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The Business of Beds: An Exploration of Hotel and Hostel Business Strategy

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The Business of Beds: An Exploration of Hotel and Hostel Business Strategy

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Abstract

At their cores, hotels and hostels are similar in that they provide a place for travelers to stay. Despite this core similarity, the structures of the two industries are radically different. The hotel industry began in the Middle Ages and has given rise to massive multinational companies, many managing more than four thousand hotels. In stark contrast, the hostel industry began in 1909 and is mostly comprised of independently owned and operated guesthouses, with the largest global chain comprising of less than twenty properties. This study first defines the hotel and hostel industries and examines the different experiences they offer and customers they serve. It next explores, compares, and contrasts the business strategies of the hotel and hostel industries. Specifically it addresses the contrast in corporate governance structures, resulting from fundamental differences in transactional efficiencies, in an effort to discover how these two industries can be so similar and yet so different.

“Hey mister, can you tell me where a man might find a bed?”

Imagine a simple, familiar situation: A weary traveler finds himself in a new town, in need of a place to sleep. What should he do? Most likely, the traveler will find himself a hotel room to suit his style and budget. However, there is a small chance he might assess other lodging options.

There are many alternatives to hotels, including hostels, a peculiar form of accommodation that exists in every corner of the world but is still very little understood. Hotels and hostels are similar in that they are both sectors of the lodging industry, which simply provide customers with a temporary place to stay in exchange for a nominal fee. Although at their core they meet the same basic need, at this point they diverge, splitting into two industries that offer very different experiences for very different customers.

Despite the similarity in their core offerings, firms in the hotel industry and firms the hostel industry are structured very differently. They choose different governance structures, such as franchising and vertical integration, to organize their businesses. The hotel industry is worth \$509 billion worldwide and includes 388 thousand hotels and motels (Marketline 2), while the hostel industry is estimated to be worth \$5 billion globally (Edwards) and is estimated to include four to five thousand properties (Martin), but both industries mainly offer customers a bed.

One would expect that the hostel industry landscape would look identical to the hotel industry landscape, except in miniature, however this is far from the case. In addition to the countless independent hotels around the world, there are numerous vertically integrated hotel firms that have consolidated their hotels into globally recognized, multibillion-dollar brands. There are very few vertically integrated hostel firms operating multiple hostels, with the largest chains

topping out at less than twenty properties (Mintel 23). Also, the hostel industry lacks a single firm utilizing a franchise model. Given the core similarities between the two industries, this difference in business strategy may come as a surprise. In order to understand the different business strategies and governance structures utilized by these two similar industries, we must realize that although each of the ten rooms in the Casa de Hilton Hostel might have beds, that is probably the only component they have in common with the 3,386 rooms in the Hilton Hawaiian Village.

The hostel industry, like its clients, is still young and only beginning to mature. Whereas the concept of a hotel goes back to the inns of the Middle Ages (Levy-Bonvin), a German schoolteacher by the name of Richard Schirrmann opened the first permanent Jugendherberge, or “youth hostel” in a castle in 1912 (Stephen). Although the hostel industry is a tiny fraction of the lodging industry, this niche offering is growing in importance and garnering the attention of big hotel companies. Accor, a multinational hotel company with 3,700 locations across ninety countries, acquired its first hostel in 2002 in order to establish foothold in the industry (Izon). Twelve years later, they now own thirteen hostels across Australia and New Zealand. Michael Issenberg, managing director in Australia and New Zealand for Accor, explained the company’s interest: “The political and economic events of the past few years have highlighted that the backpacker sector is highly resilient and is set to grow even faster in the next few years as more ‘traditional’ travelers are attracted by the backpacker style of travel.”



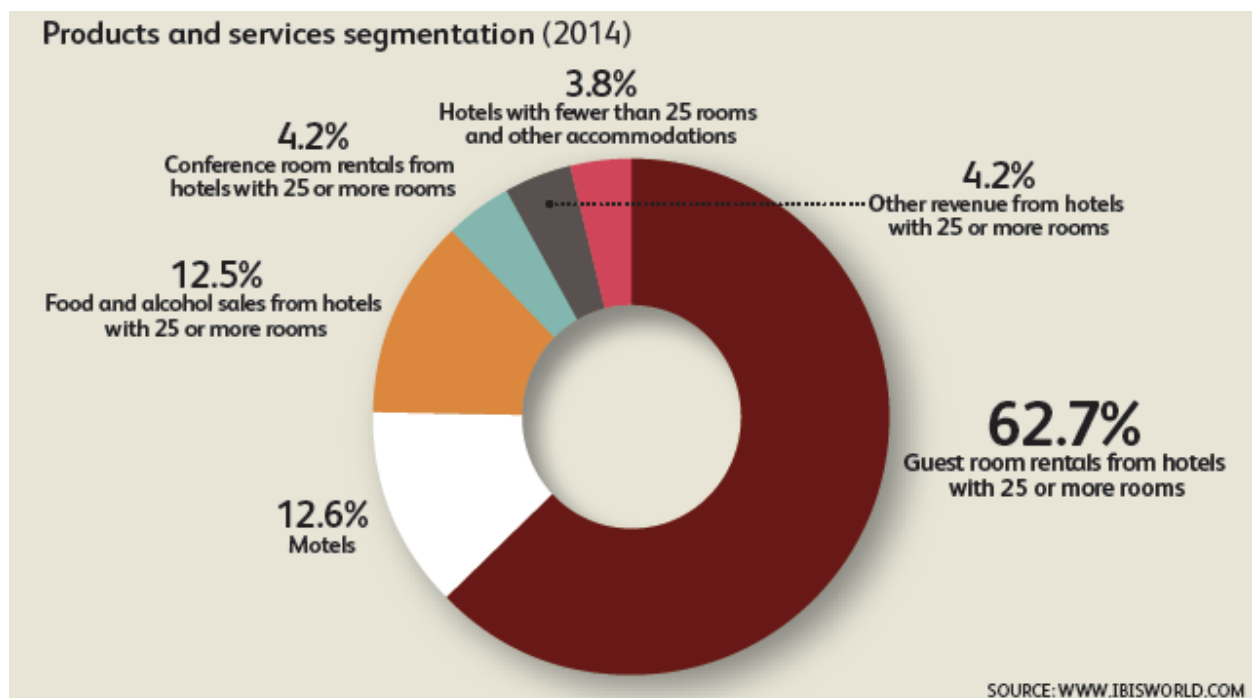
The original Jugendherberge at Altena Castle, where a hostel still exists

