1970; Landes & Posner, 1987; Ramello, 2006; Zeithaml, 1988); and (2) to fulfill the social needs of hotel guests (Aaker, 1991). As such, a reputable manager is likely to accomplish greater market shares because more satisfied customers will return to a hotel bearing the manager’s brand, recommend the hotel service to other travelers, or even pay a premium rate to stay at the hotel (Rindova, Williamson, Petkova, & Sever, 2005). Therefore, when an international hotel is created, the reputable manager is likely to contribute more to acquire and retain hotel guests compared to the developer.

In cases where the foreign manager contributes more, relative to the local developer, to the reputation of an international hotel, the two specialist firms will incur lower agency costs to organize their cooperation if the right to brand the hotel is assigned to the manager. Under manager branding, the manager is self-motivated to build and protect hotel reputation because it can claim all reputation residuals from hotel guests (e.g., higher room rates, greater franchise fees, more franchised hotels, etc.). In comparison, if the foreign manager lets the local developer co-brand the hotel through manager/developer co-branding, the developer will have to buy out the contribution made by the manager to the reputation of hotel hardware. The agency costs required for conducting this business-to-business transaction will be higher if the manager contributes more, relative to the developer, to the reputation of the manager/developer co-branded hotel. When the reputation of the local developer remains constant, the stronger the reputation of the foreign manager, the lower the agency costs of governing the two parties’ cooperation under manager branding (compared to manager/developer co-branding). Hence, I predict that:

> ***Hypothesis 1:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be lower if the foreign manager is more reputable.*

4.2.2 Manager home country arrival

The reputation of a foreign manager matters more to the success of an international hotel that attracts more visitors from the home country of the manager. Not only those home-country visitors are more likely to be familiar with the brand name of the manager as a signal of quality and/or symbolic value, but they may also be ignorant of the reputation of the local developer. This reputation gap is particularly relevant to hotel service, since it is hard for the hotel visitors to inspect the quality of service before their stay at a hotel (experience goods; see Nelson, 1970). Hence, home-country visitors rely more on their recognition of the manager brand (relative to the reputation of the developer name) when making decisions about hotel stays.

When building and protecting the reputation of an international hotel that serves more home-country visitors, the foreign manager is also more knowledgeable about the taste and preference of those guests—and better able to tailor hotel services to them (e.g., language options, dining choices, recreation, etc.). Relative to the local developer, the foreign manager can contribute more to the reputation of an international hotel that attracts more home-country guests. This “follow-the-customer” argument has been made in prior studies, where hotel chains from traveler-generating countries enjoy competitive advantages in traveler-receiving countries (Dunning & McQueen, 1981).

As a result, the foreign manager will make more contributions to the reputation of the hotel relative to the local developer when the international hotel is likely to host more home-country travelers. In such cases, manager branding will result in lower agency costs required for governing the parties' cooperation than manager/developer co-branding would. Manager branding is optimal, since the manager claims all reputation residuals from home-country visitors without having to settle misplaced reputation gains or losses with the developer through a business-to-business transaction. All else being constant, an international hotel will more likely bear only the name of the foreign manager if the hotel can potentially serve more visitors from the home country of the manager. Conversely, this hotel is more likely to be co-branded by the manager-developer dyad if it attracts fewer visitors from the home country of the manager. Accordingly, I predict that:

> ***Hypothesis 2:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be lower if the hotel can potentially host more travelers from the manager's home country.*

4.2.3 Manager entry sequence

The sequence of entry of a foreign manager in a particular target market affects its contributions to the reputation of an international hotel relative to the local developers'. An early entrant faces a customer base in the host country that is less open-minded to foreign hotel chains and therefore it must bear the responsibility to explore the local market. In addition, when an early entrant first sets up an international hotel in the target market, it is often less familiar with the needs of its local customers (Kerin, Varadarajan, & Peterson, 1992; Vanderwerf & Mahon, 1997). What makes the situation even worse is that the early entrant lacks the opportunity to learn from its predecessors in building and protecting the hotel reputation. As a result, the early-entering manager tends to contribute less to the reputation of the focal hotel relative to its local developer in attracting customer patronage.

Compared to its predecessors, a late-entering manager can contribute more to the reputation of an international hotel relative to the contribution made by local developer. To start with, a late entrant is likely to face a customer base that is more receptive to foreign hotel chains, which means that its brand reputation is more valuable in attracting and retaining local guests. A late-entering manager can also learn from its predecessors without repeating the same mistakes in building and protecting the reputation of the focal hotel (Lieberman & Montgomery, 1988). By following the footsteps of its predecessors, a late entrant can handily customize hotel services to meet local customers' expectations. Naturally, a late-entering manager can do more, while relying less on the local developer, to build and protect the reputation of the focal hotel in the target market.

Accordingly, the entry sequence of a foreign manager will alter the relative contributions made by the manager-developer dyad to the reputation of an international hotel and thereby help determine the branding decisions of the hotel. Since pioneering managers tend to contribute less to the reputation of a hotel, they are more likely to let the local developer co-brand the hotel. In so doing, they reduce the need to buy out the reputation contributions of the co-brander through a business-to-business transaction and thereafter save on the agency costs of governing manager-developer cooperation. In comparison, late-entering managers are more likely to grab the full right to brand an international hotel because they can contribute more to the reputation of the hotel relative to the local developer. In such cases, manager branding does not really escalate agency costs because the manager not only can claim its reputation residuals from hotel guests, but also can easily buy out the reputation contributions from local developers. Taken together, I predict that:

> ***Hypothesis 3:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be higher among late entrants than early entrants into the host market.*

4.2.4 Manager international experience

In both manager branding and manager/developer co-branding, foreign managers are always identifiable to guests and must monitor the actions of local developers in building and protecting the reputation of the hotel. The ability of a foreign manager to monitor a local developer, thus, affects the allocation of hotel branding rights between the two parties. Generally speaking, a manager that has accumulated more international experience is more capable of controlling developer shirking (Erramilli, 1991; Reuber & Fischer, 1997) and thereby less likely to share branding rights. The opposite holds for a manager with limited experience in international operations. When a foreign manager is able to effectively monitor the actions of local developers, it saves more on the agency costs incurred by the parties to settle reputation contributions under manager branding than under manager/developer co-branding.

Under manager branding, the developer of an international hotel acts on behalf of the brander-manager to build and protect the reputation of the hotel. Given that the developer is anonymous to hotel guests, the ability of the manager to control the actions of the developer is more important to the issue of branding agency in manager branding. As such, those managers with more international experience are more able to control developer shirking and are more inclined to retain the branding right of the focal hotel than managers with less international experience.

Under manager/developer co-branding, the ability of foreign managers to monitor the actions of local developers becomes less critical to the issue of branding agency, since local developers are also identifiable to hotel guests and thus are motivated to self-monitor their actions in building and protecting hotel reputation. In such cases, the international experience of hotel managers is less impactful on the costs of addressing the issue of branding agency, particularly in the absence of reputation interaction. By letting local developers co-brand an international hotel, those managers with less overseas experience can evade the costs that they would otherwise have to incur to address the problem of branding agency.

It is clear that the international experience of a foreign hotel manager reflects its ability to monitor the actions of the local hotel developer, even though it does not have equal impact on the agency costs incurred by the parties to solve the problem of branding agency in manager branding vs. manager/developer co-branding. Under manager branding, the foreign manager's international experience has more impact on the agency costs incurred by the parties to organize their cooperation than under manager/developer co-branding. Accordingly, those managers with more international experience are more inclined to monopolize the full right to brand a hotel than managers with less international experience. Thus, I predict that:

> ***Hypothesis 4:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be lower among those managers with more international experience.*

4.2.5 Developer age

The branding status of an international hotel is also determined by the reputation contributions made by the developer to the hotel and the ability of the developer to monitor the behaviours of the manager. Certainly, the age of a local developer is expected to affect the extent of its contributions to hotel reputation and its ability to prevent manager shirking.

A local developer with a long operation history is more likely to own a brand name that is reputable among its customers (Henderson, 1999). It also tends to know more about consumer tastes and preferences. This means that local developers with a longer operation history can contribute more to the reputation of the hotel, which in turn raises the agency costs of selling its reputation contributions to a foreign manager under manager branding. To save on such agency costs, the developer can ask to co-brand the hotel and claim the reputation residuals of its hardware facilities from the guests. If the issue of reputation interaction can be easily addressed, manager/developer co-branding can save on the agency costs incurred by the parties to establish an international hotel when the developer has a longer operation history and can therefore contribute more to the reputation of the hotel.

In addition to the greater reputation contributions, a local developer with a longer operation history is also better able to monitor the shirking behaviours of the foreign manager. However, the monitoring ability of the developer is only relevant to the costs of addressing the issue of branding agency under manager/developer co-branding. Under manager branding, the anonymous developer does not have to monitor the manager, whose action does not influence the reputation of the developer's brand. Under manager/developer co-branding, however, mutual monitoring by the manager-developer dyad becomes necessary because of the possibility of reputation interaction. Thus, a local developer that has a longer operation history (and is better able to prevent manager shirking) is more likely to co-brand a hotel with foreign managers than those local developers that are new to the industry.

Taken together, the age of a local developer influences its reputation contribution and ability to monitor the actions of the foreign manager and therefore affects the costs incurred to address the issue of branding agency. This agency-cost impact of developer age is negligible under manager branding, but it can be significant under manager/developer co-branding. To put it another way, the age of local developer can save more on agency costs under manager/developer co-branding than under manager branding. Thus, I predict that:

> ***Hypothesis 5:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be higher if the local developer has operated for a longer period.*

4.2.6 Developer international hotel involvement

Often a local developer sets up more than one international hotel with foreign managers. In such cases, a developer's involvement with international hotels may also affect the branding status of the focal hotel for two reasons. First, those developers involved in more international hotels can contribute more to the reputation of the focal hotel. Second, those developers with a higher level of international hotel involvement should be better able to monitor the behaviours of foreign managers (Fladmoe-Lindquist, 1995). As a result, a local developer who is more involved with international hotel development is more likely to co-brand an international hotel, because the costs of solving the problem of branding agency is likely to be lower in manager/developer co-branding compared to the costs in manager branding.

For instance, a developer with more international hotel involvement should be more knowledgeable about the procedures and requirements for establishing an international hotel. The developer can use this knowledge to build the reputation of a manager/developer co-branded hotel and claim the reputation residuals directly from guests. This is particularly important in the presence of reputation interaction, as the developer can draw from its prior experience with international hotels to control manager shirking. Thus, prior involvement in the international hotel industry can help the developer save on the costs of solving the branding agency issue under manager/developer co-branding. In contrast, it does not really reduce such agency costs under manager branding because the developer contributes less to hotel reputation and has no need to monitor the manager. All else being constant, a developer with more international hotels should be more inclined to co-brand a hotel with the foreign manager. Therefore, I argue that:

> ***Hypothesis 6:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be higher if the local developer has set up more international hotels with foreign managers.*

4.2.7 Developer state-ownership

While many local developers in China are private-owned companies, some developers are owned by the government (i.e., state-owned enterprises; Dewenter & Malatesta, 2001). State-owned developers in China are generally longer established compared to private-owned developers. A longer operation history of the state-owned developers can lead to stronger brand recognition in the country, where customers are more familiar and loyal to the trademark. Thus, when state-owned developers join foreign managers to create an international hotel, they can utilize their brand reputations to better attract location customers to the hotel. This means that state-owned developers can potentially contribute more to the reputation of an international hotel if they co-brand the hotel with foreign managers. A higher level of reputation contributions made by state-owned developers to an international hotel inevitably escalates the costs of solving the branding agency problem under manager branding. As an alternative, the foreign manager can let such state-owned developers co-brand the focal hotel, which in turn saves on the agency costs of governing manager-developer cooperation.

In addition, local developers owned by the government often have more resources available to enhance their monitoring ability (e.g., capital, expertise, legal power, etc.). State-owned developers can also deploy more management expertise in the monitoring procedures to protect the reputation of their hotel hardware. Yet, unless state-owned developers co-brand an international hotel, their ability to monitor foreign managers does not affect the agency costs of organizing their cooperation. Relative to private-owned enterprises, state-owned developers are better equipped to co-brand an international hotel without incurring high costs to monitor the actions of the foreign manager.

In sum, when an international hotel is established, a manager is more likely to let a developer co-brand the hotel if it is state-owned for two reasons. First, compared to private-owned developers, state-owned developers are typically better able to contribute to the reputation of the focal hotel. By letting the developer co-brand the hotel and claim the rewards (full or partial) from customers, the agency costs incurred for the manager to buy out the actions of the developer will be reduced. Second, state-owned developers are better able to monitor the manager's behaviour, a factor that matters to agency costs only under manager/developer co-branding. Taken together, I predict that:

> ***Hypothesis 7(a):*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be higher if the local developer is a state-owned enterprise.*

On the other hand, the separation of management and ownership within state-owned developers often leads to the traditional problem of ownership agency, where salaried executives try to maximize their own private gains at the expense of the government (Lin & Germain, 2003). As such, executives working for state-owned developers may lack the incentives to invest in the developers' reputation in relation to the focal hotel because reputation investment is long term in nature. Furthermore, such executives may also lack the motivation to monitor the actions of foreign managers on behalf of the government, even if they do have the resources to do so. Hence, compared to private-owned developers, state-owned developers may be more likely to relinquish their rights to brand an international hotel to foreign managers. Considering these two counter effects of state-ownership on the branding status of an international hotel, I also predict that:

> ***Hypothesis 7(b):*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be lower if the local developer is a state-owned enterprise.*

4.2.8 Developer involvement in hotel management

Although it is common for local developers to specialize in supplying hotel hardware, some of the developers also engage in the provision of hotel software. For instance, Country Garden is a construction company in China that not only supplies hardware facilities to form international hotels with foreign managers (e.g., Hilton and Maritim), but also deploys its software systems to manage 42 hotels without the involvement of foreign managers. Such hotels are not "international" in nature and bear only the name of Country Garden, where hotel development and hotel management are integrated within a single company.

When a local developer also operates some hotels that it develops, it can establish greater brand recognition in the market and hence contribute more to the reputation of an international hotel operated by a foreign manager. Greater reputation contributions made by the local developer to the focal hotel will raise the costs of solving the branding agency issue under manager branding. To save on agency costs, a manager can let the developer co-brand the hotel and claim its reputation residuals from guests. This manager/developer co-branding solution is especially efficient in the absence of reputation interaction or if reputation interaction can be cheaply addressed.

If local developers are also involved with hotel management, they will likely be more familiar with hotel operations and are better able to monitor the behaviours of the foreign managers at an international hotel. For instance, developers with hotel management expertise can better identify flawed software systems provided by the foreign manager to an international hotel. Such developers are also better able to stipulate contracts that are comprehensive enough to monitor and prevent a manager's faulty software systems from harming hotel reputation. As discussed above, the ability of a local developer to monitor a foreign manager only serves to save on the agency costs under manager/developer co-branding and has no effect under manager branding.

