VERTICAL INTEGRATION IN THE BRITISH SPANISH TOURISM INDUSTRY

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1. INTRODUCTION

The tourism industry in Spain is of paramount importance within both total Spanish service sector activity and the Spanish economy as a whole, constituting a major source of income, employment and foreign exchange. In 1986 almost 6.5 million British tourists went to Spain. Spain is the main destination for British package tourists, with about 70% of Britons travelling to Spain using a package holiday, Fitch (1987). The provision of package holidays to Spain involves some form of interaction between firms in Britain and Spain. However, the nature and extent of such connections has received little attention. This is surprising given the importance of the flow of tourists from Britain to Spain and the impact that different forms of interaction can have on the distribution of the revenues between the origin and destination countries, Sinclair and Sutcliffe (1988). This paper, therefore, studies one particular form of interaction between British and Spanish firms: the vertical integration involved in providing package holidays in Spain for tourists from Britain.

In order to study vertical integration, it may be helpful to have a brief description of the concept. Consider a final product such as petrol. It goes through a number of stages e.g. pumped to

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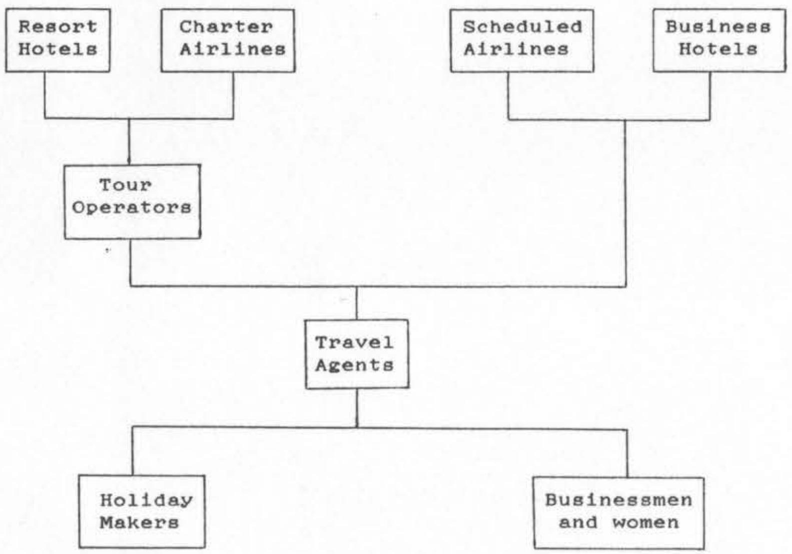
the surface, transported to a refinery, refined, transported to petrol stations and sold to the final consumers. Each of these stages can be undertaken by an independent company, with the output of the stage being sold in a market. In this case there is no vertical integration, given the definition of stages. However, if two firms in adjacent markets of such a sequence come under common control they are vertically integrated. The firm which is closer to the initial stage of the sequence is said to be 'upstream', while the firm closer to the final consumer is said to be 'downstream'.

Vertical integration can involve either open or closed internal markets. If the internal markets are open a vertically integrated firm may supply not only its linked downstream firm, but non-linked downstream firms as well, while the integrated downstream firm may be supplied by non-linked upstream firms. Closed internal markets means that the upstream linked firm supplies all of its output to its downstream partner, and that this constitutes the entire supply of this input required by the downstream firm.

2. STRUCTURE OF BRITISH-SPANISH TOURISM

A characterization of the structure of British-Spanish tourism is given in figure 1. British tourists travelling to Spain have been sub-divided into holiday makers (most of whom take package holidays) and businessmen and women. This leads to the disaggregation of hotels into resort and business, and airlines into charter and scheduled. While these sub-divisions are not watertight and the figure not exhaustive, it is felt to provide a useful broad picture of the industry. For example, although

Figure 1: The Structure of the British-Spanish Tourism Industry



Spanish resort hotels obviously supply rooms to individuals and non-British tour operators, in 1986 Britons accounted for more bednights in Spanish hotels than any other country; i.e. virtually 40%, Clark (1988). Similarly, although some of the package holidays sold by British tour operators are to countries other than Spain, Spain is the single most important destination for package holidays from Britain. Finally, while some packages from Britain to Spain use coaches, the vast majority of holidays use charter flights.