Given the relative newness of the hostel concept, there is little research surrounding the industry, especially in comparison with the mature body of research conducted on the hotel industry.

Although it represents only a small fraction of lodging industry, the hostel industry is growing in importance and merits further study. This paper will examine the differences between the hotel industry and the hostel industry. It will explore not only what makes the industries different, but also why they are different. What makes the hotel guest experience so different from the hostel guest experience when both groups of customers just need a place to spend the night? After understanding the different experiences that hostels and hotels offer, we will explore why these differences lead hotel and hostel firms to adopt very different governance structures. Finally, we will use this comprehensive review to make business strategy recommendations for aspiring hostels. As the market for hostels expands (Mintel 8), how can growing hostel firms look to the mature hotel industry for keys to success? Before we can explore any business strategies, we must first understand the hotel industry and the hostel industry, including how they work and whom they serve.

Hotels defined

Although our readers, whether they travel for business or leisure, likely have some familiarity with the experience of staying in a hotel, we must first define what a hotel is. The most general description of a hotel is a business that rents lodging on a temporary basis. Beyond this overly simple definition, hotels begin to vary. The word “hotel” may have a drastically different meaning depending on where in the world it is located; from Japan’s capsule hotels, where guests can rent a bed in a small, fiberglass capsule for ¥2000 (\$19.34) a night, to the President Wilson Hotel in Geneva, Switzerland where the 12-bedroom Royal Suite fetches £52000 (\$86,964) per night. It is to the chagrin of many a traveler that there is no global standard for the term “hotel,” but in the United States, most hotels generally contain twenty five or more rooms for rent, at a nightly rate, which each have their own bathrooms (Dallen 135).



Products and services segmentation in the US Hotel Industry (2014)

It is also customary for hotels to be given a star rating, from one to five, with more stars representing a more luxurious hotel, however, the star system is also not systematically controlled around the world. Generally hotels are considered by guests to be more luxurious if they offer higher quality (room size and decor, bed size and comfort, hotel staff and cleanliness) or more amenities. Hotels try to differentiate themselves by offering guests extra features such as swimming pools, business centers, gyms, or valet parking. Hotel extras can not only increase guest favor, but also be an important source of revenue for the larger hotels. In the United States, 20.9% of revenue in the hotel and motel industry comes from extras like conference room rentals or food and beverage sales (Brennan 14).

Dallen defines seven different types of hotels: resort, airport, conference, business, gaming, residential, and commercial (136). Resort hotels are prominently located in tourist destinations, with the emphasis being on leisure. Airport hotels are located at or adjacent to airports, with the emphasis being on convenience. They often provide shuttle services to and from the airport as an amenity. Conference hotels feature a variety of event spaces. The more notable conference hotels can facilitate conventions and other large events with thousands of attendees. Business hotels primarily focus on the needs of business travelers and provide the spaces and equipment (internet, copiers, fax machines) that they need. Gaming hotels prominently feature attached casinos. Residential hotels offer rooms at a weekly rate instead of nightly. They often feature kitchenettes and other domestic touches. Finally, a commercial hotel is a catch-all category for all other hotels. These categories, like the word “hotel” and star ratings, are not strictly defined, and most hotels fall into multiple categories, for example, the Gaylord National Resort and Convention Center. However, the categories suggest the focus of the hotel’s amenities and how

the hotel is choosing to differentiate itself. For example, it is not hard to find a hotel with a conference room to rent, but conference organizers can choose a resort hotel, making the conference more enjoyable, an airport hotel, making the conference more convenient, or a conference hotel, providing the most options for conference facilities and amenities.

Hotel guests and their buying criteria

Now that we have established what a hotel is, we must understand who stays in hotels and how they choose their hotels. Globally, the business-leisure traveler spending mix is 74.8% leisure travelers and 25.2% business travelers (Marketline, 2). Although more revenue stems from leisure travelers, on average business travelers spend more per night than leisure travelers (Brennan 16) and more frequently stay in full service hotels than limited service hotels (Tanford, Raab, and Kim 322). A research study including one thousand business and leisure travelers ranked the most important selection criteria that travelers use when choosing a hotel. The three most important criteria are location, price, and the quality of the room (Watkins 36). These three criteria constitute about 70 percent of the selection criteria. The other criteria, such as previous experiences, chain reputation, personal recommendations, loyalty programs, amenities, each have a small effect on the buying decision. There are, however, some variations between different groups of travelers.

Airport shuttle service is voted the most important amenity for business travelers, whereas leisure travelers care most about having a swimming pool. Most business travelers prefer mid-range hotels (41 percent) whereas most leisure travelers prefer economy hotels (47 percent). Both groups become more price sensitive as they move from economy to midrange to upscale. In

terms of food, business travelers want a hotel with a restaurant. Leisure travelers prefer a hotel with free breakfast (Watkins 38). As these consumer behavior insights suggest, a hotel cannot be everything to everyone. This is another reason why hotels position themselves in a certain category, so that they may portray themselves as the top choice for a certain kind of hotel guest.