My analysis suggests that when local developers are also involved with hotel management, the costs of solving the branding agency will be higher under manager branding than manager/developer co-branding. All else being constant, those developers who are also involved in hotel management are more likely to co-brand an international hotel, relative to their local counterparts who specialize in hotel development only. Therefore, I predict that:

> ***Hypothesis 8:*** *The likelihood of manager/developer co-branding (vs. manager branding) of an international hotel will be higher if the local developer is also involved in hotel management (relative to others who specialize in hotel development only).*

4.2.9 Hotel location

I have so far predicted the branding status of an international hotel by identifying the factors that affect the relative reputation contributions made by the manager and the developer to the hotel and their relative ability to monitor each other's actions. These factors, however, become more (or less) relevant depending on other conditions that are not directly associated with the characteristics of the foreign manager and the local developer. To put it differently, the two parties' contributions to the reputation of the focal hotel and their ability to monitor each other's actions will be more relevant when their hotel reputation is more heavily relied upon in attracting and retaining guests under certain conditions. For example, if an international hotel serves mostly foreign tourists, the success of the hotel should hinge more on the reputation of the manager, and therefore the ability of the manager to contribute and monitor becomes more critical. The opposite holds true if an international hotel is located in a city with few foreign visitors and serves mostly local travelers, in which case the reputation of the local developer should be more important to the popularity of the hotel, and the developer's ability to contribute and monitor becomes more relevant.

The type of city where an international hotel operates, therefore, can potentially affect the branding status of an international hotel. The reputation contributions of the manager are more significant, relative to the contributions of the developer, if the hotel is located in a tourist destination that is more likely to cater to foreign visitors than domestic travelers. Since foreign tourists are less likely to make repeat visits to an international hotel, they rely more on the hotel brand to make their purchase decision. Such foreign tourists tend to be less familiar with the brand of the local developer, and more familiar with the name of the foreign manager.

Furthermore, guests that stay in hotels located in tourist destinations are more likely to be leisure travelers who anticipate extensive service amenities at the hotel (e.g. spa, dining, fitness centre, personalized services, etc.). Since the hardware facilities provided by the local developer tend to be standardized, the added responsibilities to deliver a wider range of service amenities typically fall on the foreign manager. Therefore, if a hotel is located in a tourist city, the manager can potentially contribute more (relative to the developer) to hotel reputation, and it becomes more difficult for the developer (relative to the manager) to monitor the other party. As such, those factors that favour manager branding will be more critical among hotels located in tourist cities, while factors that favour manager/developer co-branding will have more impact among hotels located in non-tourist cities. Therefore, I argue that:

> ***Hypothesis 9:*** *The relative reputation contributions of foreign managers vs. local developers and their relative ability to monitor each other are not equally impactful on the branding status of an international hotel, depending on if the hotel is located in tourist or non-tourist destinations.*

4.2.10 Hotel classification

In addition to the tourist vs. non-tourist distinction, international hotels can also be classified into two groups based on the services offered—high-end luxurious hotels that offer extravagance amenities and extensive services (e.g., InterContinental, Waldorf Astoria, W Hotel) and low-end economical hotels that provide basic accommodation and minimal services (e.g., Days Inn, Holiday Inn Express). Again, the relative reputation contributions made by a manager-developer dyad to an international hotel and their relative abilities to monitor each other may not have equal impacts on the branding status of high-end luxurious vs. low-end economic hotels.

The manager's reputation contribution tends to be more significant in a high-end hotel than in low-end hotel. High-end hotels generally attract more foreign travelers than domestic visitors. In 2012, approximately 90 per cent of guests at high-end hotels in China were foreign visitors, according to the IBISWorld Industry Report (2013). Such foreign travelers, who are typically less familiar with the local developer's hotel brand, rely more on the manager brand that is often more reputable among them to make hotel stay decisions. In other words, the manager of a high-end hotel can contribute relatively more (and the developer relatively less) to the reputation of the hotel brand in attracting foreign travelers, which also suggests that it is relatively easier for the manager to monitor the developer (and relatively harder for the developer to monitor the manager). Therefore, those factors that favour manager branding will be more critical among high-end luxurious hotels, while other factors that favour manage/developer co-branding will be more impactful among low-end economic hotels. Thus, I predict:

> ***Hypothesis 10:*** *The relative reputation contributions of foreign managers vs. local developers and their relative ability to monitor each other are not equally impactful on branding status of an international hotel, depending on if the hotel is a high-end luxurious one or a low-end economical one.*

4.3 The Sample

I tested the above hypotheses by using a sample of international hotels in China (Hong Kong and Macau not included). Three considerations drove my selection of this empirical setting. First, China is the largest receiving country of international hotels, where the options of manager branding and manager/developer co-branding can be widely seen (IBISWorld, 2013). Second, the geographic size of China provides more credence to the findings after controlling for all location-specific variables. Third, a single-country approach controls for all country-level variables that also affect the branding status of an international hotel (e.g., economic cycles, government regulations, etc.).

Table 4.1 List of foreign hotel chains in the sample

Hotel Chain	Brand	Country	No. Hotels
InterContinental	Crowne Plaza, Holiday Inn, Holiday Inn Express, Hotel Indigo, InterContinental	UK	105
Accor Company	Grand Mercure, Ibis, Ibis Styles, Mercure, Novotel, Pullman, Sofitel	France	102
Starwood Hotel	Aloft, Four Points, Le Meridien, Luxury Collection, Sheraton, St Regis, W Hotel, Westin	USA	85
Wyndham	Days Hotel, Days Inn, Howard Johnson, Ramada, Ramada Plaza, Wyndham	USA	79
Marriott International	Courtyard, JW Marriott, Marriott, Renaissance, Ritz-Carlton	USA	34
Hilton World	Conrad, Double Tree, Hilton, Waldorf Astoria	USA	24
Hyatt	Andaz, Grand Hyatt, Hyatt, Park Hyatt	USA	18
Grand Metropark	Grand Metropark	Hong Kong	15
Banyan Tree	Banyan Tree, Angsana	Singapore	11
Best Western	Best Western, Best Western Premier	USA	11
Fairmont Hotel	Fairmont, Raffles, Swissotel	Canada	6
Carlson Hotel	Park Plaza, Radisson, Radisson Blu	USA	5
Four Seasons	Four Seasons	Canada	4
Kempinski	Kempinski	Germany	4
Langham Group	Eaton Luxe, Langham	Hong Kong	4
Anantara	Anantara	Thailand	3
JAL Hotels	Hotel Nikko	Japan	3
Groupe du Louvre	Golden Tulip, Royal Tulip	France	2
Grupo Sol Melia	Gran Melia, Melia	Spain	2
Marco Polo	Marco Polo	Hong Kong	2
Maritim	Maritim	Germany	2
Meritus Hotel	Meritus	Singapore	2
Amanresorts	Amanresorts	Singapore	1
Dusit Than	DusitD2	Thailand	1
Guoman Hotel	Guoman	UK	1
Mandarin Oriental	Mandarin Oriental	Hong Kong	1
Moevenpick	Moevenpick	Swiss	1
Pan Pacific Hotel	Pan Pacific	Singapore	1
Penta	Penta	Germany	1
Regal Hotel	Regal	Hong Kong	1
Swiss-Belhotel	Swiss-Belhotel	Hong Kong	1
The Peninsula Hotel	Peninsula	Hong Kong	1
Vantage Hotel	Lexington	USA	1
Worldhotel	Worldhotel	USA	1
Total			**535**

The list of sample hotels was compiled by Smith Travel Research (STR), an analysis company that tracks data on all major chains/brands in the hotel industry. The list consists of hotels developed by Chinese companies but managed by foreign firms. I have included only international hotels that provide accommodation on a short-term basis. Therefore, I have excluded those serviced apartment hotels that offer long-term lodging services. Since developer data was needed to test my hypotheses, I have also excluded those hotels for which I could not identify the local developers.

The final sample consists of 535 international hotels located in 122 Chinese cities as of December 31, 2014. Of the 535 hotels, 416 (78%) are manager branded and 119 (22%) are manager/developer co-branded. These hotels involve 260 Chinese development firms and 34 foreign management companies originating from 11 countries. These foreign hotel chains, their country of origin, and the number of hotels they managed in China are summarized in Table 4.1.

4.4 The Model

I have hypothesized that the choice between manager branding and manager/developer co-branding is determined by a vector of variables that capture the relative contributions made by the foreign manager and the Chinese developer to the reputation of an international hotel, as well as their relative ability to monitor each other's behaviour. Due to the binary nature of the dependent variable, I used a logistic regression model to estimate the probability of manager/developer co-branding (vs. manager branding) for all observations in the sample:

$$P(Y_i = 1) = \frac{1}{1 + e^{-(\alpha + \beta_A X_{Ai})}}$$

where the dependent variable Y_i will equal one if the *i*th hotel is co-branded by the manager-developer dyad (manager/developer co-branding) and zero if the *i*th hotel is branded by the manager only (manager branding). As such, $P(Y_i = 1)$ estimates the probability of manager/developer co-branding for the *i*th hotel. In this equation, X_A is a vector of independent variables measuring the relative reputation contributions of the manager-developer dyad and/or their relative abilities to monitor each other's actions for the *i*th hotel; α is the intercept; and β_A is a vector of estimated parameters.

4.5 Variables and Measures

I collected a vector of variables from various secondary sources to predict the probability of manager/developer co-branding (vs. manager branding) for each observation in the above binomial logistic model. I summarize the names of all independent variables and their measurements, sources, and expected impacts on the likelihood of manager/developer co-branding (vs. manager branding) in Table 4.2.

Manager reputation. I used two measures to proxy for manager reputation. First, I used the market share of the manager at the time when each focal hotel was opened in China (i.e., the percentage of sales that the manager enjoyed in the industry at that particular point of time), which reflects the manager's ability to attract and retain customer patronage. I collected this variable from Euromonitor International. Second, I collected customer satisfaction ratings for each hotel chain from *American Customer Satisfaction Index (ACSI)*. This customer satisfaction survey is conducted among America tourists and is scaled between 0 and 100. Due to the high correlation between these two measures, I used factor analysis to construct an index that I call *manager reputation*. According to Hypothesis 1, I expected the coefficient of this variable to carry a negative sign.

Manager home country arrival. From Euromonitor International, I also collected the number of visitors to China from the manager's home country for the year when each international hotel was established. Accordingly to Hypothesis 2, *manager home country arrival* should be negatively associated with the likelihood of manager/developer co-branding.

Table 4.2: Summary of independent variables

Variable	**Measure**	**Data source**	**Expected**
Manager reputation	(1) Market share of the manager (% sales in the international hotel industry) when an international hotel was established; (2) Customer satisfaction data collected from America hotel guests when an international hotel was established	(1) Euromonitor International; (2) *American Customer Satisfaction Index (ACSI)*	-
Manager home country arrival	Number of arrivals from the manager's home country when an international hotel was created	Euromonitor International	-
Manager entry sequence	Sequence that managers enter into China	STR	-
Manager int'l experience	(1) Number of hotels operated by a manager globally when an international hotel was created; (2) Number of countries the manager has hotel business in when an international hotel was created	STR	-
Developer age	Age of the local developer when an international hotel was created	Developer website, local newspaper and magazine, *ProQuest Asia*	+
Developer int'l hotel involvement	Number of international hotels owned by the local developer when an international hotel was created	Developer website, STR	+
Developer state-ownership	Dummy variable that equals one if the local developer is state-owned and zero if it is private-owned	Developer website, local newspaper and magazine, *ProQuest Asia*	+/-
Developer involvement in hotel management	Dummy variable that equals one if the local developer is involved in hotel management and zero if the developer specializes only in hotel development	Developer website, local newspaper and magazine, *ProQuest Asia*	+
Hotel location	Dummy variable that equals one if the hotel is located in a tourist city and zero if otherwise	China National Tourism Administration	Moderating effect
Hotel classification	Dummy variable that equals one if a hotel is high-end luxurious and zero if its low-end economical	STR	Moderating effect

Manager entry sequence. Based on the data provided by STR, I ranked all hotel chains in my sample according to their sequence of entry into China. Hotel chains with a lower ranking indicate earlier entry into China, and vice versa. According to Hypothesis 3, early-entering hotel chains should be more likely to co-brand an international hotel with the local developer, whereas late-entering chains should be more likely to brand the hotel through manager branding. Hence, I expected *manager entry sequence* to be negatively related to the likelihood of manager/developer co-branding.

Manager international experience. I used two measures provided by STR to proxy for a foreign manager's international experience. First, I used the number of hotels operated globally by the foreign manager at the time when an international hotel was established in China. Second, I collected the number of countries in which the foreign manager operated hotel business at that time. Because the two measures were highly correlated, I used factor analysis to construct an index that I call *manager international experience*. According to Hypothesis 4, managers with more international experience should be better able to monitor the developer and, therefore, the likelihood of manager/developer co-branding should be reduced for the hotels they establish in China. Hence, I expected the coefficient of the variable to be negative.

Developer age. *Developer age* was measured by the number of years that had passed since the local development company was first established when the focal hotel was created. I obtained this data from a wide range of sources, including the local developer's webpage, local newspapers and magazines, and *ProQuest Asia*. According to Hypothesis 5, older developers should contribute more to the reputation of an international hotel and thus should be more likely to co-brand the hotel with the manager. In other words, I expected the coefficient of *developer age* to carry a positive sign.

Developer international hotel involvement. I also collected the number of international hotels in which a local developer was involved at the time when the focal hotel was opened—a variable that I call *developer international hotel involvement.* I collected this data from STR and/or the local development companies' webpage. According to Hypothesis 6, I expected the variable to be positively related to the likelihood of manager/developer co-branding.

Developer state-ownership. I used a dummy variable to capture the ownership status of local developers in my sample, wherein the variable will equal one if a local developer is a state-owned enterprise and zero if it is not (i.e., if it is a private-owned company). I collected *developer state-ownership* from various sources, including the local developer's webpage, local newspapers and magazines, and *ProQuest Asia*. I predicted in Hypothesis 7 that the variable might have two contradicting effects on the likelihood of manager/developer co-branding, and therefore the sign of its coefficient is an empirical question to be answered later by the results.

Developer involvement in hotel management. I used a dummy variable to capture whether or not a Chinese developer had previous involvement with hotel management at the time when the focal hotel was established, wherein the variable will equal one if the developer had hotel management experience and zero if not. I collected the data on *developer involvement in hotel management* from the local developer's webpage, local newspapers and magazines, and *ProQuest Asia*. As discussed in Hypothesis 8, I expected the variable to increase the likelihood of manager/developer co-branding, in which case its coefficient should carry a positive sign.