The services supplied by a charter airline or resort hotel and their usefulness to tourists are reasonably obvious, and will not be considered further. However, the services provided by tour operators and travel agents are less transparent. Tour operators perform a role which is close to that of the pure entrepreneur of economic theory, as described by Casson (1982). Their function is to bring together those who produce and sell the service consumed by the tourist, Sheldon (1986), Burkart (1975). They accept substantial risks since, if the package does not sell, it is they who usually stand to lose most. The activities of tour operators go beyond those of the pure entrepreneur since they usually receive bookings, advertise the tours, communicate with their customers etc. A pure entrepreneur would sub-contract even these tasks.

Travel agents provide a service to customers by reducing the costs of searching for information on holidays e.g. a local one-stop service, providing advice to the tourist and sometimes providing local accountability; Welburn (1987), Mak and Moncur (1980). There are considerable advantages to retailers, such as travel agents, in offering the customer the choice of a wide range of competing products. Even travel agencies owned by a tour operator continue to sell the packages of the leading tour operators, thus having open internal markets. Moreover, excluding Lunn Poly, only about half of the turnover of British travel agents comes from selling packages, Monopolies and Mergers Commission (1986, p.11). As their name implies, travel agents merely act as agents for tour operators and do not purchase holidays on their own account.

The nature of the vertical integration which exists in British Spanish tourism can be revealed by combining two data sets (a) who owns whom, and (b) the market shares of the firms in each of the various markets. While the following data are for the entire British market, the Spanish market is of paramount importance, and this is probably reflected in the activities of the major British charter airlines, tour operators and travel agents, (excluding their business travel sales), with the exception of the tour operator, Sunmed, which specialises in other countries. For example, about two thirds of the packages sold by Thomsons and Intasun in 1985 were to Spain, Fitch (1987).

(A) The Ownership Structure of the British Mass Foreign Tourism Industry

The pattern of ownership is constantly changing, and below is the situation believed to exist in April 1988. The precise details are less important than the broad structure, because it is on the latter that the subsequent analysis will be based. Because of data problems, the analysis concentrates on situations where one company is a subsidiary of another, and may exclude situations where, even though not part of the same group, one firm exercises effective control over another and/or has a long

term contractual relationship, Wright (1975). The major groups in this industry are :-

1. **British Airways plc** (Scheduled airline)
   - Alta Holidays Ltd (Tour operator Speedbird)
   - Overseas Air Travel Ltd (Tour operator - Poundstretcher, Dollarstretcher)
   - British Airtours Ltd (Charter airline)
   - British Caledonian Group plc (Scheduled airline)
   - Sovereign Group Hotels Ltd

2. **Sunmed** (Tour operator - Go Greek, Go Turkey, Go Ski)

   - **Redwing** [50% owned by **British Airways** and 50% owned by **Sunmed**] (Tour operator - Sovereign, Enterprise, Flair, Martin Rooks)

3. **Bass plc** (Brewer)
   - Horizon Travel Centers Ltd (Travel agents)
   - Horizon Holidays Ltd (Tour operator)
   - Holiday Club (International) Ltd (Tour operator)
   - Blue Sky (Tour Operator)
   - Wings (Tour operator - O.S.L.)
   - Orion Airways Ltd (Charter Airline)
   - Bass Horizon Hotels Ltd (Hotels)
   - Bass Hotels and Holidays (UK) (Hotels - Crest)
   - Holiday Inn Hotels (outside N.America & Mexico)
   - Pontinental Española SA [Spain] (Hotels)

4. **International Thomson Organisation Ltd** [Canada] (Communications)
   - Lunn Poly Ltd (Travel agency)
   - Portland Holidays Ltd (Tour operator)
   - Skytours Ltd (Tour operator)
   - Thomson Holidays Ltd (Tour operator)
   - Britannia Airways Ltd (Charter airline)

5. **International Leisure Group plc**
   - Club 18-30 Ltd (Tour operator)
   - Global of London (Tours and Travel) Ltd (Tour operator)
   - Intasun Espana SA [Spain] (Tour Operator)
   - Intasun Holidays Ltd (Tour Operator)
   - Lancaster Holidays Ltd (Tour operator)
   - School Plan Tours Ltd (Tour operator)
   - Air Europe Ltd (Charter airline)
   - Intasun Holidays Ltd (Tour operator)
   - Merit Hotels

6. **Davies and Newman** (Shipbrokers)
   - Dan Air

7. **Midland Bank** (Retail Bank)
   - Thomas Cook (Tour operators and travel agents)

