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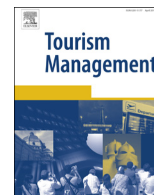

Product diversification and property performance in the urban lodging market: The relationship and its moderators

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HIGHLIGHTS

- We found the positive impact of product diversification on performance of hotel properties.
- Hotel location moderates the diversification-performance relationship.
- Diversification expansion rate erodes the benefits from product diversification.
- Foreign owned/operated can hardly leverage the benefits associated diversification.

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ABSTRACT

In this study, we investigate the relationship between product diversification and hotel property performance as well as the moderators of this relationship in the urban lodging market. Using stochastic frontier analysis with panel data, we calibrate the efficiency scores of 377 urban hotels in Beijing from 1994 to 2005. We then investigate the impact of product diversification on performance as measured by efficiency score. Results from panel data models indicate that the degree of product diversification exhibits a positive relationship with hotel performance. Hotel location, diversification expansion rate, and foreign ownership/operation are found to be significant moderating factors determining the effect of product diversification. Specifically, hotels that (a) are located farther from the city center, (b) expand diversification more slowly, and (c) are domestically owned are more likely to leverage the benefits stemming from product diversification. We provide a series of practical evaluation modules to help hoteliers improve performance.

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1. Introduction

In response to today's increasingly competitive business environment, diversification— the act of expanding into other products, markets, sectors, industries or segments (Gemba & Kodama, 2001; Park & Jang, 2012; Wang, Ning, & Chen, 2014)—has become a major strategic initiative in the hospitality industry. This strategy has been widely applied in various business fields such as marketing, management, retailing, and international business (Chang & Wang, 2007). More than a tool for reducing business risks and uncertainties, diversification enables firms to gain, and more importantly, secure competitive advantages and market dominance that would otherwise be unattainable (Li & Greenwood, 2004; Park & Jang, 2013b). In addition, from a resource-based perspective, diversification enables firms to exploit intangible resources (Andreu, Claver, & Quer, 2009) and generates economies of scale and scope that bolster managerial skills, customer loyalty, and brand reputation (George & Kabir, 2012; Wang et al., 2014). In order to satisfy a broader spectrum of customer needs, hotels have diversified their products and services beyond traditional accommodation to include meeting and event planning services, food and beverage services, casinos, and retail businesses (Chen & Chang, 2012; Kang, Lee, & Yang, 2011; Yeh, Chen, & Hu, 2012).

Understanding how diversification affects the performance of hotels has become an important research topic in hospitality management (Jang & Tang, 2009; Lee & Jang, 2007; Park & Jang, 2013b). However, most prior studies have been based on data from a sample of publicly-traded hospitality companies covering multiple properties, and have yielded little insight into the performance of individual hotel properties due to distinct diversification strategy options at the property level. Also, sample sizes were

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very limited in prior studies, which focused on only a handful of corporations. To fill this research gap, we analyze the relationship between product diversification and hotel performance from a micro perspective using panel data for 377 star-rated hotel properties in the urbanized area of Beijing from 1994 to 2005. The use of property-level panel data enables to evaluate the trajectory of performance over time because the impacts of diversification strategies are considered to be "environment-dependent" and "time-dependent" (Benito-Osorio, Guerras-Martín, & Zuñiga-Vicente, 2012). In addition, we measure hotel performance using efficiency scores generated via stochastic frontier analysis (SFA); this measure is expected to better reflect the multi-faceted nature of the hotel business than more conventional measures, such as occupancy rate, revenue per available room (RevPAR) and labor productivity (Neves & Lourenço, 2009). Lastly, we further examine several plausible contingency factors as moderators of the diversification-performance relationship: hotel location, diversification expansion rate, hotel size and foreign ownership/operation.

Since diversification generates both benefits and costs (Benito-Osorio et al., 2012), a fuller understanding of the effectiveness of diversification could help hoteliers formulate appropriate diversification strategies to improve hotel performance. In other words, understanding the relationship between diversification and performance could help clarify whether individual hotel properties should diversify product and service offerings, and if yes, what specific strategies should be leveraged. In this study, we aim to shed light on the relationship between product diversification and performance as well as contingency factors moderating this relationship. Results of the study can be used as a benchmark for determining whether product diversification is an effective strategy for securing a competitive advantage and enhancing performance in a competitive hotel market such as Beijing. The results can also help Beijing tourism policymakers better understand the hotel market and better cultivate future hotel development strategies to effectively exploit resources and maximize hotel performance.