Hotel location. I used a dummy variable to identify whether or not an international hotel was located in a tourist destination, wherein one indicates a tourist site and zero indicates otherwise. I collected the information on *hotel location* from the China National Tourism Administration. According to Hypothesis 9, I expected the impact of all predictors on hotel branding status to differ across the two types of location (i.e., tourist vs. non-tourist destinations).

Hotel classification. I also used a dummy variable to identify whether or not an international hotel was a high-end luxurious or a low-end economical hotel, wherein one indicates a high-end luxurious hotel and zero indicates a low-end economical hotel. I based this *hotel classification* on the average room rate of the hotel, as provided by STR. According to Hypothesis 10, the variable should moderate the impacts of all predictors on branding status.

I provide the statistics for each independent variable in Table 4.3, including mean, standard deviation, minimal, and maximal values. Table 4.3 also reports the correlation matrix, with the p-values of two-tailed tests and their significant levels.

Table 4.3: Descriptive statistics and correlation matrix (n=535)

	Mean	S.D.	Min	Max	1	2	3	4
1. Branding status	.22	.41	0	1				
2. Manager reputation	0	.70	-1.44	1.55	-.20***			
3. Manager home country arrival	1217.79	720.23	80.6	3341.3	-.01	.01		
4. Manager entry sequence	7.96	6.39	1	34	-.20***	-.06	.25***	
5. Manager int’l experience	0	.60	-1.47	.70	.18***	.28***	.001	-.59***
6. Developer age	17.87	14.47	1	86	.01	-.01	.21***	.08**
7. Developer int’l hotel involvement	10.50	19.04	1	86	-.14***	.07*	-.34***	-.04
8. Developer state-ownership	.19	.39	0	1	-.03	.008	.002	-.08**
9. Developer involvement in hotel management	.22	.41	0	1	-.08*	-.04	-.40***	.03
10. Hotel location	.77	.42	0	1	-.02	.006	-.008	.06
11. Hotel classification	.63	.48	0	1	-.15***	.23***	.15***	.46***

	5	6	7	8	9	10
5. Manager int’l experience						
6. Developer age	-.32***					
7. Developer int’l hotel involvement	.13***	-.24***				
8. Developer state-ownership	-.07*	.35***	-.17***			
9. Developer involvement in hotel management	.04	-.29***	.64***	-.23***		
10. Hotel location	-.04	-.07*	-.07*	-.06	.01	
11. Hotel classification	-.47***	.25***	-.28***	.08*	-.20***	.03

1. *p<.1; **p<.05; ***p<.01 (two-tailed p-value)
2. Manager home country arrival presented in thousands

4.6 Results

I present the results of the logistic regression in Table 4.4 in three settings. First, I ran a full-sample test by pooling all observations in a binomial logistic model to predict the likelihood of manager/developer co-branding vs. manager branding (labeled "full sample" in the table). I also ran two split-sample models to verify the effects of hotel location and hotel classification in moderating the impacts of predictors on hotel branding status ("split sample 1" addresses the effects of tourist vs. non-tourist destinations; "split sample 2" addresses the effects of high-end luxurious vs. low-end economical hotels).

Table 4.4: Estimated parameters of logistic models

			Split Sample-1				**Split Sample-2**			
	Full Sample		**Tourist destination**		**Non-tourist destination**		**High-end hotel**		**Low-end hotel**	
	Log odds (β)	Odds ratio (e^{β})	B	e^{β}	B	e^{β}	B	e^{β}	B	e^{β}
Manager reputation	-.97*** (.17)	.37	-1.59*** (.48)	.20	-.88*** (.19)	.41	-1.24*** (.31)	.28	.33 (.44)	1.39
Manager home country arrival	-.0005** (.0002)	.99	-.0005** (.0002)	.99	-.0007 (.0004)	.99	-.0005* (.0002)	.99	.0001 (.0006)	1.00
Manager entry sequence	-.01 (.02)	.98	-.009 (.03)	.99	-.03 (.06)	.96	-.04 (.03)	.95	.26* (.13)	1.30
Manager int'l experience	1.27*** (.31)	3.56	1.38*** (.40)	4.01	.99* (.60)	2.71	1.14*** (.37)	3.13	2.02 (1.46)	7.56
Developer age	.02** (.009)	1.02	.02 (.01)	1.02	.01 (.02)	1.01	.01 (.01)	1.01	.04** (.02)	1.04
Developer int'l hotel involvement	-.03*** (.01)	.96	-.03*** (.01)	.96	-.01 (.02)	.98	-.005 (.01)	.99	-.05** (.02)	.94
Developer state-ownership	-.60* (.32)	.54	-.98** (.41)	.37	.51 (.62)	1.66	-.87* (.49)	.41	-.08 (.49)	.91
Developer involvement in hotel management	-.02 (.38)	.97	.001 (.43)	1.00	-.85 (.95)	.42	.15 (.45)	1.16	-.67 (.82)	.51
Intercept	-.73 (.33)	.47	-.70 (.39)	.49	-.46 (.69)	.63	-.55 (.42)	.57	-2.68 (.80)	.06
No. of observations	535		412		123		340		195	
Model chi-square	87.33***		66.20***		28.72***		48.89***		56.57***	
% of correct prediction	80.37		81.80		77.24		85.59		75.38	
(Base percentage)	(63.40)		(67.50)		(55.56)		(69.23)		(63.04)	

*p<.1; **p<.05; ***p<.01 (two-tailed p-value)

The results for each logistic model include all logit coefficients (i.e., log odds (β)) that capture the probability of manager/developer co-branding, with standard errors reported in parentheses. I also present the coefficients in the odds ratio form (i.e., exponential coefficients (e^{β})).

4.6.1 Full logistic regression model

The full sample logistic model achieves an 87.33 chi-square that is significant at the 0.01 level. The model also has a correct prediction rate of 80.37 per cent, which is 17 per cent higher than the base rate (63.30 per cent). Of the eight independent variables, four of them that predict the likelihood of manager/developer co-branding (i.e., *manager reputation*, *manager home country arrival*, *developer age*, and *developer state-ownership*) are significant and bear the predicted coefficient sign. Two of them (i.e., *manager international experience* and *developer international hotel involvement*) also have a significant impact on the probability of manager/developer co-branding, but the sign of their coefficient does not conform to my prediction. The remaining two (i.e., *manager entry sequence* and *developer involvement in hotel management*) bear coefficients that are statistically insignificant.

Manager reputation carries a negative coefficient, and its impact on manager/developer co-branding is significant at a level higher than 0.001. Specifically, when the manager reputation increases by one unit, the manager is only 37 per cent as likely to let the developer co-brand an international hotel (e^{β}=.37). This result confirms Hypothesis 1 that the likelihood of manager/developer co-branding will be lower if the manager is more reputable and can contribute more to the reputation of the focal hotel.

The coefficient of *manager home country arrival* is negative and statistically significant at the 0.05 level. When the arrivals from the manager's home country increase by 1,000 in the province where an international hotel is located, the likelihood that the focal hotel is manager/developer co-branded decreases by one per cent (e^{β}=.99). This result confirms Hypothesis 2: the likelihood of manager/developer co-branding will be lower if the international hotel serves more tourists from the manager's home country, in which case the manager can contribute more to the popularity of the hotel among home-country travelers.

The coefficient of *developer age* is positive and statistically significant at the 0.05 level. Every additional year that a local developer operates increases the likelihood of manager/developer co-branding of an international hotel by 1.02 times (e^{β}=1.02). This result confirms Hypothesis 5: the likelihood of manager/developer co-branding will be higher if the local developer has operated for a longer period of time, in which case the developer can contribute more to hotel reputation and/or is better equipped to monitor the behaviour of foreign managers.

The coefficient of *developer state-ownership* is negative and statistically significant at the 0.1 level. Specifically, a state-owned developer is only 54 per cent more likely than a private-owned developer to co-brand the international hotel with the foreign manager (e^{β}=.54). My earlier discussion suggests that developer state-ownership can have conflicting effects on the branding status of the focal hotel. The results confirm Hypothesis 7(b): the likelihood of manager/developer co-branding will be lower if the developer is a state-owned enterprise due to the traditional agency problem widely associated with state ownership.

Unexpectedly, two statistically significant coefficients bear a sign opposite to what I hypothesized earlier. The coefficient of *manager international experience* is statistically significant at a level higher than 0.001, but its sign is positive rather than negative as predicted by Hypothesis 4. Specifically, when a manager's international experience increases by one unit, the manager is three times more likely to let the developer co-brand the focal hotel (e^{β}=3.56). This result contradicts Hypothesis 4, in which I predicted that a manager with more international experience would be more likely to brand the international hotel alone because it is better equipped to monitor the actions of the local developer.

I measured *manager international experience* by using an index based on the number of international hotels that a manager operates globally and the number of countries where it operates hotel business. One explanation for the contradiction is that hotel chains with more international experience are more likely to be those that operate at the low-end segment of the market, where the number of hotels and host nations tend to be greater relative to the high-end segment. This analysis is supported by my findings that *manager international experience* and *hotel classification* (in which high-end luxurious hotels were coded as one) are negatively correlated and significant at a level higher than 0.001 (see Table 4.3). Compared to high-end luxurious hotels, low-end economical hotels require less reputation contributions from the manager. This factor increases the likelihood of manager/developer co-branding, which contradicts my prediction in Hypothesis 4.

Another variable that has an unexpected impact on the probability of manager/developer co-branding is *developer international hotel involvement*. This variable bears a negative coefficient that is statistically significant at a level higher than 0.001. In particular, every additional international hotel that the developer has previously operated decreases the likelihood of manager/developer co-branding by four per cent (e^{β}=.96). This finding contradicts Hypothesis 6, in which I predicted that local developers involved in more international hotels would be more likely to co-brand the focal hotel because they can contribute more to hotel reputation and are better able to monitor the actions of the manager.

This inconsistency may be explained by the selection bias in my sample. It is plausible that developers with more experience in the hotel industry in China are better able to integrate into hotel management. As a result, they would not need to partner with foreign managers to set up international hotels. In other words, those Chinese developers that can contribute more to hotel reputation and/or are better able to monitor the actions of foreign managers were not included in my sample because their hotels are not “international hotels” for the purpose of this dissertation. In turn, those developers that were captured in my sample may be those that are too weak to integrate into hotel management. In this scenario, the developers would contribute less to hotel reputation and be less able to monitor the actions of foreign managers, relative to their local counterparts that are strong enough to integrate into hotel management. This unintended selection bias may explain the negative impact of developer international hotel on the choice of manager/developer co-branding over manager branding.

Finally, two independent variables lack a significant impact on the branding status of an international hotel. First, the coefficient of *manager entry sequence* is negative as predicted, but the effect is statistically insignificant. As such, the result does not support Hypothesis 3, and the sequence in which hotel chains expand into China does not impact the choice of manager branding vs. manager/developer co-branding. Second, the coefficient of *developer involvement in hotel management* is unexpectedly negative, and the effect is statistically insignificant. This result fails to support Hypothesis 8—and it suggests that the developer’s involvement in hotel management does not impact the branding status of the focal hotel.

4.6.2 Split-sample one: Tourist vs. non-tourist destinations

Based on their locations, I classified all of the hotels in my sample into two groups—tourist vs. non-tourist destinations. I split the sample to verify the moderating effects of hotel location on the branding status of the focal hotel. As reported in Table 4.4, five independent variables in the tourist sub-sample have a significant impact on hotel branding. The coefficient of *manager reputation* is negative as predicted and statistically significant at a level higher than 0.001. *Manager home country arrival* bears a negative impact on the likelihood of manager/developer co-branding that is significant at the 0.05 level. The coefficient of *manager international experience* is positive as explained earlier, and the impact is statistically significant at a level higher than 0.001. The coefficient of *developer international hotel involvement* is negative as explained earlier, and its impact is statistically significant at a level higher than 0.001. Finally, the coefficient of *developer state-ownership* is negative and significant at the 0.05 level.

In the non-tourist sub-sample, the coefficient of *manager reputation* is negative and also statistically significant at a level higher than 0.001. However, the effect size of the variable here is much smaller than that of the tourist sub-sample. Furthermore, the coefficient of *manager international experience* is positive as explained earlier, and it is statistically significant at the 0.1 level. This suggests it has a less consistent effect on branding status in the non-tourist sub-sample, compared to the tourist sub-sample.

The results of the two sub-samples reveal that most predictors in the tourist sub-sample have a stronger and/or a more consistent impact on the likelihood of manager/developer co-branding (vs. manager branding) than in the non-tourist sub-sample. These results support Hypothesis 9—that the predictors of hotel branding status do not have equal impacts on the branding status of an international hotel. More specifically, hotels located in tourist venues serve more foreign travelers and thus foreign managers can contribute more to hotel reputation. In contrast, hotels located in non-tourist destinations appeal more to a local customer, in which case the contributions of foreign managers to hotel reputation are less important. Overall, those predictors that favour manager branding are more critical in the tourist sub-sample, while factors that favour manager/developer co-branding have no significant impact on hotel location.

4.6.3 Split-sample two: High-end vs. low-end international hotels

In the second split-sample analysis, I classified all hotels into two groups—high-end luxurious and low-end economical hotels. I split the sample into two sub-groups to empirically verify how hotel classification moderates the impacts of other independent variables on the branding status of an international hotel. Because the effect of brand reputation is expected to be stronger in attracting and retaining travelers in the high-end market, the predictors of hotel branding should not have equal impacts between the two sub-groups.

In the high-end sub-sample, three independent variables that capture the manager's contributions are statistically significant. The coefficient of *manager reputation* is negative as predicted and statistically significant at a level higher than 0.001. *Manager home country arrival* bears a negative coefficient, and its impact on manager/developer co-branding is significant at the 0.1 level. Furthermore, *manager international experience* has a positive impact on the propensity for manager/developer co-branding that is highly significant at the 0.01 level. In addition to these three variables that measure the manager's contributions, *developer state-ownership* also bears a negative coefficient that is statistically significant at the 0.1 level.

In the low-end sub-sample, the coefficient of *developer age* is positive as expected and significant at the 0.05 level, whereas the coefficient of *developer international hotel involvement* is negative and significant at the same level; both lack a significant impact on the likelihood of manager/developer co-branding in the high-end sub-sample. Furthermore, only one variable that captures manager contributions (i.e., *manager entry sequence)* is significant in the low-end sub-sample, but it bears a positive sign that is inconsistent with Hypothesis 3 (note that this variable does not have a significant impact in the full-sample model).

The above contradiction may be explained by the stronger bargaining power that early-entering managers hold over local developers (compare to late-entering managers) in the low-end hotel sector in China. When early-entering managers expand into China, the country is likely to have less high-end hotel developers and more low-end hotel developers. Therefore, the greater numbers of low-end hotel developers may face more intense competition (vs. high-end developers) for the opportunity to collaborate with early entering managers. As a result, early-entering managers enjoy stronger bargaining power over local hotel developers when negotiating for manager branding and claiming the full reputation residuals of the hotel brand (Kerin, Varadarajan, & Peterson, 1992). As the low-end hotel sector becomes saturated with foreign managers over time, the local developers have more managers to choose from and thus the bargaining power for late-entering managers becomes weaker. Differences in managers' bargaining power may therefore explain the positive impact of manager entry sequence on manager/developer co-branding in low-end hotels.