Hostels defined

Now that we have established what the hotel industry is and who stays in a hotel, we will progress to the hostel industry. Hostels are a form of short-term, budget accommodation where backpackers and other travelers may rent a bed (usually bunk style) in a room with other guests. The number of other guests may vary from 2 to 29 in the same room. Besides the bedroom, all other facilities are also shared amongst the guests, including the bathroom, common room, and oftentimes a kitchen. Amenities are sparse and often include shared computer terminals, Wi-Fi access, a book exchange, and lockers. Popular hostel add-ons include a swimming pool, an adjoining bar/restaurant, bicycle rentals, and tour operator desks. Similar to the hotel industry, there are a number of categories that hostels use to differentiate themselves. Examples include party hostels, which feature attached bars/restaurants, and eco-hostels that pride themselves on being environmentally friendly. The star rating system is generally not applied to hostels given that they generally all offer the same, basic level of accommodation. What types of people choose to stay in this simple, economical type of lodging?

Hostel guests: the backpackers

Most people that visit hostels are backpackers. There are no set criteria for determining who is a backpacker, but there are many trends. Backpackers are typically 18 to 30 years old, although they can range from 15 to 60 years old (Dallen 214). They come from all over the world (A survey of one hostel in Portugal identified twenty five nationalities amongst the guests).

Backpackers prefer budget accommodations and care about luxuries far less than mainstream travelers. They value flexible and independent travel plans and enjoy informal and participatory recreational activities. In 1995 Laurie Murphy, a researcher at James Cook University, conducted fifty nine in-depth interviews with backpackers across seventeen different Australian hostels. Her interviews uncovered the cognitive structures and concepts most often associated with backpacking. It included the ability to put up with some things, people, and habits; to be able to relax; to learn to do things more cheaply, watch how you spend your money; and to be less conscious of time (Murphy 60). These attitudes coincide with common backpacker traits including traveling internationally for an extended period of time, often on a tight budget, willing to suffer various hardships and act resourcefully in order to make their world journey possible. Backpackers are interested in personal growth and discovery, considering most are at a transitional point in life, in between high school and college, or college and their careers. They travel to experience other cultures, meet new people, and improve their global perspective. Many backpackers spend more money than other tourists because they travel for longer periods of time to more destinations.



A group of backpackers share a meal in a Beijing hostel. Many hostels have communal kitchens that guests may use.

How and why do backpackers choose to stay at a hostel? The two main reasons why backpackers choose to stay in hostels instead of hotels are to save money and to meet other travelers, although the central reason backpackers choose to stay in hostels is cost (Murphy 55). Although hostel prices vary depending on their location, from \$45 per night in Switzerland to \$2.50 in Cambodia (prices found on Hostels.com in March 2014), they are almost always the cheapest form of accommodation in town. When choosing amongst hostels, the top five buying criteria for backpackers were cleanliness, location, personal service, security, and hostel services (Oliveira-Brochado & Gameiro 96). Besides price, many hostel guests also cite the opportunity to meet other travelers as a motivation to stay in youth hostels. Given the communal nature, hostels are much better than hotels at facilitating social interaction with new people. Oliveira-Brochado and Gameiro suggest, “Staying in a hostel is an experience rather than an accommodation” (98).

Governance structures in the lodging industries

Now that we have reviewed the traits of hotels and hostels and their clientele, we can begin to consider why the hotel and hostel industries are shaped so differently. One of the most important

business strategy decisions that firms make is the choice of governance structure. How will the firm be organized? Research illustrates that there is a wide disparity in the choice of governance structures between the hotel industry and the hostel industry. Before we can assess why hoteliers and hostel owners choose different governance structures for their firms, we must first understand the different structures used in the lodging industry. Let us consider each form of governance structure in the lodging industry and then review the merits and demerits of each.

Hotel industry governance structures

There are four main types of governance structures available to firms in the hotel industry. The simplest governance structure represents independent hotels. These are hotels that are independently owned and operated. The proprietors are responsible for providing or finding investments for the business, controlling all business operations, and reaping all the hotel's profits.

The second form of governance structure includes hotels that are members of a voluntary chain. The hotels are independently owned and operated but included in a loose alliance of member hotels. The most popular example of such an alliance is Best Western International Incorporated, which is a marketing cooperative. This alliance is responsible for maintaining the chain's brand, its policies, and quality standards. They also control a reservation system for the chain, and in some cases it may control procurement (Best Western). The individual hoteliers make their own investments and claim the hotel's profits, but they also pay for services that the chain provides to the individual hotel. This gives hotels the autonomy of an independent hotel, with the benefits of consumer recognition and lower costs.

The third form of governance structure in the hotel industry is a franchise chain. Franchised hotels are also independently owned, but operate in a more comprehensive alliance with the chain. The franchise model involves investments from both the franchiser and the franchisee, and consequently the franchisee claims the hotel's revenues after the franchise fees and royalties are paid. The hotelier has control over some staffing and property decisions, but most franchisee operations are strictly regulated by the franchise. Franchises offer hotels that are defined by the chain's policies and brand. Currently the largest example of a franchise chain is Holiday Inn Express, with 424,612 rooms worldwide (MKG Hospitality).

The final and most complex hotel or hostel governance structure represents vertically integrated hotel chains. In this form of governance, properties are not independently owned. Rather, the hotels are owned and operated by the national or international firm. The firm is responsible for all of the hotel's investments and its revenues. The chain controls everything, offering the experience that the brand has defined (Dahlstrom et al. 843). More than half of Hilton's profits come from the small number of these company owned hotels such as the Waldorf Astoria and the Hilton Hawaiian Village (Story).