8. **Hogg Robinson** (Insurance broker)
   - Hogg Robinson (Travel agents)

9. National Freight Corporation (Road freight)
Pickfords (Travel agents)

10. American Express (Bank)
American Express (Travel agents)

11. Cosmos (Tour operator)
Monarch (Charter airline)

(B) Estimates of the Market Shares of the Largest Suppliers in Various Tourism Markets

(a) British Tour Operators

Market Shares (%)

	1983	1984	1985	1986	1987
Thomson	17.0%	19.0%	20.0%	27.5%	31.5%
Intasun	11.0%	13.0%	15.0%	18.0%	18.0%
Horizon (Bass)	6.0%	6.5%	5.0%	7.0%	8.0%
British Airways(Redwing)	10.0%	7.0%	6.0%	5.0%	5.0%
Cosmos	5.5%	5.5%	4.0%	3.0%	3.0%
Totals	49.5%	51.0%	50.0%	60.5%	65.5%
Percentage controlled by the top 5 firms	49.5%	51.0%	50.0%	60.5%	65.5%

Source Financial Times 8th April 1988

(b) British Travel Agents

Number of Outlets in 1986 as a % of the Total ABTA Outlets

Thomas Cook (Midland Bank)	6.55%
Pickfords (National Freight Corporation)	4.67%
Hogg Robinson	3.65%
Lunn Poly (Thomson)	3.27%
AT Mays	3.27%
American Express	1.51%
Total	22.91%
Percentage controlled by the top 5 firms	21.40%

Source Saltmarsh(1986)

(c) British Charter Airlines

Charter Passengers Carried in 1986

Britannia Airways (Thomson)	26.7%
Dan Air (Davies & Newman)	19.5%
British Airtours (British Airways)	11.0%
Monarch Airlines (Cosmos)	9.8%
Orion Air (Bass)	6.6%
Air Europe (ILG)	5.2%
Cal Air (Rank Organisation)	4.7%
British Island Airways	3.2%
British Airways	2.2%
Total	88.9%
Percentage controlled by the top 5 firms	73.6%

Source Financial Times 30th July 1987

(d) Spanish Resort Hotels

The Spanish hotel sector is characterised by a low level of concentration, no single hotel chain constituting over 5% of the market. There is virtually no vertical integration with firms located in Britain. Bass is an exception, owning a small chain of hotels in Spain, Pontinental Española, (and having recently acquired the Holiday Inn chain located outside North America and Mexico), and Thomson has owned a chain called Thomson Iberica. However, Thomson's current policy of not investing in hotels (Fitch, 1987), is the policy which is common to most of the firms in the British mass foreign tourism industry.

(C) The Nature of Vertical Integration

The above data reveal that :-

(a) The markets for British charter flights and tour operation are reasonably concentrated, while those for British travel agency and Spanish resort hotel rooms are not. The considerable rise in the market shares of the two largest tour operators has accompanied by intense price warfare, sometimes accompanied by excess capacity. Although the degree of concentration in the market for travel agencies has remained virtually unchanged, the 1986 Monopolies and Mergers Commission decision to allow travel agents to offer discounts to customers may bring about an increase in market concentration in the future.

(b) The major area for vertical integration is between large tour operators and large charter airlines e.g. (i) Thomson-Britannia, (ii) ILG - Air Europe, (iii) Horizon - Orion, (iv) Redwing & British Airtours and (v) Cosmos - Monarch.

(c) The vertical integration with travel agents is much weaker. Thus Thomson has only 3% of this market via Lunn Poly, while Bass has a much smaller market share via its own travel agencies. Thomas Cook has approaching 7% of the travel agency market, but only a small share of the tour operation market.

(d) Vertical integration into Spanish hotels is very small.

(e) The broad conclusions are that there is considerable vertical integration between tour operators and charter airlines, but little other vertical integration.

(f) While the travel agents are necessarily located in the origin country and the hotels in the destination country, the geographical location of the tour operators and the charter airlines is open. It is interesting to note that for tourism from Britain to Spain such firms are predominantly located in the origin country i.e. Britain.

(g) The data are somewhat patchy, but it appears that the internal markets for vertically integrated firms in British Spanish tourism are open, and so:-

(i) charter airlines supply flights to tour operators other than those with which they are vertically integrated e.g. only 50% of Britannia's flights are for Thomson's tours, Nuutinen (1986),

(ii) tour operators use charter airlines other than those with which they are vertically integrated e.g. only some 30% of ILG's tours use Air Europe charter flights, Nuutinen (1986),

(iii) travel agents sell the packages of a wide range of firms in addition to those of the tour operator in the same group.