Once again, the results from the two sub-samples confirm my argument that those factors that favour manager branding have stronger and more consistent impacts on the branding status of a high-end luxurious hotel. In comparison, those factors that favour manager/developer co-branding have stronger and more consistent impact on the branding status of a low-end economical hotel. The reason is that brand power is more critical to the success of hotels at the high-end segment than those at the low-end segment. The findings here confirm Hypothesis 10, in which I predicted that hotel classification has moderating effects on the branding status of international hotels in China.

4.7 Summary

In this chapter, I developed a set of hypotheses to verify the agency view of hotel branding using a sample of international hotels in China. My fundamental argument is that the branding status of an international hotel is contingent upon the relative contributions made by the manager-developer dyad to the reputation of the hotel and their relative abilities to monitor each other's actions—two factors that dictate the costs incurred by a hotel manager and developer in addressing the issue of branding agency. Based on their respective backgrounds and the nature of the focal hotel, the parties should optimize the branding status of an international hotel to save on agency costs. My results in general support the argument that a foreign manager is less likely to let a local developer co-brand an international hotel if the manager can contribute more to the reputation of the hotel and/or is better able to monitor the actions of the local developer. In contrast, a local developer is more inclined to co-brand an international hotel if it can contribute more to hotel reputation and/or is better able to monitor the actions of the foreign manager. These results are consistent with the agency view of international hotel branding. In addition, I have also found that the impact of these agency factors on the branding status of an international hotel are contingent on whether the hotel is located in a tourist vs. non-tourist destination, as well as whether the hotel is assigned to the high-end vs. low-end segment of the market.

CHAPTER 5: THE EFFECTS OF HOTEL BRANDING STATUS ON ROOM RATES: EMPIRICAL EVIDENCE FROM CHINA

In Chapter 4, I argued that the costs incurred to address branding agency issues in manager-developer cooperation are contingent upon factors that capture the parties' relative contributions to the reputation of the hotel brand and their relative ability to monitor each other's behaviour. As the parties opt for a branding status that minimizes agency costs, those factors that affect agency costs will predict the choice between manager branding and manager/developer co-branding of the focal hotel.

In this chapter, I empirically probe how the branding status of an international hotel affects the premium rate that the hotel can command in the market. I compare the actual branding status of each focal hotel with its optimal branding status as predicted in Chapter 4, where the difference between the two is called *branding gap*. A narrower branding gap indicates better incentive alignment in the manager-developer dyad to build and protect the reputation of the hotel brand. When the two hotel specialists' incentives are better aligned, they will increase their branding efforts, which in turn raise the room rate of the hotel due to its popularity among guests. Using the same sample of international hotels collected from China in Chapter 4, I empirically verify the relationship between branding gap and hotel premium rates in three settings: within the same franchise network, within the same geographic location, and within the overall Chinese hotel market.

5.1 Branding Gap and Hotel Room Rate

Depending on the branding status of an international hotel, the reputation residuals of the hotel brand can be allocated differently between the manager and the developer (see Chapter 3).

Under manager branding, for instance, the manager is the sole hotel brander and claims all reputation residuals of the hotel from guests through a business-to-consumer transaction. The developer is an anonymous contributor to the franchise brand who does not capture any residuals from the guests; instead, it sells its reputation contributions at a pre-determined fee to the brander-manager through a business-to-business transaction. Under manager/developer co-branding, on the contrary, both parties are identifiable in the market and can claim their respective reputation residuals from travelers through two business-to-consumer transactions. Even in the presence of reputation interaction, they only settle with each other a portion of their reputation contributions through two business-to-business transactions.

The payoff structure, based on the branding status of a hotel, dictates the incentives of the manager and the developer to invest in the hotel's reputation. Claiming the entire reputation residuals of a manager-branded hotel, the manager is highly motivated to optimize its branding efforts to earn higher rewards from travelers. The developer, however, claims no reputation gains from its actions, including those that contribute to the hotel brand and, thus, has no incentives to make such efforts. Because the manager is the only party motivated to invest in the reputation of the hotel, manager branding will be the perfect branding option if the manager is the sole reputation contributor to the hotel and the developer provides no reputation contributions at all. In this case, the joint investments made by the manager-developer dyad to build the hotel brand will be optimal because there are no misplaced reputation gains or losses between the two parties.

In reality, manager branding is always imperfect because the developer must be able to contribute to hotel reputation in some ways, no matter how trivial its contributions are. Although the developer also contributes to the reputation of the hotel, the manager alone claims all of the reputation residuals—not only from its own software systems, but also from the developer's hardware facilities. Whereas the manager is highly motivated to invest in the reputation of the hotel brand, the anonymous developer lacks the incentives to do so because it only benefits the reputation residuals earned by the manager. As a result, the incentives of the two parties to build and safeguard the reputation of a manager-branded hotel will be misaligned.

In cases where manager branding is sub-optimal, the joint reputation investments made by the manager-developer dyad in an international hotel will be reduced due to two reasons. First, because the anonymous developer cannot recoup the associated rewards from travelers, it will minimize its reputation investments towards the hotel brand to save on operation costs (e.g., by delaying renovations on its hardware facilities). As the developer lowers its efforts, the joint investments made by the two specialist firms in hotel reputation will be reduced. As a result, the focal hotel will suffer from insufficient reputation investments unless contractual actions are taken to restore the incentives of the developer to invest in the reputation of a manager-branded hotel.

Second, the contractual actions taken by the manager to restore the developer's incentives to invest in hotel reputation will raise the costs incurred by the parties to govern their cooperation, which inevitably reduces the resources available for reputation investments. To restore the developer's incentives to build the hotel brand, for instance, the brander-manager can pay a fee to buy out the reputation contributions of the non-brander-developer. For this business-to-business transaction to work, the parties must incur extra agency costs to design a contract that allows for full settlement of misplaced reputation residuals. Even if the incentives of the manager-developer dyad are perfectly aligned, the agency costs incurred by the parties to govern such a business-to-business transaction could be extremely high, leaving a smaller amount of resources available for them to invest in the reputation of the hotel brand. To save on the costs of governing their cooperation, the parties may opt for an incomplete contract, in which their incentives to invest in hotel reputation are still misaligned—but not as seriously as in cases where no contractual actions are taken.

To address the issue of incentive misalignment under manager branding, a developer that also contributes to hotel reputation can ask to co-brand a hotel that currently bears only the brand name of the manager. When a manager-branded hotel is converted into a manager/developer co-branded hotel, the manager remains a brander that is entitled to the reputation contributions of its hotel software. As a co-brander, the developer is no longer anonymous in the market but can now claim the reputation residuals of its hotel hardware from guests. Therefore, manager/developer co-branding alters the payoff arrangement between the two specialist firms, where both parties can each appeal to hotel guests and receive their respective reputation gains through two residual streams.

Manager/developer co-branding will be an optimal branding status for an international hotel if the manager and the developer both make reputation contributions to the hotel and all guests can separately reward them for their respective reputation contributions to the software systems and hardware facilities of the hotel. In the absence of reputation interaction, manager/developer co-branding works perfectly to realign the incentives of the manager-developer dyad in optimizing their joint investments in hotel reputation. In this scenario, the parties do not need to incur extra agency costs to govern their cooperation because they are both branding principals who claim reputation residuals from hotel guests through two business-to-consumer transactions.

In reality, the efforts made by the manager-developer dyad to boost the reputation of a manager/developer co-branded hotel are not always separable to their common guests because the actions of one party are likely to impact the brand reputation of the other. In the presence of reputation interaction, each party contributes not only to its own brand reputation but also to the brand reputation of the other. Claiming only the reputation residuals of their own brand, the parties receive no rewards for their efforts to improve the reputation of the other. With the presence of reputation interaction, the incentives of the two co-branders are still misaligned, and their joint investments in the reputation of the manager/developer co-branded hotel are still sub-optimal.

Again, contractual solutions can be used to realign the incentives of the two co-branders, thus escalating the agency costs of governing manager-developer cooperation and taking away resources that could otherwise be used to build hotel reputation. Or, the two co-branders can simplify their relationships to save on agency costs if incentive misalignments are tolerable. In the latter case, the joint investments of the two co-branders in the reputation of the manager/developer co-branded hotel would remain sub-optimal because misplaced reputation gains or losses caused by reputation interaction cannot be fully settled.

The above analysis reveals that the issue of incentive misalignment will always be present because the branding status of an international hotel can never be optimal, regardless of the branding status of the hotel and the solutions used by the parties to realign their incentives. Using the terms presented in Chapter 4, the actual branding status of the focal hotel is either zero or one (i.e., either manager branded or manager/developer co-branded). However, the predicted optimal branding status of the focal hotel is a continuous variable between zero and one that captures the likelihood of manager/developer co-branding over manager branding. In this regard, a gap between the actual branding status and the optimal branding status of an international hotel is inevitable.

The concept of *branding gap* is illustrated through the calculation in Figure 5.1. Assume that Hotel A is a manager-branded hotel positioned at "zero" (in the zero vs. one dichotomy). If the likelihood of manager/developer co-branding predicted in Chapter 4 for Hotel A is 0.4 (along the zero-to-one continuum), then there exists a branding gap of 0.4 for this particular hotel (i.e., 0.4 - 0 = 0.4). Likewise, assuming that Hotel B is a manager/developer co-branded hotel positioned at "one," and the likelihood of manager/developer co-branding predicted in Chapter 4 for this hotel is 0.8, then the branding gap of Hotel B is 0.2 (i.e., 1- 0.2 = 0.8).

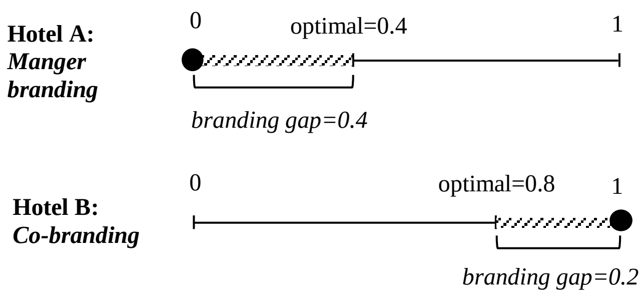

Figure 5.1: Conceptualization of branding gap
(0: Manager branding; 1: Manager/developer co-branding)

By measuring the deviation of the actual branding status from the optimal branding choice for an international hotel, this branding gap actually captures the extent to which the incentives of the manager-developer dyad are misaligned in optimizing their joint investments in the reputation of the hotel. When the branding gap is narrower, the incentives of the two specialist firms are better aligned to invest in the hotel brand, and the agency costs incurred in restoring their incentives are lower. Therefore, more resources are available for the parties to invest in the reputation of the focal hotel regardless of its actual branding status. The opposite holds if the branding gap of an international hotel is wider. Branding gap hence affects the joint investments made by the manager-developer dyad in an international hotel, which alters the reputation of the hotel brand and dictates the hotel room rates.

The reputation of a hotel brand can dictate room rates for two reasons. First, because customers cannot observe hotel service quality before purchase, the manager-developer dyad can invest in hotel reputation to reduce quality uncertainty for travelers. As the hotel becomes more reputable in the market due to such investments, its brand sends stronger quality signals to potential guests because only those branders that provide high quality services are willing to invest in reputation (Klein & Leffler, 1981; Nelson, 1974). Hotel guests can thus rely on brand reputation as a guide to service quality and save on search costs. As a result, they are more willing to pay a premium rate for staying at a hotel that bears a reputable brand. To preserve their ability to charge this premium rate, it is in the interest of hotel branders to keep their quality promise. Thus, a stronger hotel brand also serves as a hostage to guarantee service quality to the guests because reputable hotel branders are less likely to cheat on service quality (Klein & Murphy, 1988; Telser, 1980; Williamson, 1984).

Second, the brand image of a hotel conveys symbolic meanings that allow guests to identify, enhance, or even communicate their self-images (Aaker, 1997; Belk, 1988). Through advertising campaigns, therefore, the brander of the hotel can invest in such symbolic meanings to make the hotel brand more appealing to customers (Wernerfelt, 1990). Those customers who value the symbolic meanings embedded in the hotel brand can generate more psychological satisfaction from the hotel brand and, thereafter, they are more willing to pay a premium price for their stay at such a hotel (Stahl, Heitmann, Lehmann, & Neslin, 2012). The brander of the hotel can then use the premium to recover their advertisement investments in brand images.

With the analysis above, I have established a direct link between the branding status of an international hotel and the premium rate that it can command in the marketplace. To start with, the manager and the developer of an international hotel are expected to optimize the branding option for the hotel in a way that minimizes branding gap. The size of the branding gap affects the incentives of the parties in building and protecting the reputation of the focal hotel, which in turn affects the reputation of the hotel brand in the market and dictates the room rate that travelers are willing to pay for their stay at the hotel. A narrower branding gap implies that the incentives of the manager-developer dyad are better aligned, and the parties will invest more to build the quality signals and the symbolic meanings of the hotel brand in order to boost the popularity of the hotel. As a result, the hotel can command a higher room rate due to its stronger brand reputation/image compared to other hotels operating in the market. The opposite holds as the branding gap becomes wider. To sum up, the wider the gap between the actual branding status and the predicted branding status of a hotel, the lower the premium rate that the hotel can command, and vice versa.

5.2 Hypotheses Development

Thus far, I have established the relationship between hotel branding gap and hotel premium rates. Regardless of the actual branding status of a hotel, there always exists a gap from its optimal branding status. This branding gap distorts the incentives of the manager-developer dyad to invest in hotel reputation and, consequently, reduces their joint investments in the reputation of hotel brand in two areas: incentive misalignments and the extra agency costs incurred to realign their incentives. Sub-optimal investments in hotel reputation lead to a weaker hotel brand that is less capable to reduce quality uncertainty and enhance symbolic consumption for travelers. As a result, the hotel will be unable to charge a premium rate in the market because its brand is neither reputable nor glamorous.

In the next section, I hypothesize the negative relationship between hotel branding gaps and hotel premium rates, where the premium rate of a hotel is defined based on three reference groups: all hotels within the same franchise chain, all hotels within the same geographic location, and all hotels within the overall Chinese market.