2. Literature and hypotheses

Over the past decades, strategic management scholars have examined several types of diversification strategies. Geographic diversification is a strategy based on operating in multiple geographic markets (Barney & Hesterly, 2008). Firms are expected to benefit from this strategy by organizing bundles of activities internally to develop and exploit firm-specific advantages in knowledge and products, an approach that has been substantiated by internalization theory (Buckley & Casson, 1976). As a specific type of geographic diversification, international diversification is focused on increasing the size of a firm's foreign operations relative to its overall business portfolio (Tihanyi, Griffith, & Russell, 2005). Another well-known diversification strategy, product diversification, is focused on increasing the scope of a firm's product portfolio (Wang et al., 2014). Product diversification can be further categorized into related and unrelated diversification. The former refers to expansion within markets that are related to a firm's core product offering, whereas the latter refers to expansion into non-core product markets (Chang & Wang, 2007).

Many strategic management scholars have studied the relationship between product diversification strategies and firm performance (Alesón & Escuer, 2002; Benito-Osorio et al., 2012; Kim & Gu, 2003; Lee & Jang, 2007; Li & Greenwood, 2004; Siggelkow, 2003). From a resource-based perspective, product diversification improves firm performance by enhancing synergy, achieving economies of scale and scope, and improving the efficiency of resource allocation (Li & Greenwood, 2004; Purkayastha, Manolova, & Edelman, 2012). As product diversification level increases, more opportunities become available for deploying resources (such as customer bases, sales and distribution facilities, and knowledge on existing products) across different product categories, and create more complementary values to customers (Zahavi & Lavie, 2013). This perspective is embodied in the premium diversification model, which posits a positive relationship between diversification and performance (Benito-Osorio et al., 2012). Several theories have been used to explain the benefits associated with penetration into other product categories. First, according to market power theory, diversified firms are able to establish market power advantages that are largely unavailable to their more concentrated peers (Palich, Cardinal, & Miller, 2000) through aggressive operation efforts. The strengthened market power is partly attributed to the reciprocal buying and selling within the diversified firm (Grant, Jammine, & Thomas, 1988), and this vertical integration substantially reduces operation/production costs. Second, market efficiency theory suggests that unlike concentrated firms, the diversified firm gains remarkable financial benefits by accessing internally generated resources in capital formation, which is generally less costly than external financial resources (Taylor & Lowe, 1995).

On the other hand, from an agency-based perspective, the costs involved in diversification may outweigh benefits, and a negative relationship between the two is plausible (Braakmann & Wagner, 2011); this perspective is summarized in the discount diversification model (Benito-Osorio et al., 2012). Two types of costs arise when firms diversify their product portfolio. Adjustment costs refer to the inefficiency in transferring resources to different product categories (Hashai, 2015), and this cost can be explained by the negative transfer effect along diversification expansion. When firms penetrate to other product dimensions, they may inappropriately deploy nonfungible resources that are useful for one product but might not be proper for the other (Zahavi & Lavie, 2013). On the other hand, coordination costs refer to the costs of sharing and creating linkage across different product categories (Hashai, 2015). Results of a number of studies support this argument and show that diversification strategies can result in increased costs through diversified operations, ultimately decreasing performance (Denis, Denis, & Yost, 2002; Fauver, Houston, & Naranjo, 2004; Kang, Lee, Choi, & Lee, 2012).

In today's hotel industry, diversification has become integral to gaining a competitive advantage, especially for international businesses (Tang & Jang, 2010); yet diversification strategies in the hospitality industry vary from country to country. For example, the U.S. lodging industry generally employs geographic and brand diversification (Kang et al., 2012), whereas the Chinese hotel industry is characterized by a high degree of product diversification, targeting distinct market segments (Gu, Ryan, & Yu, 2012). Despite the prevalence of diversification studies in strategic management (Benito-Osorio et al., 2012), few researchers have considered the hospitality industry specifically (Lee & Jang, 2007; Park & Jang, 2013a, 2013b). In the hospitality literature, previous diversification studies were focused on market diversification (Lee & Jang, 2007), geographic/international diversification (Jang & Tang, 2009; Kang & Lee, 2014; Kwun, 2010; Tang & Jang, 2010), product diversification (Chen & Chang, 2012; Kang et al., 2011; Wang & Xu, 2009), and brand diversification (Choi, Kang, Lee, & Lee, 2011). Table 1 provides a summary of previous studies of diversification strategies in the hospitality and tourism industry. As the table shows, the literature is based mainly on hotel group data and financial/accounting measures of performance in the U.S. context, and offers mixed results.

Product diversification is prevalent in the hotel industry as a strategy to assimilate demand externalities, generate intra-firm knowledge diffusion, share resources, and reduce operational

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