3. THEORETICAL EXPLANATIONS OF VERTICAL INTEGRATION IN BRITISH-SPANISH TOURISM AND THEIR CONSISTENCY WITH REALITY

The decision to undertake vertical integration is based on the net effect of a wide range of costs and benefits, a number of which are operative in the case of British-Spanish tourism. It is also possible that these causal factors differ in their importance as between companies. In these circumstances, it is difficult to isolate a single or even a few powerful variables which explain vertical integration in this industry. However, it should be possible to divide the explanations into those that are consistent with the facts and those that are not. To this end, various explanations will be considered and their consistency with the current stated of vertical integration in British-Spanish tourism will be examined.

Services, such as tourism, differ from goods in various important ways; see Holmstrom (1985). The literature relating to vertical integration is oriented towards industries which produce some physical product, and little explicit consideration has been given to vertical integration in services. An exception is the study by Buckley (1987), which proposed that the transactions cost approach be adopted when analysing the structure of the tourism industry. While this may prove to be a useful framework, it is questionable whether all the various motives for vertical integration can be encompassed by a transactions costs approach, and the analysis here is more eclectic. The various motives will now be considered, together with an assessment of the extent to which they are consistent with the vertical integration in British-Spanish tourism.

(a) Factors Tending to Promote Vertical Integration

(i) CONTRACTS

(1) Contractual Problems In an uncertain world it is very costly to specify a contract that covers all possible future states of the world. Therefore the contract will be incomplete, and the parties will have to try to come to an ad hoc agreement when occasion requires, Williamson (1975). Even if the contract is complete, one of the parties may engage in post-contractual opportunistic behaviour, i.e. try to alter or breach the terms of the contract to its own advantage, Klein et al (1978).

Contractual incompleteness and opportunistic behaviour are governed by the relative bargaining positions of the two firms at the time the contract is relied upon. During the contract, the relative bargaining positions of the firms may change. For example, if one of the firms invests in management systems which are geared to a particular customer, the downstream firm may try to decrease (to marginal cost) the price paid to the upstream firm because the capital is irrecoverable and has no alternative use. The upstream firm may also try to

capture the profits being made by the downstream firm by threatening to cut off supplies.

For example, a hotel may refuse to accommodate a tour operator's clients at the last moment, e.g. overbooking. In this case the tour operator is vulnerable because of the time-related nature of the business. The tour operator may be able to sue for breach of contract, but this is expensive and there will be a delay during which time it will lose profits and/or reputation. Conversely, the tour operator, may threaten to use some other hotel unless the supplier decreases its price to marginal cost. Opportunistic behaviour may be carried out by any party in a contract. By violating the terms of the contract, the offending party gets a once and for all gain, but may lose future profits.

Vertical integration is a way of preventing these contractual problems. Thus, vertical integration is predicted to increase when there are large irrecoverable investments and when uncertainty is considerable, making contracts difficult to specify, monitor and enforce. Since the probability that such contractual problems will occur is greater in a situation of small numbers bargaining, vertical integration is more likely to be consistent with market concentration in both the upstream and downstream markets. This motive for vertical integration is consistent with the facts, in that tour operators and charter airlines (which have concentrated product markets) are integrated, while travel agents and resort hotels (which do not) are not usually integrated.

(2) Synchronization. There is a strong need for the synchronization of the various services contained in a package holiday from Britain to Spain e. g. flights, airport transfer and rooms. Such coordination problems may create difficulties for contractual relationships but can be reduced by vertical integration. Thus the need to coordinate the provision of flights, airport transfer and hotel rooms predicts the integration of tour operators, charter airlines and resort hotels. The theory's predictions are thus consistent with the integration of tour operators and charter airlines but inconsistent with the lack of integration of hotels.

(3) Transacting Costs. Vertical integration removes the need for the upstream firm to spend time and money seeking out a buyer for that proportion of its output supplied to its linked downstream firm, e.g. marketing and advertising expenditure, while the downstream firm will not have to search for a suitable supplier. These savings are in addition to the removal of the contractual problems considered above. The transacting costs theory predicts the vertical integration of **any** pair of firms that trade with eachother as part of a vertical chain and so is inconsistent with the non-integration of many firms in British-Spanish tourism. However, it constitutes an additional motive which in some cases tips the balance for integration.