5.2.1 Within-chain premium

In their expansions into China, most foreign managers operate a number of hotels located in multiple cities throughout the country. Accor, for instance, operates 106 international hotels in 50 cities in China. Likewise, Wyndham Hotel Group operates 47 international hotels that span across 47 cities in the country. While the hotels within those chains are affiliated with the same foreign manager, they do not necessarily charge the same rates due to certain location-specific factors. As suggested earlier in this chapter, the variations in hotel rates within the same franchise system can result from the gap between the actual branding status and the predicted branding status of a particular hotel

Expectedly, foreign managers do not make the same branding decision for all their affiliated hotels in China, since the optimal branding status of each hotel differs depending on the unique characteristics of the hotel location. A major tourist city, for example, can attract more international travelers who are unfamiliar with the brands of local hotel developers and thus rely more on the names of foreign hotel managers to make their patronage decisions (Dunning & McQueen, 1981; Terpstra & Yu, 1988). As such, foreign managers can solely brand hotels located in tourist cities to better enhance customer popularity. In a city where the Chinese hotel developer is already reputable and well recognized, foreign managers should let the local developer co-brand the focal hotel so that the developer can contribute more to build customer patronage. As these examples demonstrate, the optimal branding status for each hotel operated by the same foreign manager will vary based on the characteristics of the location in which the hotel is situated.

While the parties involved in an international hotel can optimize their branding decision based on location-dependent factors, the actual branding status of the hotel is always sub-optimal, and a branding gap always exists. Moreover, the size of the branding gap varies across all hotels affiliated with the same chain because of random errors committed by each manager-developer dyad (e.g., a developer abuses its political power to co-brand a hotel when it is more optimal for the hotel to bear only the manager brand). According to my earlier analysis, the narrower the branding gap of a particular hotel, the higher the rate it can charge compared to other hotels in the same chain system. I call this premium rate *within-chain premium*.

The within-chain premium of a particular hotel can be calculated by comparing the room rate charged by a hotel with the average room rate charged by all other hotels operated by the same foreign manager in China. For example, as illustrated in Figure 5.2, if the room rate of the Hilton hotel in Shanghai (P_S) is higher than the average rate of all other hotels operated by Hilton in China (P_{chain}), this particular hotel will enjoy a within-chain premium (i.e., $P_S - P_{chain} > 0$). In contrast, if the room rate of another Hilton hotel in Xiamen (P_X) is lower than the average rate charged by all other Hilton hotels in China, a within-chain discount will incur (i.e., $P_X - P_{chain} < 0$).

	Accor	Hyatt	Shangri-La	Hilton	Marriott	Fairmont	.	.
Beijing								
Shanghai				$\boldsymbol{P_S}$				
Anhui								
Xiamen				$\boldsymbol{P_X}$				
Xian								
Sichuan								
.								
.								
				$\boldsymbol{P_{chain}}$				

Figure 5.2: Within-chain premium

Because foreign managers do not make the same branding decision in establishing each hotel, the branding gaps for their affiliated hotels in China are expected to vary. Since there is always a branding gap in every hotel, I argue that the joint efforts made by the manager-developer dyad to build the reputation of the hotel will always be sub-optimal, and the brand name of the hotel and its ability to charge a premium rate over other hotels within the same chain will suffer as a consequence. The gap between the actual branding status of an international hotel and its optimal branding status thus can be used to determine the premium (or discount) on its room rate, relative to other hotels operated by the same foreign manager in China. Therefore, I expect that:

> ***Hypothesis 1:*** *Of all hotels operated by the same foreign manager in China, the wider the gap between the actual and the optimal branding statuses of a hotel, the lower the premium enjoyed (or the higher the discount suffered) by this particular hotel relative to others within the same franchise chain.*

5.2.2 Within-location premium

Most Chinese cities host multiple international hotels competing for similar consumer bases. Beijing alone, for instance, hosts 216 international hotels that are affiliated with 30 foreign managers. Likewise, visitors in Shanghai can select from 168 international hotels operated by 31 foreign managers. In setting up a hotel in the same city, all foreign managers are expected to make their branding decisions based on company-level factors. For example, a foreign manager that operates more hotels worldwide is more recognized and trusted among travelers (Contractor & Kundu, 1998b). In order to better attract customer patronage within a specific location, the manager may take advantage of its strong reputation and solely brand the hotel. On the other hand, a manager that is less experienced in the industry would have less ability to monitor the developer, and its brand reputation would therefore be more vulnerable to the developer's shirking behaviour (Fladmoe-Lindquist & Jacque, 1995). In this case, the foreign manager can let the local developer co-brand the hotel, such that the developer is also encouraged to contribute to the hotel brand. As each foreign manager has different characteristics, the branding statuses of hotels located in the same location will differ.

Each manager-developer dyad will experience unique dynamics in negotiating the allocation of hotel branding rights between the two parties. The actual branding statuses of all hotels located in the same location should be made to reflect the dynamics of each manager-developer pair. Moreover, as illustrated previously, the actual branding status of an international hotel is always sub-optimal. This means that all international hotels in the same Chinese city differ not only in their branding status but also in the gap between their actual and optimal branding statuses. In cases where the branding gap of a particular hotel is narrower, the incentives of the manager-developer dyad are better aligned to build and protect the reputation of the hotel brand. The brand reputation of the hotel will therefore be stronger to attract and retain traveler patronage, which in turn raises the room rate that the hotel can command in the market, compared to other hotels within the same location. I call this premium rate *within-location premium*.

A hotel's within-location premium can be measured by comparing the room rate charged by the hotel with the average rate charged by all others operating in the same location. As shown in Figure 5.3, for instance, if the room rate of the Marriott hotel in Sichuan (P_M) is higher than the average room rate of all hotels operated by other foreign managers in the same geographic location ($P_{location}$), then Marriott Sichuan enjoy a within-location premium (i.e., $P_M - P_{location} > 0$). However, Marriott Sichuan suffers from a within-location discount (i.e., $P_M - P_{location} < 0$) if its room rate (P_M) is lower than the average rate of all international hotels in the same location.

	Accor	Hyatt	Shangri-La	Hilton	Marriott	Fairmont	.	.	
Beijing									
Shanghai									
Anhui									
Xiamen									
Xian									
Sichuan					$\boldsymbol{P_M}$				$\boldsymbol{P_{location}}$
.									
.									

Figure 5.3: Within-location premium

Expectedly, some international hotels are branded more optimally than others, even if they are all located in the same geographic location. In cases where the branding status of an international hotel is more optimal than others in the same location, the incentives of the manager-developer dyad are better aligned to build and protect the reputation of the hotel among travelers, in that stronger brand reputation will allow the hotel to charge a higher room rate. The opposite holds when the branding gap of an international hotel is wider relative to others in the same geographic area. As such, I predict that:

> ***Hypothesis 2:*** *Of all international hotels situated within the same location in China, the wider the gap between the actual and the optimal branding statuses of a particular hotel, the lower the premium enjoyed (or the higher the discount suffered) by this hotel relative to others in the same geographic location.*

5.2.3 Overall premium

Thus far, I have probed the effect of inter-chain or inter-location factors on the branding status of an international hotel, as well as the impact of branding gap on its room rate compared to others within the same hotel chain or in the same geographic location. With all inter-chain and inter-location factors being taken into account at the same time, I will now explore the impact of a hotel's branding gap on its premium or discount room rate over the average room rate of all international hotels in China. Regardless of the chain with which an international hotel is affiliated or the geographic area in which the hotel is located, the branding gap of the hotel can be used to predict the premium it can potentially charge relative to all international hotels in the overall Chinese market. I call this premium *overall premium*.

The overall premium of an international hotel captures the difference between the room rate of the focal hotel and the average rate of all international hotels in China. As demonstrated in Figure 5.4, for instance, if the room rate of the Fairmont hotel in Xian ($P_{F\text{-}Xian}$) is higher than the average rate charged by all international hotels in China ($P_{overall}$), then Fairmont Xian will enjoy an overall premium in China (i.e., $P_{F\text{-}Xian} - P_{overall} > 0$). Likewise, if the room rate of the Shangri-La hotel in Anhui ($P_{S\text{-}Anhui}$) is lower than the average rate of all international hotels in China, the Shangri-La Anhui will suffer from an overall discount ($P_{S\text{-}Anhui} - P_{overall} < 0$).

	Accor	Hyatt	Shangri-La	Hilton	Marriott	Fairmont	.	.
Beijing								
Shanghai								
Anhui			$P_{S\text{-}Anhui}$					
Xiamen								
Xian						$P_{F\text{-}Xian}$		
Sichuan								
.								
.								

$P_{overall}$

Figure 5.4: Overall premium

As illustrated, the gap between the actual and the optimal branding statuses of an international hotel in China is the joint outcome of chain- and location-level factors. Those hotels with a less optimal branding status (i.e., a wider branding gap) will enjoy a smaller premium (or offer a bigger discount) on their room rate relative to the overall average room rate of all international hotels in China. I therefore predict that:

> ***Hypothesis 3:*** *Of all international hotels in China, the wider the gap between the actual and the optimal branding statuses of a hotel, the lower the premium it will enjoy (or the higher the discount it must offer) relative to the average room rate of all international hotels in the overall Chinese market.*

5.3 The Sample

I tested the hypotheses above with the same sample that I used to predict the branding status of an international hotel in Chapter 4. In addition to the full-sample model, I also divided all hotels into two groups based on their branding status (manager branding vs. manager/developer co-branding). I used the two sub-samples to verify whether or not the negative relationship between branding gap and room rate is specific to the branding status of the focal hotel. These two sub-samples also allow me to further probe whether or not the manager-developer dyad of a hotel optimizes its branding decision to maximize the room rate of the hotel.

5.4 The Model

According to my hypotheses, I expected the size of the hotel branding gap of each focal hotel to be negatively related to three types of hotel premium rates: within-chain premium, within-location premium, and overall premium. I ran three ordinary least squares (OLS) models to estimate the effect of the branding gap on each of the premium rates that an international hotel commands in China:

$$P_{Ci} = \alpha_C + \beta_{C1}\, BG_i + \beta_{C2} X_i + \varepsilon_{Ci}$$

$$P_{Li} = \alpha_L + \beta_{L1}\, BG_i + \beta_{L2} X_i + \varepsilon_{Li}$$

$$P_{Oi} = \alpha_O + \beta_{O1}\, BG_i + \beta_{O2} X_i + \varepsilon_{Oi}$$

where the dependent variable $\mathrm{P_i}$ captures the premiums of the *i*th hotel, which I calculated by taking the difference between the highest published rate of a double-bedded room for the hotel ($\mathrm{R_i}$) and the average of the comparable rates for each reference group ($\overline{\mathrm{R}}$), i.e., all hotels within the same chain ($\mathrm{P_{Ci}} = \mathrm{R_i} - \overline{\mathrm{R_C}}$), all hotels within the same location ($\mathrm{P_{Li}} = \mathrm{R_i} - \overline{\mathrm{R_L}}$), and all hotels in China ($\mathrm{P_{Oi}} = \mathrm{R_i} - \overline{\mathrm{R_O}}$). I used the highest published rate of a double-bedded room for two reasons. First, a double-bedded room is the most popular room type among the hotels in my sample. Second, this approach eliminates extensive time-dependent factors that might cause the room rate of a hotel to fluctuate over the year (e.g., national holiday, seasonal effect, economic cycle, etc.). I collected all room rates from Smith Travel Research (STR).

On the right hand side of the equations, $\mathrm{BG_i}$ represents the branding gap for the *i*th hotel (i.e., $|\mathrm{Y_i} - \mathrm{P}(\mathrm{Y_i} = 1)|$), which I calculated by taking the difference between the actual branding status of the *i*th hotel (i.e., $\mathrm{Y_i}$ = 0 if manager branded; $\mathrm{Y_i}$ = 1 if manager/developer co-branded) and the predicted branding status defined in Chapter 4, (i.e., $\mathrm{P}(\mathrm{Y_i} = 1)$ as the probability of manager/developer co-branding). In addition, X_i is a vector of control variables that may also affect the room rate of the *i*th hotel; α_C, α_L, and α_O are intercepts; β_{C1} , β_{C2} , β_{L1}, β_{L2}, β_{O1}, and β_{O2} are estimated parameters; and ε_{Ci}, ε_{Li}, and ε_{Oi} are error terms.

5.5 Variables and Measures

To isolate the effect of branding gap on hotel premium rates, I controlled for hotel-, firm-, and location-level factors that can also alter the room rates of an international hotel. These control variables are included in all three OLS models that verify the impact of branding gap on within-chain premium, within-location premium, and overall premium.

Manager reputation. An international hotel operated by a reputable manager is likely to command higher room rates in the marketplace. This is particularly true in my sample, where the foreign manager is always identifiable to travelers regardless of the branding status of an international hotel. The reputation of the manager, hence, must be controlled in verifying the impacts of branding gap on the premium rates that the focal hotel can command in the market. The measure and data source for *manager reputation* can be found in Chapter 4, where I used the same variable to predict the choice between manager branding and manager/developer co-branding. I expected the variable to carry a positive coefficient.

Manager hotel. As noted in Chapter 4, those managers that operate fewer international hotels are more likely to position their hotels at the high-end segment, and vice versa. Hence, the number of hotels that a foreign manager operates worldwide may affect the room rates that it can charge in the market. Specifically, those managers who operate a greater number of international hotels are more likely to be at the bottom of the market pyramid. As a result, *manager hotel* was expected to carry a negative coefficient. I collected the number of hotels operated under a particular manager brand from STR.

Developer age. Local developers that have operated for a longer period of time in China are more likely to build a larger customer base and possess a stronger brand. The age of the local developer, hence, may affect the room rates of an international hotel if the hotel also bears the developer brand (i.e., a manager/developer co-branded hotel). This one-sided impact can be captured through an interaction term between developer age and hotel branding status (a dummy variable that equals one if the hotel is manager/developer co-branded, and zero if it is manager branded). As such, I expected the coefficient of *developer age* to carry a positive coefficient only when the focal hotel is co-branded by two specialist firms. The data sources for this variable are described in Chapter 4.

Developer state-ownership. As noted in Chapter 4, state-owned enterprises tend to suffer from the problem of ownership agency, where salaried executives lack the incentives to invest in brand reputation (Lin & Germain, 2003). This means that state ownership may harm the ability of an international hotel to charge a premium rate, but this negative reputation effect holds only when the focal hotel also bears the developer brand. To capture this factor, I used a dummy variable that equals one if the local developer is a state-owned enterprise and zero if it is a private-owned company. I expected this dummy variable to bear a negative coefficient only among manager/developer co-branded hotels. The data sources for *developer state-ownership* are described in Chapter 4.

Hotel age. A hotel with a longer operation history has had more time to establish its popularity among guests and, thereafter, it is more likely to command a premium rate in the market. Thus, I expected *hotel age* to bear a positive coefficient, regardless of the branding status of the focal hotel. I collected the variable from STR.

Hotel star rating. International hotels are commonly classified through a five-star rating system to reflect their service quality. Hotels with a higher star rating should be able to command higher room rates compared to those with a lower star rating. Hence, I expected *hotel star rating* to be positively related to room rates, regardless of the branding status of the focal hotel. I collected data on hotel ratings from Agoda, a popular online travel agency.