Hostel industry governance structures

On average, the hostel industry has far less complexity in its governance structures than the hotel industry. Most hostels are independently owned and operated. There are, however, many popular voluntary chains in the hostel industry. An example of such an alliance is Hostelling International, which represents four thousand hostels worldwide (Hostelling International). Currently, there are no chains of franchised hostels in existence. There are only a handful of

vertically integrated hostel chains, located in Europe and Oceania. The largest firm in Europe, A&O Hotels and Hostels, which started in only 2000, currently manages sixteen hostels (Mintel 16).

Using hotel attributes to predict governance structure

Now that we understand the different formats that hotels and hostels use to organize their firms we can consider the many strategic advantages and disadvantages associated with each form of governance structure. These pros and cons will help illustrate why the hotel and hostel industries have favored certain governance structures. Research shows that the size of a hotel and its local market, as well as the number of amenities it offers, helps determine which form of governance is most advantageous (Dahlstrom et al. 845).

In terms of size, the larger the hotel is, the more likely it is to be a corporately owned hotel or a franchise. Independent hotels are responsible for the entirety of the investment, making large sizes untenable for most single-location firms. Brand recognition, reservation systems, and expensive marketing campaigns help bring in more guests, which is crucial if hoteliers have more beds to fill. Corporately owned hotels are also more stringently regulated, helping hoteliers to better protect the large investment of a sizeable hotel. As the number of rooms increases, the number of independent hotels decreases and the number of vertically integrated hotels increases.

The size of the local market also impacts corporate governance. Densely populated areas command higher real estate prices. Besides requiring a larger investment, which limits independent ownership, this adds pressure for hotels to be more profitable per square foot. Urban

hotels reap more economies of scale, especially when the firm integrates multiple hotels in the same city. This decreases operating costs, including the monitoring costs incurred by hotel franchisors and corporations.



The Hilton Hawaiian Village boasts five pools (including a 10,000 square-foot Super Pool and the longest waterslide in Waikiki), twenty two acres of gardens, twenty restaurants and bars, a 24-hour Business Services Center and its own US Post Office. Such amenities require capital outlays and operational expertise that only vertically integrated firms are able to provide.

The number of amenities that the hotel offers is the third predictor of governance structure.

Besides adding to the cost of building and operating the hotel, extra hotel amenities, such as swimming pools and athletic courts, require specialized expertise in order to operate them effectively so that they improve their guests' stays. Thus extra amenities encourage hoteliers to consolidate into a chain in order to develop and share that expertise. Whether a small sauna or a

massive ski gondola, from the resource-based view of the firm, it will be easier if the chain develops expertise that it can deploy in all locations, versus independent hotels that must each learn how to operate amenities effectively.

Dalhstrom et al's research on how hotel size, local market size, and number of amenities predict governance structure in the hotel industry is likely to hold true for the hostel industry. Most hostels are small and offer few amenities, thus explaining why most are independently owned and operated. Correspondingly, the few hostels that are a part of chains usually have over one hundred beds, are mostly located in European metropolitan areas, and most feature many amenities (Mintel 23-31).

Do transaction cost economics predict governance structure?

Besides hotel size, market size, and number of featured amenities, what other factors explain the difference in prevalent governance structures between the hotel and hostel industries? The factors supporting each governance structure go beyond internal operations. Different governance structures impose different costs on potential guests, thus affecting the customer's choice of lodging. Hotel and hostel firms are aware of these costs, and thus they consider them when deciding how to govern their organizations.

The economist Oliver Williamson wrote about transaction cost economics (TCE), which are those costs incurred in making an exchange and are considered a major factor in business transactions (Coase, 1937; Williamson, 1981, 1985). These costs, although not always measured in dollars and cents, can be significant. For example, if a baker makes apple pies every day, she

can either go out to a local market looking for a fruit vendor selling satisfactory apples every morning, or she may contract with an apple merchant to provide quality apples regularly, thereby reducing her transaction costs. These transaction costs are a major reason why firms exist, as opposed to buyers and sellers simply conducting all of their business transactions in the open market. Hotel and hostel guests are also affected by transaction costs and three factors of transaction cost economics are at play in the traveler's decision-making process when choosing a place to stay.

Transaction cost economics as applied to choosing lodging

The first factor is uncertainty, specifically behavioral uncertainty. Behavioral uncertainty is defined as the inability of economic actors to foresee the intentions and actions of potential counterparties in the contracting process (Kim & Li 3). Because a hotel or hostel provides the intangible service of a place to stay, there is far greater uncertainty in this transaction than there is when contracting to buy a tangible good. Travelers frequently go to great lengths to mitigate that uncertainty before making a reservation, hence why most hotels and hostels have detailed, comprehensive websites, allowing potential guests to imagine their experience at a hotel or hostel before they have even made their booking. Information asymmetries and opportunism also make uncertainty problematic for potential guests. The seller (the hotel or hostel) has far more information about the service provided than the potential guest does. As previously mentioned, hotel star ratings are an effort to balance this information asymmetry. This information asymmetry is coupled with opportunism, which suggests that economic actors in a transaction relationship might seek their self-interest, creating a serious risk for the hotel or hostel guest. It is very common for hotels and hostels to paint an idealistic picture in their marketing materials,

using professional photography to woo potential customers. The information asymmetry which is inevitable in the lodging buying decision, coupled with sellers' penchant for opportunism is what has given rise to popular websites like Trip Advisor, which enables other buyers (former guests) to write reviews after their stays. Buyers are far more likely to trust the reviews of former guests than hotel websites, given there is no reason for reviewers to exploit the vulnerability of potential customers.