(ii) UNCERTAINTY

(1) Carlton's Model of Demand Uncertainty In a model proposed by Carlton (1979) the upstream suppliers, e.g. airlines and hotels, have to decide on their service capacity and prices for the next year in a context of uncertainty concerning the demand for their outputs. Thus, for example, airlines buy sufficient aeroplanes to carry their projected passengers at their pre-set price. In this model the upstream producers (airlines and hotels) may find that, ex post, they have excess capacity. Because of this risk,

upstream producers may set their prices to include a mark-up to cover the costs of such excess capacity. To the extent that the lags in service capacity, e.g. ordering a new aeroplane, exceed one year, the model applies with even greater force.

In this model there is an incentive for some form of vertical integration. Such integration converts part of the upstream firm's demand from being stochastic to deterministic i.e. it has a guaranteed market for the sale of its services to the integrated downstream firm. Therefore the price charged need not include any premium to cover the risk of having unused capacity. Hence the tour operator is supplied with flights more cheaply than if these were bought from independent firms. The remaining sales, if any, of the upstream firm remain subject to the stochastic market demand for its output, and so it may have to charge a risk premium to cover the possible costs of unused capacity.

The tourism industry is characterised by considerable uncertainty concerning next year's demand for package holidays to Spain, and hence for hotel rooms and charter flights. When applied to the tourism industry, the Carlton model suggests the integration of tour operators with charter airlines, which accords with the facts, but it also suggests the integration of tour operators with resort hotels, which does not.

(2) Assurance of Markets. The Carlton model addresses the issue of excess capacity. However, it is also possible that due to uncertainty there may, ex post, be insufficient capacity, e.g. overbooked hotels, no spare seats on planes etc. In such a case there is excess demand, since the market price is assumed not to rise. This possibility creates an additional incentive for vertical integration, so that the supplies of a downstream tour operator are assured in years of high demand and the sales of upstream firms are assured in years of excess demand, Green (1986). It also suggests that integrated firms may be capable of supplying well in excess of the minimum requirements of the linked downstream firm e.g. a tour operator. This motive implies integration between any pair of vertically related firms, and so is consistent with integrated tour operators and charter airlines but is inconsistent with the lack of integration between tour operators and resort hotels.

(3) Information Acquisition. Arrow (1975) argues that vertical integration takes place in order for the downstream firm to acquire information. Each upstream firm e. g. charter airline or chain of resort hotels, is assumed to know what its own output will be one year in advance, but this decision is kept secret. It is also assumed by Arrow that a positive correlation exists between the output decisions of the upstream firms, presumably because they are all subject to roughly the same market forces. For example, transport and accommodation are complements and this creates a relationship between airlines and hotels. Waterson (1984) has termed such a situation mutually related markets.

Each downstream firm e. g. tour operator, has to decide a year in advance on its capacity, and the projected prices of its inputs are used in this decision. Therefore the downstream firms wish to forecast their input prices a year in advance. Their forecasting ability can be improved by joining with an upstream firm. Indeed, the more upstream firms with which they are joined, the better will be their ability to forecast next year's input prices. This model implies the complete integration of all

upstream firms, such integration being most beneficial when next year's input prices for the downstream firms are hard to predict. Arrow's model differs from that of Carlton in at least one crucial respect; in Carlton's model input prices are fixed ex ante, while in Arrow's model input prices are set by the market.

Arrow's model could be adapted to show that as well as providing information to a downstream firm about the plans of upstream firms, vertical integration may also provide a flow of information to upstream firms, about their product markets e.g. trends in consumer tastes. In addition, upstream or downstream vertical integration with open internal markets will provide information to a firm about the activities of its rivals in the firm's input or output markets. For example, if a tour operator is integrated with a charter airline and a travel agency, it will be aware of any negotiations by rival tour operators to purchase airline seats or to sell holidays via the travel agency. The implication of the information acquisition motive is the integration of all firms in the tourism industry, (except possibly travel agents who are less affected by a lack of knowledge of next year's plans of the upstream firms). This is contradicted by the lack of integration of the resort hotels, although it supports the integration of tour operators and charter airlines.