Urban hotel. Compared to hotels located in rural areas, international hotels in urban areas are more likely to charge a higher room rate because of the need to recoup the higher costs of acquiring hotel properties. I expected the *urban hotel* to be positively related to the premium rate of an international hotel. Using data collected from STR, I created a dummy variable that equals one if the hotel is located in an urban area, and zero if it is located in a rural area.

Conference hotel. Some international hotels can also be used as conference sites. Such hotels require extra investments in software systems and hardware facilities (e.g., conference rooms, video and audio equipment, etc.). To recoup these sunk investments, conference hotels are likely to command a higher room rate over their non-conference counterparts. The variable *conference hotel* was expected to carry a positive sign. I used data collected from STR to create a dummy variable that equals one if the hotel is a conference hotel, and zero if otherwise.

Tourist city. International hotels located in a tourist city in China appeal to more foreign visitors who can afford to pay higher room rates relative to domestic travelers. Therefore, such hotels are more likely to command a premium room rate compared to others located in a non-tourist city. In other words, I expected the variable *tourist city* to bear a positive coefficient.

Using data compiled by the China National Tourism Administration, I created a dummy variable that equals one if the focal hotel is located in a tourist city, and zero if otherwise.

GDP per capita. I also controlled for provincial GDP per capita to capture the disparities of living standards that may affect hotel room rates. I collected this data from *China Statistical Yearbook (2013)*. I anticipated that hotels located in a province with higher GDP per capita would be more likely to charge higher room rates. Thus, I expected the control variable *GDP per capita* to bear a positive sign.

I provide a summary of all control variables and their measurements, data sources, and expected impact on hotel room rates in Table 5.1.

Table 5.1: Description of control variables

Variable	**Measure**	**Data source**	**Expected**
Manager reputation	(1) Market share of the manager (% sales in the international hotel industry) when an international hotel was established; (2) Customer satisfaction survey data conducted on America hotel guests when an international hotel was established	(1) Euromonitor International; (2) *American Customer Satisfaction Index (ACSI)*	+
Manager hotel	Number of hotels operated under a particular manager brand	Smith Travel Research (STR)	-
Developer age	Age of the local developer when an international hotel was created	Developer website, local newspaper and magazine, *ProQuest Asia*	+
Developer state-ownership	Dummy variable that equals one if the local developer is state-owned and zero if private-owned	Developer website, local newspaper and magazine, *ProQuest Asia*	-
Hotel age	Number of years since the hotel has been established	STR	+
Hotel star rating	Five-star rating of an international hotel	Agoda	+
Urban hotel	Dummy variable that equals one if the hotel is in an urban area and zero if otherwise	STR	+
Conference hotel	Dummy variable that equals one if the hotel is a conference hotel and zero if otherwise	STR	+
Tourist city	Dummy variable that equals one if the hotel is located in a tourist city and zero if otherwise	China National Tourism Administration	+
GDP per capita	GDP per capita in the province where a hotel is established	*China Statistical Yearbook* (2013)	+

The descriptive statistics of all variables in this chapter and the correlation matrix are shown in Table 5.2.

Table 5.2: Descriptive statistics and correlation matrix (n=535)

	Mean	S.D.	Min	Max	1	2	3	4	5	6
1. Within-chain premium	1.59	83.97	-231	443						
2. Within-location premium	.25	113.47	-240	675	.51***					
3. Overall premium	-.08	133.75	-170	751	.63***	.84***				
4. Branding gap	.28	.24	.01	.98	.02	-.06	-.08**			
5. Manager reputation	0	.70	-1.44	1.55	-.04	.03	.04	-.27***		
6. Manager hotel	488.14	659.03	2	4,877	-.01	-.26***	-.29***	.13***	.13***	
7. Developer age	17.87	14.47	1	86	-.06	.20***	.18***	.005	-.01	-.17***
8. Developer state-ownership	.19	.39	0	1	-.04	-.001	.02	-.03	.008	-.01
9. Hotel age	5.57	3.75	1	20	.12***	-.04	.009	.16***	-.26***	.03
10. Hotel star rating	4.42	.71	2	5	.04	.45***	.52***	.08**	-.09**	-.51***
11. Urban hotel	.71	.45	0	1	-.07*	.09**	.03	-.02	.05	.004
12. Conference hotel	.15	.36	0	1	.02	.10**	.15***	-.12***	.18***	-.15***
13. Tourist city	.77	.42	0	1	.11***	.0009	.17***	-.02	.006	.01
14. GDP per capita	60,522	22,351	22,922	99,607	.11***	.001	.11***	-.002	.01	.02

	7	8	9	10	11	12	13
7. Developer age							
8. Developer state-ownership	.35***						
9. Hotel age	-.18***	.06					
10. Hotel star rating	.33***	.08**	-.06				
11. Urban hotel	.08*	.02	-.16***	.03			
12. Conference hotel	.10**	-.02	-.05	.25***	-.01		
13. Tourist city	-.07*	-.06	.04	.07*	.03	.11***	
14. GDP per capita	-.02	.008	.14***	-.01	-.04	.07*	.34***

1. *p<.1; **p<.05; ***p<.01 (two-tailed p-value)

2. Within-chain premium, within-location premium, and overall premium are presented in US dollars

3. GDP per capita is presented in yuan

5.6 Results

Table 5.3 presents the results of the OLS models that I used to analyze the relationship between branding gap and each type of premium rate defined earlier in this chapter (i.e., within-chain premium, within-location premium, and overall premium). *Branding gap* bears an unexpectedly positive coefficient in predicting within-chain premium, yet its impact is statistically insignificant. As such, the result does not support Hypothesis 1 and suggests that the size of branding gap has no effect on a focal hotel's room rate, relative to other hotels operated by the same foreign manager in China. This insignificant result could be due to the fact that many foreign chains in China operate a rather small number of hotels (e.g., 23 hotel chains operated five and less hotels in China) and, consequently, the within-chain variations in room rates are not big enough to capture the full impact of hotel branding gap.

Table 5.3: Estimated parameters for the regression models

	Within-chain premium	Within-location premium	Overall premium
Branding gap	1.57 (18.71)	-41.40* (22.64)	-56.49** (24.85)
Manager reputation	-2.02 (5.63)	11.39* (6.81)	17.16** (7.48)
Manager hotel	.002 (.006)	-.004 (.008)	-.002 (.008)
Developer age	.25 (.46)	.36 (.56)	.07 (.61)
Developer state-ownership	-43.78* (22.55)	-45.93* (27.28)	-44.40 (29.94)
Hotel age	2.40** (1.03)	1.02 (1.25)	2.87** (1.37)
Hotel star rating	6.13 (6.14)	73.37*** (7.43)	101.54*** (8.15)
Urban hotel	-9.22 (8.16)	19.80** (9.88)	8.66 (10.84)
Conference hotel	1.27 (10.57)	-10.49 (12.79)	-10.18 (14.04)
Tourist city	13.96 (9.25)	-13.66 (11.19)	28.67** (12.28)
GDP per capita	.0002 (.0001)	.0001 (.0002)	.0005** (.0002)
Intercept	-60.43* (31.01)	-326.75*** (37.52)	-505.44*** (41.18)
F statistic (df)	2.13** (11, 523)	14.43*** (11, 523)	23.93*** (11, 523)
R^2	.04	.23	.33
Adjusted R^2	.02	.21	.32

*p<.1; **p<.05; ***p<.01 (two-tailed p-value)

In predicting within-location premium, the model has an adjusted R-square of 0.21 that is significant at the 0.01 level. The coefficient of *branding gap* is negative as predicted and significant at the 0.1 level. This result confirms Hypothesis 2: a wider gap between the actual and optimal branding statuses of a hotel lowers the premium enjoyed by the hotel, relative to other hotels located in the same geographic area. In other words, smaller branding gaps indicate better incentive alignment in a manager-developer dyad in maximizing their joint investments in hotel reputation, which in turn boosts the premium rate charged by the focal hotel.

Concerning the impact of branding gap on the overall premium enjoyed by the hotel, relative to all international hotels in China, the model has an adjusted R-square of 0.32 that is significant ($p<0.01$). The coefficient of *branding gap* is negative as predicted and significant at the 0.05 level. This finding supports Hypothesis 3: a wider branding gap leads to a lower overall premium claimed by the focal hotel.

The results also support my prediction that the control variables *manager reputation* and *hotel star rating* increase the premium rate enjoyed by the hotel, relative to other hotels located in the same geographic location as well as the overall Chinese market. *Developer state-ownership* decreases, while *urban hotel* increases, the within-location premium. Additionally, *hotel age*, *tourist city*, and *GDP per capita* all boost the overall premium of the focal hotel.

5.6.1 Split-sample models on branding gap and hotel premium rates

The negative relationship between the branding gap and room rate premium confirmed in the tests above suggests that manager-developer dyads choose a branding option that maximizes the brand power of the focal hotel to charge a premium rate. To further verify the robustness of this finding, I repeated the same test by splitting the full sample into two sub-samples, based on the branding status of each hotel (manager branding vs. manager/developer co-branding).

Table 5.4 reports the results of the split-sample OLS models that predict the impacts of branding gap on the room rate premium enjoyed by the focal hotel, relative to other hotels in the same geographic location and all international hotels in China.

In the manager-branding sub-sample, *branding gap* bears a negative coefficient as predicted. Its impact on the within-location premium and the overall premium is statistically significant at the 0.1 and 0.01 levels, which supports Hypotheses 2 and 3. In contrast, in the manager/developer co-branding sub-sample, *branding gap* bears a positive coefficient but this unexpected result is statistically insignificant. It suggests that the size of the branding gap has no impact on the the room rate of a manager/developer co-branded hotel, a finding that fails to support Hypotheses 2 and 3.

Table 5.4: Estimated parameters for the split-sample regression models

	Within-location premium		**Overall premium**	
	Manager brand	**Co-brand**	**Manager brand**	**Co-brand**
Branding gap	-78.67* (42.09)	55.21 (61.38)	-133.32*** (43.30)	77.19 (64.34)
Manager reputation	3.14 (8.55)	14.81 (17.63)	3.85 (9.41)	18.00 (18.48)
Manager hotel	-.02 (.01)	.01 (.009)	-.01 (.01)	.01 (.01)
Developer age	-	.77 (.61)	-	.50 (.64)
Developer state-ownership	-	-78.40*** (25.86)	-	-84.33*** (27.10)
Hotel age	.40 (1.48)	3.56 (2.26)	2.20 (1.63)	6.03** (2.37)
Hotel star rating	69.85*** (8.83)	62.17*** (17.03)	102.49*** (9.72)	74.69*** (17.85)
Urban hotel	11.88 (11.43)	49.50** (19.06)	-2.59 (12.57)	45.71** (19.98)
Conference hotel	-10.54 (14.34)	-9.17 (27.60)	-15.10 (15.78)	11.81 (28.93)
Tourist city	-8.08 (13.16)	-32.41 (19.78)	38.50*** (14.47)	-3.77 (20.74)
GDP per capita	.0002 (.0002)	-.0007 (.0004)	.0005*** (.0002)	-.0003 (.0004)
Intercept	-295.53*** (45.09)	-321.46*** (89.48)	-485.06*** (49.60)	-452.77*** (93.79)
No. of observations	416	119	416	119
F statistic (df)	15.78*** (9, 406)	3.44*** (11, 107)	26.90*** (9, 406)	3.97*** (11, 107)
R^2	.25	.26	.37	.28
Adjusted R^2	.24	.18	.35	.21

*p<.1; **p<.05; ***p<.01 (two-tailed p-value)

The above findings can be interpreted as below. To start with, *branding gap* reduces hotel room rates only in the manager-branding sub-sample, which indicates that branding agency is a more serious issue for manager-branded hotels. To put it differently, foreign managers (full branding principals) may encounter greater difficulty in buying out the reputation contributions of Chinese developers (full branding agents) because of the high costs of solving one-way full branding agency under manager branding. Conversely, *branding gap* lacks the predicted negative impact on hotel room rates in the manager/developer co-branded sub-sample, which suggests that two-way partial branding agency under co-branding is not really a serious governance issue, where the two co-branders can more easily settle misplaced reputation gains or losses caused by reputation interaction.

The results for the control variables in the split-sample OLS models are largely consistent with those in the full-sample models. Since the developer's brand name is anonymous in manager-branded hotels, developer-related control variables (*developer age* and *developer state-ownership*) are not applicable in the manager-branding sub-sample and are therefore excluded. In the manager-branding sub-sample, *hotel star rating* carries a positive coefficient, and its impact on within-location premium and overall premium is statistically significant at the 0.01 level. Also, *tourist city* and *GDP per capita* are positively associated with overall premium and are highly significant ($p<0.01$).

In the manager/developer co-branding sub-sample, *hotel star rating* is positive as predicted and is significant to both within-location premium and overall premium ($p<0.01$). *Developer state-ownership* carries a negative coefficient and is also significant to the two types of hotel premium at the 0.01 level. The coefficient of *urban hotel* is positive and significant in predicting both within-location premium and overall premium ($p<0.05$). Lastly, *hotel age* is positive and has a significant impact on overall premium ($p<0.05$).

5.6.2 A two-stage model

The argument that a manager-developer dyad chooses an optimal branding option to maximize the brand reputation of the focal hotel to maximize room rates can be directly tested through a two-stage model. In other words, the choice of manager branding vs. manager/developer co-branding is a self-selected decision made by the two specialist firms to maximize the room rates of a hotel (Shaver, 1998; Shehata, 1991). In this regard, I used the Heckman's two-stage model to verify whether the two hotel specialists purposely select the branding status of the focal hotel to increase its room rates.

In the first-stage, I used a probit model to predict the likelihood that a hotel is co-branded by the manager-developer dyad (as opposed to manager branding only), using those variables that may also affect the room rates of the hotel:

$$P(Y_i = 1) = \beta_A X_{Ai}$$

where the dependent variable Y_i will equal one if the *i*th observation is a manager/developer co-branded hotel, and zero if a manager-branded hotel. In this probit model, $P(Y_i = 1)$ captures the probability of manager/developer co-branding for the *i*th international hotel; X_{Ai} is a vector of independent variables that affect both the branding decision and the premium rates of the *i*th hotel; and β_A is a vector of estimated parameters.