The second element of transaction cost economics that is a factor in the decision to book a hotel or hostel is the frequency of recurring transactions. In transaction cost economics frequency is important because each new agreement between a buyer and a seller in the market requires gathering information, evaluating options, and negotiating. The more frequently a buyer must make a transaction, the more time and money is spent on these transaction costs. How does this apply to the traveler's decision of choosing a place to stay? Each time a traveler needs to find lodging he or she must go through the process of searching for potential hotels or hostels, then evaluating the advantages and disadvantages of each place, and also searching for the best possible price. The more frequently a person stays at a hotel or hostel, the greater his or her transaction costs are.

The third element of transaction cost economics that effects the decision to book a hotel or hostel is asset specificity. Specific assets serve a particular purpose, and thus consumers incur a cost when only certain vendors provide the appropriate goods and services in the open market. There is less market competition mitigating sellers' opportunism when only a select group of sellers have the specific asset a buyer requires. Asset specificity affects the lodging booking decision in

two ways. First, all travelers have their own specific needs, wants, and budget. Thus, lodging is not a commodity. If a family requires a two-bedroom suite with room service and a water slide, their list of options is quickly narrowed. If a backpacker wants a hostel that has a restaurant on-site, this also reduces potential options. Thus, travelers incur costs associated with the specificity of the asset that they are procuring; a place to stay.

Evidently, transaction cost economics affects how travelers choose their lodging. The uncertainty of booking a room that one has never seen before, the frequency with which travelers book accommodations, and the specificity of the traveler's criteria incur different costs on hotel guests than they do hostel guests. Let us explore how the transaction cost economics of booking a place to stay affects these different groups travelers.

The effects of transaction cost economics on hotel guests

First, consider how transaction costs affect hotel guests. Hotel guests are broken into leisure travelers and business travelers, staying at full service or limited service hotels. Leisure travelers on vacation obviously wish to ensure that their time away from home and work is enjoyable. Business travelers want to ensure that their hotel enables them to be comfortable and productive while they are working away from home. Obviously, no hotel guest wishes to suffer the inconvenience of a disappointing hotel, or a room that does not live up to expectations. In fact, 24.9% of the buying criteria of leisure travelers and 24.7% of the buying criteria of business travelers are based on previous experiences with the hotel, the hotel's reputation, or the recommendation of others (Watkins 36). Evidently, hotel customers are very concerned about how their uncertainty of a hotel's quality could potentially impact their stay. Thus, they highly

value factors that reduce uncertainty and decrease the odds that their choice of accommodation leads to unpleasant surprises.

How does a hotel put potential guests' minds at ease so that they are not concerned about the risks of uncertainty? Having a well-known brand name that a franchisor or a vertically integrated company provides has the power to reduce the buyer's transaction costs and be very influential to the hotel guest. Brand recognition is considered one of the greatest barriers to entry for new hotel firms as they try to establish a reputation amongst the major hotel chains and thus being a part of a franchising chain is considered a key success factor for hotels (Brennan 20). This barrier to build a new brand can be almost insurmountable, thus many new independent hotel firms position themselves as boutique hotels, like the Washington School House Hotel, consisting of twelve rooms inside of a schoolhouse built in 1889. Boutique hotels target a niche segment, where a different experience is desired. In these segments, boutique hotels do not have to compete against Hilton or Marriott's billion-dollar name brands. The uncertainty surrounding an original, unknown name is a bad thing for a hotel unless it is part of creating a special experience for its guests.



Brand equity is vital in the hotel industry

Transaction costs based on frequency are also important to hotel guests, particularly hotel guests that are traveling for business. It is apparent that business travelers have even more incentive to gravitate towards big brand name hotels than leisure travelers because most leisure travelers do not travel nearly as much as the average business traveler. In a survey of 400 business travelers, the average was eleven domestic and seven international trips a year, with a cumulative thirty-six nights away from home (Jonas 8). There are many professionals who must perpetually travel for their job. These mobile professionals are often referred to as road warriors, given the amount of time they spend “on the road.” In a survey of 2,100 travelers, sixty-eight percent of business travelers regularly stay hotels that are a part of the same chain (Ferencsik 2006). Road warriors are constantly living out of their suitcases in hotels around the world, thus in order to reduce the transactional costs associated with the frequency of their traveling, business travelers will often give preference to the big brand hotels, the ones they know and love, which they can depend on regardless of what city they are located in.

Finally, asset specificity is also important to hotel guests. Leisure travelers may specifically desire a resort hotel. Business travelers might need the facilities provided by a conference hotel. Besides specific amenities, many hotel guests use credit cards or rewards programs that offer them special advantages when they book with particular hotels. For hotel guests, this transaction cost is more of an opportunity cost than a dollar cost, in that they may book a place to stay that is not associated with their reward-bearing cards, but then they must forgo the air miles, points, or bonus amenities that are associated with these programs. This is especially relevant for business travelers, many of who travel frequently enough that their benefits accrued can be quite substantial. In fact, it is common for business travelers to pay for their vacations using loyalty

points or air miles that they have accrued while traveling for business. Thus, it is no surprise that such rewards programs are three times more important to business travelers as they are to leisure travelers (Watkins 36).

The effects of transaction cost economics on hostel guests

Next, let us consider the impact of transaction costs on the average hostel guest: the backpacker. The difference for backpackers is not in whether they are affected by transaction cost economics, but the magnitude of these effects. In most cases, backpackers either experience fewer transaction costs, or they are more willing to tolerate transaction costs than their hotel guest counterparts.