(4) Input Price Uncertainty. Backward integration by a tour operator into the supply of one or more inputs which have an uncertain price and a less than perfectly elastic supply curve is explained by the model of Oi and Hunter (1965). If an input (such as flight insurance) has a perfectly elastic supply curve, backward integration by a tour operator into this market has no effect on the variability of profits of the tour operator. However, if an input (such as airline seats) has an inelastic supply curve, backward integration is highly likely to reduce the variability of the tour operator's profits. This is because, instead of being subject to year to year price variations for this input, the vertically integrated firm owns the underlying capital assets and has removed this source of variability. Vertical integration is not the only possible solution as the same reduction in uncertainty can be obtained by entering into futures contracts for the supply of the inelastic inputs, although this may lead to contractual problems. This theory predicts integration between tour operators charter airlines, and tour operators and resort hotels. Its predictions are borne out in the former case, though not in the latter.

(iii) MARKET POWER

(1) **Price Discrimination.** Suppose that an upstream firm (e.g. an airline or hotel) wishes to charge different prices to different tour operators. The problem for the upstream firm, at least with a physical product, is to prevent those customers charged a low price from reselling it to those charged a high price. With a service it is often easier to prevent price discrimination. However, even here it may be possible to resell flights and rooms. Price discrimination implies concentration in the upstream market, while different price elasticities in the downstream market indicate some form of imperfect competition in this market. Therefore, it is likely that situations of concentration in both upstream and downstream markets, such as the charter airline and tour operator markets, will be conducive to price discrimination. Resale can be prevented by the upstream firm

integrating with those downstream firms to whom low prices are to be charged. This blocks resale by low to high price downstream firms. This suggests that airlines will wish to integrate with the tour operator which has the most elastic demand curve. Although this motive is broadly consistent with the facts, its effects are hard to separate from those of other factors e.g. contractual problems.

(2) **Disequilibrium.** Most economic models analyse equilibrium situations, but for British-Spanish tourism, where demand fluctuates considerably, a disequilibrium approach should be considered. Blair, Cooper and Kaserman (1985) have presented a simple disequilibrium model which gives a motive for vertical integration, and may contain some useful insights for the tourism industry. Suppose there is an increase in the demand for package holidays but, due to various short term rigidities in supply, this leads to only a small increase in sales and a large increase in profits. These excess profits create an incentive for output to be expanded either by an increase in the capacity of existing tour operators, or by new tour operators starting up. Upstream firms e.g. charter airlines or resort hotels, which supply an input to tour operators have an additional motive to increase the output of package holidays. To the extent that an increase in the output of holidays increases the demand for an input supplied by a particular upstream firm (e.g. charter flights or hotel rooms) and this increases the profits of the supplier, the supplier has an additional motive to increase the output of package holidays. In consequence, the firms with the strongest incentive to ensure an increase in the output of holidays are upstream oligopolists e.g. charter airlines, and this implies forward integration by

such firms into the tour operation market. When there is a drop in the demand for package tours, such firms also have the strongest incentive to maintain output levels. This motive implies that charter airlines, who sell in a concentrated market, have an extra motive to start up tour operators but that resort hotels, who are not concentrated, do not. It is also consistent with the low levels of integration with travel agents.

(b) Factors Tending to Prevent Vertical Integration

There are also some factors which will tend to reduce the incentives for vertical integration:-

(1) Foreign Investment Risk. Vertical integration may involve assets in another country e.g. a Spanish hotel chain. This exposes the company to restrictions by the host country on foreign direct investment, such as requirements for local participation which may involve the extreme of expropriation of the local assets. There is also the possibility that the origin country may restrict capital outflows. The abolition of exchange controls by Britain in 1979 coupled with the entry of Spain into the EEC in January 1986 and Spain's agreement to eliminate capital controls by 1992, means that such problems in British-Spanish tourism are small. This motive will discourage integration with the resort hotels, which is largely in accordance with the facts. It is also consistent with the integration between tour operators and charter airlines as both are based in Britain. However, it does not explain the lack of integration with travel agents which are also located in Britain.

(2) Increased Fixed Costs. If a tour operator rents hotel rooms, the entire price of each hotel room is a variable cost to the

tour operator. If the tour operator and resort hotel are vertically integrated, even if the tour operator ceases to rent rooms from its linked hotels, the substantial fixed costs of the hotel now apply to the firm as a whole, Porter (1980). A high level of fixed costs can create problems for the group if there is a decline in demand e.g. for rooms in a particular resort. This motive is consistent with the lack of integration with resort hotels, and it may be an important reason for the lack of such integration.

