



Do independent hotels benefit from the presence of branded ones?



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ABSTRACT

This paper investigates the performance changes of independent hotels due to the presence of nearby branded hotels in Texas. The moderating effects of these performance spillovers are also examined. Evidence from empirical analysis shows the existence and moderate significance of spillover effects from branded to independent hotels. Further analyses indicate that younger and higher-class independent hotels benefit significantly from performance spillovers from branded hotels. Higher-class branded hotels generate the vast majority of spillovers for their independent peers in the vicinity. Moreover, between the two types of branded hotels, franchised hotels generate the vast majority of spillovers, whereas contributions from chain-operated hotels are negligible. Suggestions are provided to independent hotels on how to improve their performance through spillovers from branded hotels.

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1. Introduction

The hotel industry has been long characterized by a dichotomy of independent and branded hotels. Independent hotels typically lack sufficient resources due to a small ownership structure and no brand affiliation, which often engenders poor performance as suggested by the resource constraint theory (O'Neill & Carlback, 2011). Branded hotels, on the other hand, capitalize on valuable resources such as marketing, operational, and technological assistance from franchisors (Hayes, Ninemeier, & Nikker, 2017). Franchising is a business strategy and arrangement that allows one business entity to use the logo, trademarks, operating systems, standards, services, and resources of another business entity in a given location for a specified period of time in exchange for a fee (Blair & Lafontaine, 2005). Despite relatively high franchise royalty fees and the potential for highly restricted agency, many studies have showed that branded hotels are operated more efficiently than their independent counterparts (Ingram & Baum, 1997a). Hence, a significant performance gap has been recognized between independent and branded hotels.

In the economics and management literature, the term *spillovers* (or externalities) refers to the conditions under which firms can acquire information created by others without paying for that information in an economic transaction, while the creators of the information have no effective recourse under prevailing laws if other firms utilize the information (Grossman & Helpman, 1991). Performance spillovers derive from

knowledge's incomplete excludability (Romer, 1990). To generate and diffuse these spillovers, there must be significant performance gaps between two involved parties. In other words, spillover-generating firms must possess some advantages over receiving firms. In addition, there must be channels for transferring the externalities that do not involve market transactions because these transfers are unintentional, involuntary, and indirect (Crespo & Fontoura, 2007; Sinani & Meyer, 2004). In the context of the lodging industry, independently-operated hotels may benefit more from the spillovers generated by branded properties (i.e., chain-operated and franchised hotels) that are better performed, more engaged in innovation activities and endowed with more resources (Orfila-Sintes, Crespi-Cladera, & Martínez-Ros, 2005), although independent and branded hotels learn from each other.

It is commonly assumed that branded hotels could make it difficult for their independent counterparts to remain competitive in a given market; however, the co-existence and equilibrium of both branded and independent hotels in local markets have proven otherwise. Many other factors, including spillovers of performance from the former to the latter, have not been fully considered. Spillovers enable independent hotels to improve performance by creating higher quality products and services, which can in turn lower the operating cost and generate more demand once consumers become aware of them (Canina, Enz, & Harrison, 2005).

Drawing on the strategic management literature, we empirically test the spillover effect and the moderating factors of this effect from branded to independent hotels that may explain the co-existence of these hotel properties in a competitive lodging market. We posit that branded hotels generate significant spillovers to independent hotels with

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moderating factors and develop detailed arguments for these expectations in the following theory section.

We aim to make several contributions to the current understanding of hotel management and organization forms in the lodging market. First, from a theoretical point of view, this paper represents the very first research effort in which a conceptual framework explaining the mechanism of performance spillovers from branded to independent hotels is presented, along with a discussion of different channels triggering the spillovers through both demand- and supply-side aspects. We advance current knowledge theoretically by adding demand-side spillovers and consumer-induced innovation channel in the service-focused and customer-centered hospitality industry, which may greatly enrich the spillover literature and extend the scope of its channels. Second, using a panel data set we test and validate the spillover effect and its moderating factors in the lodging industry among different types of hotel operations. Lastly, based on the empirical results, we suggest ways in which independent hotels can improve their performance by taking advantage of spillovers from their branded neighbors. Our results may help independent hotels how to internalize these benefits under the nature of spillovers.

2. Literature review and hypothesis development

2.1. Spillovers from branded to independent hotels

Spillovers are essentially endogenous outcomes of the interactions between firms with superior performance/technology as generators and those with inferior performance/technology as receivers (Wang & Blomström, 1992). Within the context of the U.S. lodging industry, we regard branded hotels to be spillover generators and independent hotels to be spillover recipients with the premise that branded hotels are better performers due to brand equity or value, generally offering superior managerial practices and being more productive than their independent counterparts (Carvell, Canina, & Sturman, 2016; Ingram & Baum, 1997a; O'Neill & Carlbach, 2011). This gap becomes one of the pre-conditions that the performance spillover occurs. The potential spillover effects from branded hotels to boost the performance of independent ones can be explained from both demand- and supply-side perspectives.