Hostel guests suffer from uncertainty regarding their hostel that is similar to the uncertainty that hotel guests face. Backpackers experience the same information asymmetry when booking a hostel they have never seen before, and risk the same opportunism that hotel guests experience. However, backpackers are far more willing to tolerate transaction costs associated with uncertainty and accept hardships while traveling. In fact, Murphy's study on the social interactions of backpackers found that having a high level of tolerance was the most common theme amongst cognitive structures and concepts associated with backpacking (Particularly "ability to put up with things, people, and habits," ranked number one, and "to have fun, be easy going, don't get uptight," number three)(Murphy 60). Thus, a noisy hostel and a worn-out mattress are far less likely to have a meaningful impact on the backpacker than they would on the business traveler. Evidently the cost of uncertainty is less for hostel guests than it is for hotel guests.

Many hostel guests also face transaction costs associated with frequency, given that they travel for extended periods of time. Hostel guests often live out of their backpacks the way business travelers live out of their suitcases. The difference, however, is that hostel guests often travel nonstop for a fixed period of time, as opposed to those hotel guests that travel every so often, every single year. Considering that most backpacking odysseys occur during a semester abroad or a gap year that lasts between four and eight months (Sørensen 853), business travelers, who on average spend thirty-six nights away from home per year for business (Jonas 8), accrue more traveling experience during the first five years of their careers than backpackers do during their long-term journeys. Thus, although backpackers and business travelers both incur transaction costs based on the frequency of their travel, these costs take very different forms, and ultimately are accrued more by business travelers than backpackers.

Transaction costs related to asset specificity draw the most striking difference between hostel guests and hotel guests. Backpackers generally have fewer specifications. We see less variability amongst the offering of hostels. Sure, different hostel guests may assign different values to cleanliness or convenience of location, but they are typically far less discerning than hotel guests, who often require a certain type of room and certain required amenities.

How transaction cost economics affect governance structure

In summary, hotel guests are highly affected by transaction costs. Costs associated with the uncertainty of picking a hotel, the frequency with which they travel (especially for business), and their specific criteria when choosing a hotel weigh heavily on the hotel guest. Meanwhile, most hostel guests consider uncertainty to be less costly. They travel frequently for only a short burst

of time, and they have fewer specific criteria that a hostel must meet. Given that we now understand the difference in transaction costs, we can better understand why the governance structure breakdown for the hostel industry is very different from the breakdown for the hotel industry. Each governance structure offers a different set of advantages and disadvantages for both the firms and their customers. How then, do transaction cost economics affect governance structure?

First, let us examine the hotel industry. Although there are many independent hotels, there are also a handful of large corporations that dominate the industry. In fact, the three largest vertically integrated hotel firms, InterContinental Hotels Group, Marriott International, and the Hilton Hotels Corporation, control thirty-six percent of the US hotel market (Brennan 25). These three companies represent thirty-eight of the largest, most well known hotel brands in the world. Some are franchises while others are company owned, but what matters most to hotel guests is the trust placed in each hotel by virtue of the brand name. Big brands reduce the costs of uncertainty. This enables guests to lower their frequency costs by having a brand they can rely on around the world. It also reduces the asset specificity costs given that the hotels and their rooms are standardized across the brand. Thus, transaction cost economics affects how people choose hotels and why hoteliers choose vertical integration, franchising, and voluntary chains for their governance structures, in order to give consumers a brand they can trust.

Next, we consider how transaction costs determine hostel governance structures. The overwhelming majority of hostels are independently owned and operated. Backpackers are less fazed by uncertainty, they travel frequently for only a short burst of time, and their lodging needs

aren't very specific. Hence, there is less authority granted to a hostel brand name. Voluntary chains are popular in the hostel industry, especially the omnipresent Hostelling International. However, these chains function quite differently than hotel chains. Hotel chains like Best Western put their chain brand first, such that guests might not even realize the hotel is independently owned. Meanwhile, hostels put their own brand first, such that guests might not even recognize that the hostel is a member of a voluntary chain. This is likely because accreditation, like that from Hostelling International, may simply mean that the hostel conforms to a certain set of minimum requirements. It is not a testament to the type of person the hostel is meant for and the kind of experience it offers its guests. Evidently, transaction costs are very different for hostel guests, which leads to more fragmented governance structures in the hostel industry than the hotel industry.



Best Western hotels emphasize the chain's brand more than the hotel's brand

Summary of governance structure effects on hotels

Now that we understand why firms in the hotel and hostel industry choose certain governance structure, we review the effects of these governance forms. First, let's consider the effect on hotels. Independent hotels are smaller than vertically integrated hotels. They have a harder time raising capital. Consumers take a gamble when they check into a previously unheard-of hotel, unless the novelty is the selling point. Independent hotels face higher costs because they have

smaller buying power. They have little operational expertise and therefore tend to offer fewer amenities. Given that travel trends change frequently, independent hotels face demand that is subject to the current popularity of their location. They are also at the mercy of the economy given that recessions dampen discretionary travel.

Meanwhile, larger, vertically integrated hotel firms have the necessary capital to open new locations frequently. They offer predictable service and a dependable brand name. They reap large economies of scale by vertically integrating their operations across the firm and across their hotels and use their global presence to nurture their brand names. Their geographical diversity reduces their portfolio risk, and by offering different brands and different price points, they further insulate the firm from market fluctuations. Travelers value their brands and identify with them, traveling confidently because they know what level of quality awaits them when they check in, regardless of what city they find themselves in.