The purpose of this stage-one model is to generate a corrector called the inverse Mills ratio (λ), whose coefficient measures the self-selection effect of branding decisions on room rates for manager-branded and manager/developer co-branded hotels in the stage-two models as defined below (Heckman, 1979). As demonstrated below, I only ran this two-stage test on the overall premium enjoyed by a hotel, relative to all international hotels in China:

$$P_{sub-M,i} = \alpha_M + \beta_{M1}X_i + \beta_{M2}\lambda_i + \varepsilon_{M,i}$$

$$P_{sub-MD,i} = \alpha_{MD} + \beta_{MD1}X_i + \beta_{MD2}\lambda_i + \varepsilon_{MD,i}$$

where the dependent variable $\mathrm{P_{sub,i}}$ captures the overall premium of the *i*th hotel, which is calculated by taking the difference between the highest published rate of a double-bedded room for the hotel ($\mathrm{R_{M,i}}$ for a manager-branded hotel; $\mathrm{R_{MD,i}}$ for a manager/developer co-branded hotel) and the average of the comparable rates from the reference groups ($\overline{\mathrm{R_M}}$ for manager branding; $\overline{\mathrm{R_{MD}}}$ for manager/developer co-branding), i.e., all manager-branded hotels ($\mathrm{P_{sub-M,i}} = \mathrm{R_{M,i}} - \overline{\mathrm{R_M}}$) and all manager/developer co-branded hotels ($\mathrm{P_{sub-MD,i}} = \mathrm{R_{MD,i}} - \overline{\mathrm{R_{MD}}}$). $\mathrm{X_i}$ is the same vector of control variables presented earlier in this chapter; λ_i is the inverse Mills ratio; α_M and α_MD are intercepts; β_M1 , β_M2 , β_MD1, and β_MD2 are estimated parameters; and $\varepsilon_\mathrm{M,i}$, $\varepsilon_\mathrm{MD,i}$ are error terms. Table 5.5 reports the findings of the Heckman's two-stage model.

The first-stage probit model achieves a 33.68 chi-square and a correct prediction rate of 78.32 per cent. Two (out of four) variables that concurrently affect the hotel branding status and hotel premium rates have a significant effect on the likelihood of manager/developer co-branding. Specifically, m*anager reputation* carries a negative coefficient that is significant at the 0.01 level, whereas *manager hotel* bears a positive coefficient and is significant at the same level. The results are consistent with my findings in Chapter 4.

Table 5.5: Estimated parameters for the two-stage model

	Stage 1: Branding status	Stage 2: Overall premium	
		Manager brand	**Co-brand**
Manager reputation	-.47*** (.09)	39.15 (33.86)	-348.37 (213.33)
Manager hotel	.0002*** (.00009)	-.03 (.02)	.20* (.10)
Developer age	.004 (.004)	-	4.06* (2.17)
Developer state-ownership	-.20 (.17)	-	-238.86** (95.14)
Hotel age	-	1.68 (1.65)	5.96** (2.33)
Hotel star rating	-	96.09*** (9.59)	69.35*** (18.15)
Urban hotel	-	1.99 (12.59)	47.45** (19.86)
Conference hotel	-	-12.13 (15.93)	-2.40 (28.58)
Tourist city	-	39.53*** (14.62)	-4.26 (20.54)
GDP per capita	-	.0005** (.0002)	-.0003 (.0004)
Intercept	-.98*** (.11)	-388.13*** (137.34)	-1,971.68** (874.93)
Inverse of Mill's ratio	-	-62.65 (86.74)	1,064.42** (595.07)
No. of observations	535	416	119
Model chi-square	33.68***	-	-
% of correct prediction	78.32	-	-
(Base percentage)	(71.43)	-	-
F statistic (df)	-	25.55*** (9, 406)	4.19*** (11, 107)
R^2	-	.36	.30
Adjusted R^2	-	.34	.22

*p<.1; **p<.05; ***p<.01 (two-tailed p-value)

In the second-stage, the model that covers manager-branded hotels has an adjusted R-square of 0.34 that is significant at the 0.01 level. The variable that captures whether the manager-developer dyad makes the decision on manager branding to increase the overall premium of a hotel (i.e., the inverse Mills ratio) bear a negative coefficient that is insignificant. This result suggests that the two hotel specialists do not purposely select manager branding over manager/developer co-branding in order to command a higher room rate in China. The result implies that manager branding is more likely to be the default branding option that was not self-selected by the two specialists to maximize hotel room rates.

In comparison, the model that covers manager/developer co-branded hotels has an adjusted R-square of 0.22 that is significant at the 0.01 level. Unlike the results for manager-branded hotels, the inverse Mills ratio bears a positive coefficient that is significant at the 0.05 level—which suggests that the two hotel specialists self-selected manager/developer co-branding to increase the overall premium of the focal hotel. This finding supports the agency view of hotel branding.

The results of the two-stage analysis are consistent with those of the split-sample model. As reported earlier, *branding gap* hurts the brand reputation of a hotel and, consequently its ability to charge premium room rates only in the manager-branding sub-sample. This suggests that branding agency is a more serious issue for manager-branded hotels. To save on the costs of dealing with branding agency, the manager-developer dyad can self-select co-branding to realign their incentives in boosting the power of the hotel brand to maximize room rates. This explains why the inverse of Mill's ratio bears a positive and significant coefficient only in the manager/developer co-branding sub-sample.

5.7 Summary

In this chapter, I empirically verified how the choice between manager branding and manager/developer co-branding affects the room rate of an international hotel. I argue that the gap between the actual and optimal branding statuses of a hotel (*branding gap*) distorts the incentives of the manager-developer dyad to invest in hotel reputation. If the incentives of the two hotel specialists are better aligned, the parties can more easily harmonize their joint investments in the reputation of hotel brand without incurring a high cost to address the branding agency issue. As a result, the hotel can command a higher room rate due to the greater investments made by the two specialist firms in the reputation of the hotel brand.

My results support the argument that, when the branding status of an international hotel is more optimal, the incentives of the manager-developer dyad are better aligned to build and protect the reputation of the hotel among travelers, where a stronger brand name will allow the hotel to command a higher room rate in the market. These results are consistent with the performance implications of the branding agency view. In addition, I have found that the negative impact of branding gap on hotel room rate is contingent on the branding status of a hotel. The results also indicate that manager branding is the default branding option, and the two hotel specialists choose manager/developer co-branding purposely to increase hotel room rates.

CHAPTER 6: CONCLUSION

In this dissertation, I analyze the branding status of international hotels, defined as those in which a foreign management company transfers it hotel software systems (e.g., business format, booking network, operation know-how, etc.) outside of its national borders to combine them with hotel hardware facilities (e.g., land, building, furniture, etc.) owned by a local development company in another country. When the two hotel specialists work together in setting up an international hotel, the right to brand the software-hardware bundle of the hotel can be assigned to the management company only (*manager branding*), to the development company only (*developer branding*), or to both of them (*manager/developer co-branding*). Under all three branding options, the ownership rights to hotel software and hotel hardware are the same.

The rise of international hotels has attracted research attention from scholars who focus on the institutional modes used by hotel chains to expand globally. In particular, many of those scholars have focused on the market-vs.-integration paradigm, in which foreign managers either transfer hotel software to local developers for exploitation through franchising or develop their own hotel hardware in the host market through integration. Prior researchers have adopted either internalization theory or agency view to predict the choice between franchising and integration. In doing so, they have tended to overlook the branding status of an international hotel for two reasons. First, regardless of the choice made between franchising vs. integration, the focal hotel bears the name of the manager, and the hotel branding status is an irrelevant issue to scholars. Second, both theoretical lenses are sub-fields of organizational economics based on *business-to-business* transactions (manager-developer) that do not cover the status of hotel branding, which traditionally serves to facilitate *business-to-consumer* transactions (brander-guest).

The market-vs.-integration paradigm predicts the assignment of hotel ownership rights to either an entrepreneurial franchisee or an integrated chain, without altering the branding status of the focal hotel. However, when the branding status of an international hotel is taken into account, integration is not the only option for hotel chains to expand globally when franchise contracts are too costly to write and enforce. While keeping the ownership structure of a franchised (manager-branded) hotel constant, the full right to brand the hotel can be reallocated between the two specialist firms to accommodate alternative contractual formats under developer branding or manager/developer co-branding. This is a prominent issue that has received little attention from business scholars. In particular, the literature still lacks guidelines on the allocation of hotel branding rights and the elaboration of the associated performance consequences.

In my dissertation, I address these critical gaps in the literature and answer understudied questions about international hotel branding. In this chapter, I summarize the agency view on international hotel branding and the empirical findings derived from my study of a sample of international hotels in China. Following that, I discuss the contributions of my study to the literatures on internalization theory, agency view, branding, and organizational economics as a whole. Next, I draw managerial implications from these conceptual models and empirical results. Finally, I highlight the limitations of my study and provide directions for future research.

6.1 Research Overview

In this dissertation, I adopt an agency view to examine how different branding options for an international hotel align the incentives of a manager-developer dyad and thereafter vary the agency costs to organize their cooperation. I begin my analysis by isolating the branding rights from the ownership rights to an international hotel. In doing so, I define another agency problem—called *branding agency*—that differs from the traditional issue of *ownership agency*. More specifically, branding agency refers to a condition under which the non-brander of the manager-developer dyad in an international hotel lacks the incentives to contribute to the reputation of the hotel brand unless the brander pays a fee to buy out its reputation contributions. In the business-to-business transaction used to settle those reputation contributions, the brander is the principal who claims the reputation residuals in the hotel brand directly from guests, while the non-brander is the agent who receives a fixed fee for its contributions to hotel reputation. The nature of this principal-agent relationship, thus, will change if the right to brand the software-hardware bundle of the focal hotel is reassigned between the two specialist firms.

Even when the ownership rights to an international hotel remain unchanged, the right to brand the hotel can be assigned in three ways: to the foreign manager who owns hotel software (*manager branding*), to the local developer who owns hotel hardware (*developer branding*), or to both of them (*manager/developer co-branding*). Under these three branding options, the principal-agent roles of the two hotel specialists vary, as do the agency costs incurred to govern their cooperation. My premise is that the branding status of an international hotel is essentially a governance decision that can be manipulated to minimize the agency costs of regulating the manager-developer dyad in an international hotel. In cases where all three branding options fail to save on agency costs, hotel management and hotel development should be combined within an integrated company that brands the overall software-hardware bundle—the fourth branding option that I call *integrated branding*. This is the agency view of international hotel branding that I propose in my dissertation.

Based on this agency view, I conduct two empirical tests on a sample of international hotels collected from China, in order to answer the two questions raised in this dissertation. In the first test, I identify those factors that may affect the costs of solving the branding agency issue in the manager-developer dyad and use them to predict when a foreign manager would let a local developer co-brand an international hotel in China. I focus only on the choice of manager branding vs. manager/developer co-branding because of the challenges involved in identifying developer branding and the scarcity of integrated branding. I argue that the choice between manager branding and manager/developer co-branding is contingent upon two factors that dictate the costs incurred by the manager and the developer to address the issue of branding agency: (1) their relative contributions to the reputation of the focal hotel; and (2) their relative abilities to monitor each other's actions in building and protecting the hotel brand. To save on agency costs, according to my hypotheses, the right to brand an international hotel should be assigned to the party that contributes more to the reputation of the hotel brand and is better able to buy out the reputation contributions of the other.

My results show that a foreign manager is less likely to let the local developer co-brand an international hotel if the manager can contribute more to the reputation of the hotel and/or is better able to monitor the actions of the local developer. In contrast, a local developer is more inclined to co-brand an international hotel if it contributes more to hotel reputation and/or is better able to monitor the actions of the foreign manager. Furthermore, I found that most factors that favor manager branding have a greater impact on hotels located in tourist destinations or those classified in the high-end segment of the hotel market (vs. hotels located in non-tourist destination or those classified in the low-end segment). The opposite holds among those factors that favor manager/developer co-branding. These findings address a critical gap in the literature by providing guidelines on the allocation of international hotel branding rights between two specialist firms.

In the second test, I examine how the branding status of an international hotel affects the premium rate that a hotel can command in the market. By comparing the actual branding status of a focal hotel with its optimal branding status, as predicted in Chapter 4, I create a new construct called the *branding gap* to capture the difference between the two. A wider branding gap indicates poorer incentive alignments in the manager-developer dyad to build and safeguard the reputation of the hotel brand. In such case, the two specialist firms are more likely to shirk their branding efforts—which in turn reduces the premiums that the hotel can command, relative to all other hotels within the same franchise chain, within the same geographic location, and within the overall Chinese market.

My results support the argument that when the branding gap is narrower, the incentives of the manager-developer dyad are better aligned to build and protect the reputation of a hotel brand among travelers. In turn, a stronger brand reputation allows the hotel to charge a higher room rate compared to other hotels within the same geographic location and within the overall Chinese market. As an important caveat, I have found that a narrower branding gap increases hotel room rates only in manager-branded hotels, and it does not seem to affect the room rates of manager/developer co-branded hotels. My results also suggested that manager/developer co-branding is a branding decision that can be made purposefully by the two specialist firms to increase the room rates of an international hotel. These results address the other gap in the literature identified above, concerning the performance implications of branding rights reallocation in the international hotel industry.

6.2 Contributions

To the best of my knowledge, this dissertation is the first study to treat the branding status of an international hotel as a governance decision that can be deliberately made to save on the agency costs of organizing *business-to-business* transactions between two specialist firms in the international hotel industry, a perspective that differs from the traditional role of branding in facilitating *business-to-consumer* transactions. This dissertation is also the first study that uses a vector of agency factors to predict the choice of manager branding vs. manager/developer co-branding, two branding options that are common in the international hotel industry. Furthermore, this dissertation addresses the implications of hotel branding status for room rates. In doing so, it makes important theoretical and empirical contributions to multiple fields.

6.2.1 Theoretical contributions

The rise of international hotels has attracted attention from scholars who have drawn on either internalization theory or agency theory to compare the choice of franchising vs. integration. Both literature streams are sub-fields of organizational economics that do not cover consumers. Consequently, those studies based on the two literature lenses tend to ignore the branding status of international hotels. Under the market-vs.-integration dichotomy, branding becomes an irrelevant issue because a franchised hotel and a company-owned hotel both bear the same brand name owned by a foreign manager. Therefore, the drivers behind hotel branding and its performance implications have remained understudied in the literature on organizational economics.

My analysis moves beyond the business-to-business focus of organizational economics to also cover consumers. In doing so, I build a triadic model that consists of one business-to-business transaction (manager-developer) plus two business-to-consumer transactions (manager-consumer and developer-consumer). Using this triadic model, my dissertation contributes to internalization theory by identifying multiple contractual formats available to organize manager-developer cooperation in the international hotel industry—each of which corresponds to a unique allocation of hotel branding rights between the manager and the developer. Instead of asking who should *own* the hotel, I address the question of who should *brand* the hotel. By taking the status of hotel branding into account, I present a two-stage process through which a hotel chain can choose its optimal mode of foreign entry: (1) the choice between equity vs. contractual mode must be made and (2) if contractual mode is chosen, the choice between three different contractual-mode branding options. Clearly, integration is the alternative mode for hotel chains to expand globally only when all contractual formats under manager branding, developer branding, and manager/developer co-branding are proved infeasible. In other words, when a franchise contract is too costly to arrange, the parties involved can alter the branding status of the focal hotel to facilitate their cooperation without resorting to the integration of hotel management and hotel development within a single company.