2.1.1. Demand-side spillovers

Branded hotels enjoy greater market visibility and awareness due to their advertising, promotion, and (inter)national geographical presence (Ivanova & Ivanov, 2015a). Through customer rewards programs, loyal guests are allured to the accumulated rewards and the widely applicable use of the rewards (O'Neill & Mattila, 2010). Apart from loyal guests stick to a hotel brand, other customers may also prefer branded hotels because of the quality signaling effect of the brand to reduce risks associated with stay in an unfamiliar property (O'Neill & Mattila, 2010). Therefore, well-established brands become valuable intangible assets to induce and retain a higher level of lodging demand (Enrique, José, & Jorge, 2007) and generate more sustained cash flows (O'Neill & Mattila, 2006).

Demand-side spillovers are manifest in service related industries such as restaurants and hotels when more customers are attracted to the area due to a reduction in consumer search costs (McCann & Folta, 2009). According to Chung and Kalnins (2001), branded hotels have traits and capabilities that can reduce consumer search costs and attract more demand to an area because they have well-recognized brand names and effective marketing/advertising efforts that could greatly penetrate to the potential market. In addition, independent hotels may receive another demand-related benefit called 'differentiation spillover' (Canina et al., 2005). This particular spillover arises when branded hotels invest to make the location more attractive, which will increase the demand of all hotels (including independent hotels) in

the same area (Silva, 2016). Consequently, independent hotels are able to obtain the spillovers associated with the heightened regional lodging demand due to the presence of branded hotels. Also, because location is regarded as a paramount determinant of customers' hotel selection (Chu & Choi, 2000), neighboring hotels sharing similar location characteristics are highly substitutable. When there is a convention or mega event in town, branded hotels typically cannot meet all the demand surge. A number of convention/event attendees will flow over to nearby independent hotels for places to stay or for better value. At the same time, some leisure travelers have no choice but to stay at independent hotels. When the rooms are completely sold out, branded hotels will often walk potential guests to properties under the same management company or independent hotels in proximity that they think they will not lose business to in the future; rivalry branded properties would be the last and least favorable options to recommend. Therefore, independent hotels may gain their demand-side spillovers from customer overflow of nearby branded hotels, especially when rooms of branded hotels become unavailable during peak seasons.

2.1.2. Supply-side spillovers

A resource-based view suggests branded hotels in general, are endowed with more affluent financial, marketing, human resources, and accumulated management know-how and expertise (Ivanova & Ivanov, 2015b). They include national advertising, brand recognition and awareness, customer loyalty programs, operational support, operation standards, training procedures, system design, management consultation, and other resources that provide competitive advantages over independent hotels (Garcia-Falcon & Medina-Munoz, 1999). As a result, branded hotels are able to invest and develop newer innovations (Ottenbacher, Shaw, & Lockwood, 2006), establish better facilities and structures (Ivanova & Ivanov, 2015a), and adopt more intense technology (Siguaw, Enz, & Namasivayam, 2000) that independent hotels cannot afford, such as marketing efforts in search engines, centralized reservation systems, and revenue management department. In addition, branded hotels are more likely to achieve economies of scale with a lower per unit cost in operation and marketing through franchise (Ivanova & Ivanov, 2015a). They are able to negotiate a better deal with suppliers and partners to get lower prices due to higher volumes of purchase. The franchise can also offer a platform for developing innovation by facilitating mutual learning and allowing for innovation testing across affiliated branded hotels.

Branded hotels' advantage of resource and scale provides a nurturing environment to develop, transfer, and test different types of innovation. Then inter-firm organization structure within a hotel brand/chain facilitates the knowledge transfer and diffusion that enable affiliated firms access knowledge developed within the alliance, which are hardly available to independent hotels (Dahlstrom, Haugland, Nygaard, & Rokkan, 2009). This technology gap between branded and independent hotels largely triggers the supply-side spillovers. Better managerial practice and technological knowledge not only directly affects the performance of the firm that owns the knowledge (i.e., branded hotels), but may also produce spillover effects that may increase other firms' performance (i.e., independent hotels) (Arrow, 1962).

Foreign direct investment (FDI) literature has identified at least four major channels or mechanisms through which these supply-side spillovers may be present. They are demonstration/imitation, labor mobility, competition, and export (Blomström & Kokko, 1998; Crespo & Fontoura, 2007). While export is only applicable for FDI-related spillovers between foreign and indigenous firms, the rest are universally applicable and are briefly introduced below.

First, through demonstration/imitation, the recipient firm is able to reduce innovation costs simply by learning, imitating, and reproducing products and processes based on the advanced technologies and managerial practice demonstrated by the spillover-generating firms in the local market (Meyer & Sinani, 2009). The demonstration effects take place through interactions between spillover generators and recipients

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