Summary of governance structure effects on hostels

Independent hostels vary in size, but they are rarely the largest of hostels. Each independent hostel has its own personality, and this uniqueness can be a selling point. Their guests do not know what to expect when they check in, but they are comfortable with the ambiguity; in fact, for many travelers the ambiguity is a desired component of the experience. Independent hostels are less affected by economic recessions than independent hotels. Mikael Hansson, CEO of Hostelling International stated, “The industry has navigated the financial crisis reasonably successfully. In spite of growing economic and competitive pressure, there is a number of key indicators, such as Revenue Per Available Bed and occupancy rates, which confirm the basic

health of the youth travel accommodation industry” (Mintel 10). A possible explanation for the industry’s ability to weather the economic storm is because the hostel industry is sometimes there to catch travelers who get priced out of hotels when travel budgets are cinched. Aaron Chaffee, Vice President of Development for Hostelling International points out that independent hostels are often owned by people who are passionate about hostelling culture and are less motivated by strong returns on investment than hoteliers. Finally, independent hostels offer few amenities and run simple operations, therefore, there are fewer areas of operation that can be optimized through the operational excellence that is developed in vertically integrated hostel firms.

As opposed to the unique personality of independent hostels, chain hostels have enlisted branding consultants to create unified images that are consistent across their many locations (Mintel 28). They leverage this brand equity to create backpacker loyalty, even offering proprietary mobile apps or computer terminals for backpackers to book a bed at a hostel in the same chain for later legs of their travels. Chain hostels are also reaping economies of scale by servicing more beds with fewer staff. Many chain hostels have bars, restaurants, or swimming pools, important amenities that attract backpackers but require specialty knowledge that can be utilized across the chain. For example, every St Christopher’s Inn has a Belushi’s backpacker bar attached, which offers daily activities and specials specifically targeted at backpacker interests and budgets (St. Christopher’s Inns).

Recommendations for Accor's Base Backpackers

Now that we understand how the governance structure of the firm affects the lodging it offers its guests, we apply this knowledge to make recommendations to the hostel industry. How can budding hostel firms apply these insights? Particularly we make our recommendations to Accor Hotels, a major hotel company based in France that has developed a presence in the hostel industry in Australia and New Zealand over the past decade. Their hostel brand is called Base Backpackers, and these four recommendations can help Accor make Base successful as it becomes a larger part of Accor's portfolio.



Accor is reaching out to different types of travelers with Base Backpackers than those that would normally stay at an Accor property. First, Accor should consider moving beyond the Australian and New Zealand markets and into the massive, competitive European hostel market. Through vertical integration, Accor can

achieve economies of scale in expensive, European cities. Consider St. Christopher's Inns, which owns seven hostels, all within the London metropolitan area. Everything from laundry services to toilet paper procurement can be accomplished more simply and inexpensively when the firm can share resources on such a large scale. If Accor were to acquire or build new hostels in another popular backpacking city, such as Berlin or Dublin, and harness such efficiencies, it would be able to reduce costs enough to cut prices. Given the relative expense of backpacking through these pricey European capitals, a price disparity between Accor's efficient hostels and independently owned hostels would make a material difference to backpackers and make for successful hostels.

Besides Europe, Asia is also a popular backpacking region and an excellent option for Accor's hostel expansions. India, Vietnam, Thailand, and Cambodia are very different destinations from England, Germany, and Ireland, and thus, they would necessitate a different approach. These lesser-developed countries create higher transaction costs based on uncertainty. Concerns such as whether the water is drinkable, whether the receptionist speaks English, or whether the neighborhood is safe at night are far more relevant to backpackers in Hanoi than backpackers in Hamburg. Given the low cost of living in this region, cost savings take less priority as well; the most expensive hostel in Delhi costs a fraction of the cheapest in Denmark. Thus, Accor should consider a franchise or voluntary chain structure for future Asian hostels. By unifying these hostels under a brand that backpackers can trust, Accor can mitigate the higher levels of uncertainty in this region and win backpackers' brand loyalty. A vertically integrated governance structure would likely be prohibitively expensive in Asia, given that Accor employees would demand European wages and customers would demand Asian prices. The cost of monitoring

these hostels through a franchisor-franchisee relationship would obviously lead to prices that would exceed independently owned competitors, but even frugal backpackers would likely be willing to spend some extra Dong, if it meant they could rest easy in their Accor-approved bunk beds.

As the hostel industry broadens its appeal and raises its prices, Accor should look for new places for hostels to grow. There are opportunities for hostels to spring up in new, specialized places where consumers do not expect them. Airport hostels could offer unparalleled convenience to the traveler with an uncomfortably long layover, or an early morning flight. A resort hostel on the beach would appeal to vacationers who need the luxury of a swim-up bar, but do not mind sleeping in a bunk bed if it cuts the price of their vacation in half. The hostel industry is losing its stereotypical image of stained mattresses, young vagabonds, and early curfews. Just as hotels offer guests the experience that the brand defines, Accor can employ new hostel brands and its marketing expertise to redefine exactly what a hostel can offer.