The establishment of the triadic model in this dissertation also contributes to agency theory. According to traditional agency theory, an integrated chain must incur agency costs to monitor salaried employees deployed to run a company-owned hotel. By reassigning the ownership rights of a company-owned hotel to a franchisee, the hotel chain can save on agency costs because it no longer needs to monitor the entrepreneurial owner of the franchised hotel. Under this agency view, the market-vs.-integration paradigm corresponds to the assignment of hotel ownership rights to an entrepreneurial franchisee vs. an integrated firm.

By separating hotel branding rights from hotel ownership rights, I have identified another agency issue called *branding agency*, where the non-brander partner in the manager-developer dyad is not motivated to build or protect the reputation of the branding partner. The traditional agency theory ignores this branding agency issue, which can persist in franchising and can only be addressed through reallocations of hotel branding rights. Since my triadic framework also considers branding rights and the associated reputation residuals, it makes an important contribution to agency theory which has traditionally addressed only ownership rights and the associated operation residuals.

My triadic model also contributes to the branding literature by defining an institutional role for branding to play in facilitating business-to-business transactions. Traditionally, branding has been understood to facilitate business-to-consumer transactions, where the provider of a good or a service is also its brander. Under my triadic framework, two specialist firms that work together to deliver hotel services to travelers can compete for the right to brand their joint output (i.e., the software-hardware bundle of the focal hotel). Reallocations of hotel branding rights realign the incentives of the manager-developer dyad to build and protect the hotel brand, which inevitably alters the costs of organizing their cooperation. In other words, the right to brand the software-hardware bundle of an international hotel can be reassigned to economize on the agency costs of regulating manager-developer cooperation. In this regard, the branding system plays an institutional role in facilitating business-to-business transactions, which goes beyond its traditional function in promoting business-to-consumer transactions.

Taken together, the triadic model proposed in this dissertation reveals the benefits of modeling organizational economics through a two-dimensional space, rather than a one-dimensional continuum. The traditional market-vs.-integration paradigm only captures the costs of using one contractual format (i.e., franchise contracts) to support manager-developer cooperation. My triadic model addresses the possibility that an international hotel can be structured through management contracts, an alternative contractual format that shifts the branding rights of the focal hotel from the manager to the developer. The two contractual formats differ in that the developer sells its contributions to hotel reputation to the manager through a franchise contract, whereas the manager sells its contributions to hotel reputation through a management contract. This bilateral view implies that the transaction used by the manager-developer dyad to settle reputation residuals can be conducted in two opposite directions. As such, organizational economics should be modeled through a two-dimensional space that captures the relative costs of settling reputation residuals between the parties under manager branding vs. developer branding. It turns out that the traditional choice of franchising (manager branding) vs. integration (integrated branding) is a special case in this two-dimensional space that also considers developer branding and manager/developer co-branding.

6.2.2 Empirical contributions

While treating the branding status of an international hotel as a governance decision, this dissertation empirically predicts the branding status of an international hotel and the performance implications of hotel branding, using a sample of international hotels in China. In doing so, it makes empirical contributions to the literature in organizational economics (i.e., internalization theory and agency theory) and branding.

This dissertation contributes to empirical studies in internalization theory by focusing on the assignment of branding rights in the service sector. Most conventional internalization studies have been conducted on samples drawn from the manufacturing sector to investigate the market-vs.-integration paradigm (Agarwal & Ramaswami, 1992; Gatignon & Anderson, 1988; Kogut & Singh, 1988). In contrast, this dissertation draws on a sample of international hotels to predict the branding status of the focal hotel. Unlike the manufacturing sector, the service sector involves higher levels of professional skills, specialized know-how, and customization (Brouthers & Brouthers, 2003; Erramilli & Rao, 1993; Larsson & Bowen, 1989). These characteristics make it more difficult for service firms to transfer their advantages across borders, compared to their manufacturing counterparts. Since the international hotel industry represents one of the most rapidly growing sectors in recent years, the use of a service sample in this dissertation represents an important empirical contribution to internalization theory research, which has traditionally focused on manufacturer samples.

This dissertation makes further empirical contributions to internalization theory by looking beyond the market (contractual mode)-vs.-integration (equity mode) dichotomy to identify the optimal contractual mode of organizing inter-firm cooperation. Traditional studies in internalization theory have focused mostly on the choice between contractual restraints vs. hierarchical directives to support international cooperation (Anderson, 1988; Anderson & Gatignon, 1986; Shane, 1996). In the international hotel industry, the distinction between contractual mode and equity mode lies in the assignment of hardware ownership rights to local developers or foreign managers. Foreign managers often face substantial barriers that prevent them from acquiring real properties to build their own hotels. In cases where the ownership rights to hotel hardware are controlled by local developers, the key issue to foreign managers is no longer the assignment of ownership rights. What is important instead is the assignment of branding rights, where franchising is not the only contractual mode available to organize the foreign manager's cooperation with local developers. In my dissertation, I empirically predict when a foreign manager should allow a local developer to co-brand the focal hotel in China. The choice of manager branding vs. manager/developer co-branding corresponds to two distinct contractual formats used to structure an international hotel. As such, my empirical findings contribute to the literature on internalization theory by taking the variations in contractual formats into account—an issue that is critical in those industrial sectors where local governments restrict inward direct investment.

This dissertation also makes empirical contributions to the agency literature. Most empirical studies based on the agency theory were designed to identify factors that affect agency costs between two domestic firms (Anderson, 1985; Gallini & Lutz, 1992; Krueger, 1991). Unlike this traditional approach, my dissertation focuses on the cooperation between a foreign manager and a local developer in the Chinese hotel industry. In this cross-border context, the principal-agent relationship becomes more complicated because it is more difficult for an integrated firm to control shirking among salaried employees that have been deployed to run an overseas operation. These monitoring difficulties further explain why some firms avoid expanding into foreign markets through the integration mode that they prefer to use at home. My study of international hotels in China contributes to the agency literature by identifying more factors that can also alter the agency costs of regulating inter-firm relationship across boarders (e.g., manager entry sequence into the host market, the number of visitors from the manager's home country, etc.).

Another empirical contribution of this dissertation to the agency view is the confirmation of branding agency. Many empirical tests of the agency theory have been conducted to predict the choice of franchising vs. integration that corresponds to the assignment of ownership rights to a franchisee vs. an integrated firm (Bergen, Dutta, & Walker, 1992; Contractor & Kundu, 1998a). In cases where the ownership rights to an international hotel remain constant, my study predicts the assignment of branding rights *exclusively* to the foreign manager or *jointly* to the manager-developer dyad. By presenting an empirical comparison of these two branding options, this dissertation contributes to the agency theory by confirming the persistence of branding agency as an issue in franchising, even when hotel ownership rights have been assigned to local developers.

This dissertation empirically confirms the governance function of branding. As noted previously, most prior studies have addressed franchising as a mechanism whereby unknown entrepreneurs borrow reputation from well-known franchisors (Roberts & Dowling, 2002; Wernerfelt, 1988). If the branding system simply serves to attract customer patronage in the hotel industry, the choice of manager branding vs. manager/developer co-branding can be solely determined by the relative brand power of the manager and the developer in reducing quality uncertainty or enhancing symbolic appeal for travelers. However, the empirical findings in my dissertation show that a foreign manager may also allow a local developer to co-brand a hotel, not only because the developer has a stronger brand, but also because the developer can contribute more to the reputation of the hotel brand and/or is better able to monitor the actions of the manager. These findings have confirmed the institutional function of branding in facilitating *business-to-business* transactions, an important empirical contribution to the branding literature, which has traditionally focused on the power of branding in promoting *business-to-consumer* transactions.

Overall, the conceptual framework and empirical findings presented in this dissertation contribute to organizational economics by verifying the institutional role of branding in facilitating inter-firm cooperation across all business sectors. In many cases, two or more specialist companies work together to deliver a product or service to consumers. In the international hotel industry, as shown in this dissertation, the right to brand the software-hardware bundle of a hotel can be assigned to the manager only, to the developer only, or to both parties jointly. As a guideline, hotel branding rights should be assigned optimally to save on the agency costs of organizing manager-developer cooperation. This rule can be extended to all types of inter-firm cooperation, where the right to brand the joint output of two or more specialist companies should be allocated in a way that best aligns their incentives to save on the costs of governing their cooperation. Thus, the allocation of branding rights is not a zero-sum game, in which the parties involved compete for the right to claim reputation residuals from consumers based on their relative brand power. Instead, it can create a win-win outcome, in which the parties involved optimize the branding status of their joint output and split the savings on the costs of addressing the issue of branding agency.

6.3 Managerial Implications

The branding agency view I present in this dissertation encourages business practitioners to approach the allocation of branding rights as a governance tool to facilitate inter-firm cooperation. This branding agency view is particularly useful in the global business setting, where managers have traditionally focused on entry mode choices based on the allocation of ownership rights, without considering the allocation of branding rights. In cases where branding rights allocation has been an issue, managers have tended to rely on brand power to settle it. As an alternative, the branding agency view presented and tested in this dissertation provides new and useful guidelines to help organize inter-firm cooperation across borders in several ways.

First, when two specialist firms work together to serve consumers, they can each appeal to their common customers by co-branding their joint output. Hence, manager/developer co-branding should be seen as the default option to structure inter-firm cooperation. This is particularly true in the absence of reputation interaction, where consumers can correctly distinguish the reputation of one firm from that of the other and reward them separately for their respective reputation contributions. In such cases, consumer sanctions alone are strong enough to regulate the actions of the two specialist firms. As a matter of fact, co-branding can be widely seen in the consumer market as a way to support the cooperation between two unaffiliated companies (e.g., Citi+Visa credit cards, Dell+ Intel-Inside Dell desktops, Teflon+All-Clad non-stick pans, and so on).

Second, when two firms work together to provide a product to consumers, they should not rely entirely on their relative brand power as the only factor relevant to branding status. Instead, they must consider their relative capacities to contribute to the reputation of the product brand. The party that already owns a reputable brand is NOT always the party that can contribute more to the product brand. In such cases, the allocation of branding rights based solely on brand power might encourage shirking by the party who is forced to remain anonymous in the marketplace but can contribute more to the reputation of the product brand. As long as branding rights are allocated optimally, the brander will maximize its efforts to build and protect the reputation of the product, even if it does not own a reputable brand from the outset.

Third, the parties of an inter-firm cooperation must also consider their relative abilities to monitor each other when determining the branding status of the final product. When the joint output of two specialist firms bears only one name, the brander claims its reputation residuals by paying a fee to buy out the reputation contributions of the non-brander. As such, the brander will be held responsible by consumers not only for its own actions but also for the actions of the non-brander that can alter the value of the final product. Thus, the relative abilities of the parties to control each other's shirking is another critical factor to consider when allocating branding rights in inter-firm cooperation.

Fourth, branding is traditionally a tactical decision made at the operational level to boost the competitiveness of the branded products or services. In this dissertation, I have shown that branding is also a strategic decision that can be made at the corporate level to promote inter-firm cooperation. Misallocation of branding rights between the parties of an inter-firm cooperation may prove to be a strategic error that dooms the long-term success of their joint output. When Apple introduced its first personal computer (PC), it farmed out the central processing unit (CPU) to Motorola but chose to keep Motorola anonymous in the market. In contrast, IBM allowed Intel to put the Intel Inside logo on its PCs. The difference in branding strategies shaped the incentives of Motorola vs. Intel to invest in CPU development, which might explain the fall of Apple PCs (or the rise of IBM PCs). In this sense, the allocation of branding rights represents a strategic decision that should be reserved for the top management teams of the parties of inter-firm cooperation.

6.4 Limitations and Future Research

In this dissertation, I investigate the governance role of branding in promoting inter-firm cooperation in the international hotel industry. To my best knowledge, this is the first study that takes an agency approach to examine the branding status of an international hotel. Like any novel theory or pioneering study, this dissertation does not address all of the issues related to the agency view on international hotel branding. Below, I list the limitations of this study and highlight several promising directions for future research.

First, in this dissertation, I propose and verify that two hotel specialists allocate the rights to brand an international hotel in a manner that economizes on the costs of solving the issue of branding agency. This agency view is built on the assumption that the parties that work together to establish an international hotel are both rational profit-maximizers. In fact, there are other factors that are non-economic in nature but can still affect the branding status of an international hotel (e.g., government policies, particularly in the context of China). This dissertation does not cover such non-economic factors. Future researchers can address these factors—for example, by compiling a multi-nation sample to investigate how government policies affect the branding status of an international hotel.

Second, in the empirical tests I conducted, I address the choice of manager branding vs. manager/developer co-branding. Due to data unavailability in China, I did not address two other branding options for international hotels—developer branding and integrated branding. This gap can be addressed through future research based on samples collected from countries that impose fewer restrictions on foreign ownership of international hotels under integrated branding. Future scholars can also conduct fieldwork to identify contractually managed hotels (the cases of developer branding). By building on the research findings presented in this dissertation to include developer branding and integrated branding, future studies can produce a full-scale test for the agency view on international hotel branding.

Third, the findings of my empirical tests are drawn from secondary data that proxy for the costs of solving the problem of branding agency. Although the use of secondary data is common in empirical studies of international business, there always exists a gap between the variable used in the test and the construct developed in the theory. To further verify the explanatory power of the agency view in my dissertation, future researchers can collect primary data from international hotels to directly measure the costs that the parties involved must incur to address the problem of branding agency. In doing so, they can eradicate—or at least narrow—the variable-construct gap that potentially exists in this study.

Fourth, my dissertation is built on a two-party setup that includes only the manager and the developer of an international hotel in China. As mentioned earlier in this chapter, the delivery of a product or service may involve the joint efforts of two or more specialist firms. The two-party setup in my study can be extended to predict the allocation of branding rights in cases where three or more parties are involved. For instance, many hotels allow unaffiliated firms to operate a coffee shop or restaurant near the lobby area. The branding status of those shops and restaurants can be predicted using the agency view presented in this dissertation. At one extreme is triple-branding, where the software systems, hardware facilities, and coffee shops or restaurants of a hotel carry three distinct brands of their respective operators. At the other extreme is single branding, where all three components carry a single name. In this case, the two-dimensional space presented in Chapter 3 must be expanded into a three-dimensional space that captures the relative costs incurred by three specialist firms to address the issue of branding agency.

Lastly, my dissertation draws on a sample of international hotels in China. Future studies can expand this scope of inquiry in several directions. For instance, the empirical setting can be expanded to cover a multi-country sample to investigate, for example, the impacts of nation-level factors on international hotel branding. Empirical tests of the branding agency view can also be conducted on samples drawn from outside of the hotel sector. In fact, the core arguments presented in this dissertation holds in all industries where two or more specialist firms work together to serve consumers. In others words, the right to brand the joint output of all parties involved can be allocated in an optimal manner to promote inter-firm cooperation. To be more exact, future research can draw on this dissertation to build a general framework about the institutional function of branding in all nations and all industries. In this general model, the right to brand the joint output of multiple specialist firms should be assigned to the party that contributes most to the reputation of the final product and is best able to control shirking by the cooperative partner(s).

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