(3) Reduced Flexibility. If a tour operator is integrated with a charter airline there is a presumption that the tour operator will acquire flights from the in-house supplier. Being tied to a particular supplier, or distributor, can create difficulties if it becomes inefficient, out of date, suffers a drop in quality or from a change in tastes etc., Porter (1980). The linked firm would then be locked into a markedly inferior source of supply, or outlet for its product, and so would be at a competitive disadvantage, even if the linked firm has no fixed costs. Any vertical integration conflicts with this motive and so, while it is consistent with the lack of integration between tour operators and resort hotels, it is rejected as of major importance for British-Spanish tourism.

(4) Dulled Incentives. Vertical integration may well mean that the upstream firm has, in effect, a captive buyer, while the downstream firm has a predetermined source of supply. Even if these firms remain reasonably competitive, this cosy relationship may dull the incentives for them to keep searching for the best available source of supply or method of distribution. This motive applies to any vertical integration.

In addition to the motives presented above, fourteen other motives were also considered. These are (1) quality control, Casson (1986a), (2) higher quality, Etgar (1978), (3) secrecy Harrigan (1983), (4) indivisibilities in demand and supply, Casson (1984), (5) high fixed costs, Casson (1984), (6) technological change, Casson (1984), (7) Bernhardt's (1977) model of demand uncertainty, (8) uncertainty and synchronization, Perry (1984), (9) barriers to entry, Casson (1986b), (10) economic survival, Shubik (1959), (11) avoidance of taxation and exchange controls, Casson (1984), (12) avoidance of price controls, Casson (1984) and (14) diversity of operations, Porter (1980). It was concluded that none of these motives was consistent with the pattern of vertical integration in British Spanish tourism, and so they were not presented in this paper.

4. CONCLUSIONS

With many motives and only a few markets, drawing conclusions from the analysis is a difficult and subjective process. Of the twenty seven motives considered, thirteen appear to fit the facts of British-Spanish tourism to a greater or lesser extent. These motives are contractual problems, synchronisation, transacting costs, Carlton's model of demand uncertainty, the assurance of markets, information acquisition, input price uncertainty, price discrimination, disequilibrium, foreign investment risk, increased fixed costs, reduced flexibility and dulled incentives. Therefore these motives will be examined further and an attempt will be made to form some judgments concerning their relative importaance.

It has been found for British-Spanish tourism that market concentration in two adjacent markets (tour operation and charter airlines) is consistent with vertical integration between firms in these markets. This conclusion conforms with those of MacDonald (1985) and Levy (1984,1985) who have conducted empirical studies of American industry. The problem is to decide which, if any, of the thirteen motives is implied by this finding. Concentration in both the upstream and downstream markets implies bargaining between oligopolists and oligopsonists. This market structure is conducive to both contractual problems, (e.g. post-contractual opportunistic behaviour), and price discrimination, and vertical integration may result from the desire to avoid such outcomes. The disequilibrium model, only requiring concentration in the upstream market, also shows how market concentration may give rise to vertical integration. Market concentration may be associated with some of the other motives, but any such relationships are less obvious.

Foreign exchange risk is consistent with the lack of vertical integration with foreign hotels and neutral with respect to integration between firms based in Britain. The other eight motives do not appear to be fully consistent with the current state of vertical integration in British-Spanish tourism. However, they are individually capable of explaining at least some of the integration that exists and, in combination, can explain the major features of the existing linkages. The motives which are consistent with the vertical integration between tour operators and charter airlines but not with the absence of such integration between tour operators and resort hotels are synchronisation, transacting costs, Carlton's model of demand uncertainty, assurance of markets, information acquisition and input price uncertainty. Conversely, the motives of increased fixed costs, reduced flexibility and dulled incentives provide reasons for the lack of integration between tour operators and resort hotels, but cannot explain the presence of integration between tour operators and charter airlines. Therefore a combination of one or more elements from each of these sets is sufficient to explain the actual pattern of vertical integration.

This paper has attempted to specify some of the theories which may explain vertical integration, and to identify those motives which appear to be the most promising in accounting for the pattern of vertical integration in British-Spanish tourism. Given the data currently available, it is not possible to further identify the explanatory power of the various possible motives. Additional work is necessary to pursue this question using surveys and interviews with the firms concerned. This would provide extra information about the relative importance of the competing motives, and a better understanding of the forces at work in this service industry.

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