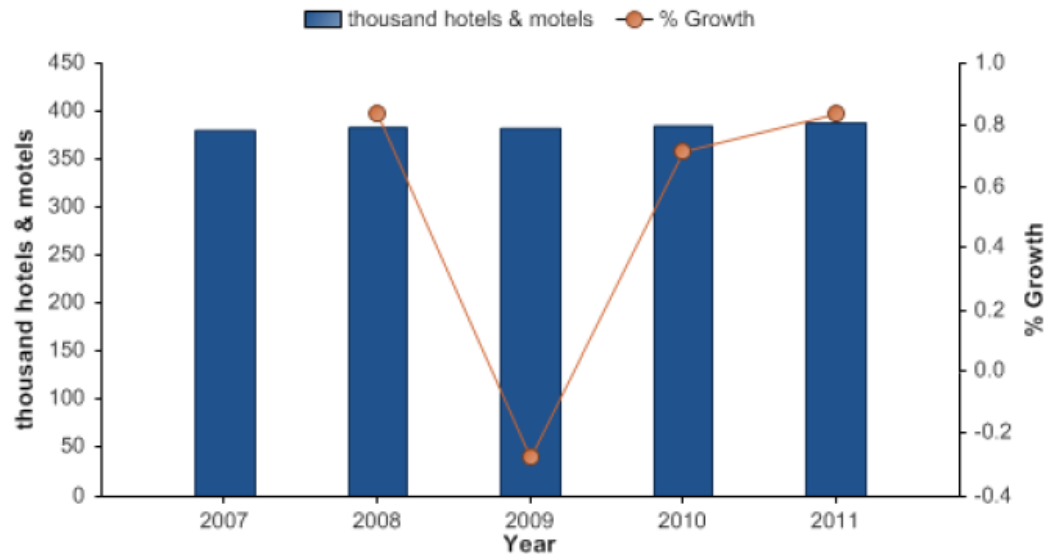
Besides determining where to grow, our findings also suggest how Accor can increase the appeal of its hostels. Mintel's 2013 research on hostels found that there are an increasing number of guests that are older, with higher spending power than typical backpackers (5). There are also an increasing number of hostel guests that are traveling for business. With these trends in mind, Accor should build future hostels with specialized amenities that can be marketed to guests with greater needs for asset specificity. Private guest rooms and facilities such as conference rooms and swimming pools would appeal to these older, better-heeled guests that are willing to pay a premium. Accor can transfer the organizational expertise related to these amenities from its hotel

divisions in order to offer these specialized extras more efficiently and effectively than independent competitors.

Discussion

The findings of this study answer a question that any casual traveler could pose: Why are hotels and hostels so radically different if they both, in essence, offer beds for rent? We approached the question from a business strategy perspective, and thus reviewed research about governance structures and transaction cost economics, and how they affect hotels and hostels. This strategic approach touched upon other important components of these industries: their customer bases' demographics, the history of the industries, etcetera. Let us reorder the lessons we have learned about hotels and hostels during our business strategy review in terms of cause and effect.

First, the concept of a hotel has existed since the Middle Ages and the basic idea of renting a room for a nightly fee appeals to most travelers across all demographics. Consequently, the hotel industry is large, diverse, and mature. Like in any industry, there are new trends brought about by cultural shifts or technological changes, but for the most part the industry remains consistent with little growth. Meanwhile, the concept of shared budget accommodations for young travelers started only in the early twentieth century. Its appeal, although widening, is limited mostly to young, adventurous travelers on a budget. There is rapid growth and change in the hostel industry, but it is still relatively small, and large hostel chains are only beginning to ascend to prominence. Thus, only this basic fact pattern is required to understand why in 2014 the hotel and hostel industries take such drastically different forms. A historical review shows why they are different. Our business strategy review illustrates how they are different.



SOURCE: MARKETLINE

MARKETLINE

The hotel industry is mature with very little growth globally

While conducting research on business strategy in the hostel industry, it became apparent how small the body of research on this industry is, especially in comparison to the amount of scholarly work that has concerned the hotel industry. What questions might further research on the hostel industry aspire to answer?

Large research firms such as Mintel, Marketline, or IBISWorld should work to create a more thorough profile of this global industry. As it stands, the amount that is known about the global hostel industry is minimal. There are only imprecise, unreliable estimates of the number of hostels globally. A hostel census, although difficult to compile, would be very helpful to researchers who need to know where the hostel industry is most concentrated (most likely Europe, however that may be biased because European nations keep the best records), and in what regions is the industry expanding most rapidly. It may also discover if there any places

where the hostel industry is contracting. Customer information of all varieties would also improve the body of research. Instead of the anecdotal evidence that researchers currently use, which is typically compiled from a small group of hostels, a larger sample set would be more informative. This data could include basic information taken from hostel reservation ledgers (Prices per bed, length of stays, demographics of guests) or information obtained by surveys (Is this your first hostel stay? How often do you stay in hostels? How did you choose this hostel? Rate your experience). Fortunately, researchers need not travel to every hostel in every corner in the world in order to obtain this information. Almost all of the world's hostel bookings are made through five hostel booking websites (Mintel 5). By working with the companies behind these sites, researchers could easily capture data on almost all the hostels in the world.

Another opportunity for research comes from our observation that the boundary between hotels and hostels is rapidly becoming unclear. Some hotels have converted private rooms to shared rooms in order to gain access to hostel associations and booking platforms, while at the same time hostels have converted shared rooms to private rooms in order to appeal to wealthier travelers (Dallen 220). Further studies should explore which contexts make such broad appeal advantageous and in which contexts such a wide grasp creates a diluted experience that does not appeal to any group of customers. Hostels generally appeal to a narrow audience of mostly young backpackers, which leads to another important marketing research question. Further studies should explore how hostels might widen their appeal in order to grow their potential customer base. Under what conditions would more families, business travelers, and other groups that almost always opt for hotels while traveling, consider staying in a hostel?

Amenities and alternate revenue streams would also be an important area for research. We discovered in this study that most hostels have minimal amenities and gain almost 100% of the revenue from their nightly room fees, whereas in the hotel industry amenities are an important attractor and the fees they generate (food and beverages, conference room reservations) make a substantial impact on hotel profitability. What amenities are most important for hostels? In what type of hostels do they have the largest impact? How can hostels use amenities to attract more customers and create alternate revenue streams? Popular hostel amenities such as swimming pools, in-house bars/restaurants, and equipment rentals should be assessed for their bottom-line impact.

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