



# Are innovations relevant for consumers in the hospitality industry? A hedonic approach for Cuban hotels



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## HIGHLIGHTS

- Consumers are willing to pay more for hotels that show greater innovative activity.
- Quality, diversification, customization, and the chain increase the willingness to pay for a hotel room.
- An original method for solving the collinearity in hedonic functions with many attributes is proposed.

## ARTICLE INFO

### Article history:

Received 21 May 2015

Received in revised form

9 February 2016

Accepted 13 February 2016

Available online xxx

### Jel:

D46

L83

O32

### Keywords:

Innovation

Hospitality industry

Prices

Hedonic pricing method

## ABSTRACT

This paper evaluates the impact of innovative activity in the hotel industry on the willingness to pay by consumers. To this end, we estimate a hedonic price function where innovation is identified indirectly through certain attributes that previous literature has linked with hotel innovativeness. The test is performed on a representative sample of Cuban hotels, considering a large number of attributes of hotels and rooms. To solve the usual problems of collinearity, a million alternative models are estimated by choosing the variables included in a random manner and obtaining the final coefficients by means of an internal meta-analysis. The results are completed with a variance decomposition analysis. The results highlight the importance of the attributes linked to innovation and internationalization on the determination of room prices in Cuban hotels: membership of international hotel chains, high quality offers, diversified rooms, and adaptability to specific needs of each client.

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## 1. Introduction

Tourism has become one of the activities on which the economic growth of many countries is based. Within this sector, the hotel industry is one of the key pieces both for its ability to generate

added value and employment and because, in itself, it contributes to generating a tourist attraction at destinations. This is the reason these companies have to develop innovative activities with three basic objectives: improve efficiency through new productive and organizational processes; contribute to the generation of attraction through new products or attributes; and improve the marketing of tourism activities (COTEC, 2007).

Although many authors have maintained that the innovative activity of an economy revolves around the manufacturing sector because of the material nature of its production (Dosi, 1988), in

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recent years, it has been emphasized that innovation in the service sector has a different nature because the production is immaterial and innovations take place in a different manner (Miles, 2003, 2008). However, there is also a belief in the service sector, in general, and in the hotel industry, in particular, that improvements from the innovation process are not reflected in prices but in profits (Hjalager, 2010). In this regard, Sandvik, Duhan, and Sandvik (2014) review recent literature on this topic and conclude that the relationship between innovative activity and profitability is weak in the hotel industry. This is probably the reason behind the low proportion of innovative firms in this industry. Another reason is that in the service sector, innovation does not necessarily imply innovation expenses because typical innovation activities are often part of the managerial or distributional activity of the firm. As Christensen (2008) found, many firms consider themselves to be innovative but do not incur innovation expenditures. Sandvik et al. (2014) introduce a new argument for explaining the weakness in the relationship between the innovativeness of hotels and their profitability based on the existence of some intermediary issues around this relationship. This means that innovation affects profits by means of the improvement in competitive market advantage, sales growth and capacity utilization. In this regard, room rates are a good mediator because strengthening competitive market advantages should be immediately collected on the variation in prices.

Hall and Williams (2008) propose a broad definition of innovation activities in services; it includes all activities that introduce a new product or solve a certain problem. Then, all managerial activities related to generating or introducing new ideas, processes, products or services, reorganization, cost cutting, the introduction of a new budgetary system, the improvement of communications or the generation of a new organizational structure are also innovations.

Thus, following Hjalager (2010), innovation can occur in five ways: product or service innovations, process innovations, organizational or managerial innovations, market innovations, and institutional (or network) innovations. In this regard, Orfila, Crespi, and Martínez (2005) argue that in this industry, and as a result of the close interaction between production and consumption (coterminality), the classical division between product and process innovations is difficult to make because innovation in one field usually leads to innovation in another (Barras, 1986).

In this context of coterminality, the market price at which rooms are sold, besides being a major strategic variable of hotel companies, will become a true reflection of the market value of the innovations introduced in the hotel service. In other words, the equilibrium price will reveal how much consumers are willing to pay for each relevant feature of the hotel, including innovative attributes. It is true that this does not refer only to visible aspects (hotel facilities and services) but also intangibles (reputation, branding, marketing strategy, etc.), as well as those derived from its location. In a context of equilibrium in this market—i.e., the existence of a price that clears the market—any innovation that has market value will lead to increased demand, which will increase the market price.

The need for innovation activities by hotel companies contrasts with the scarcity of studies that have attempted to analyze the impact of these innovation strategies on firm performance (Hjalager, 2010). In this regard, Sandvik et al. (2014) found a positive effect of innovative activity on Norwegian hotel profitability. Similarly, Hilman and Kaliappan (2015), when analyzing the Malaysian hotel industry, found a strong link between process innovation, especially in the case of larger hotels, and their performance, identifying innovativeness as a key strategy of the firms. However, there is a lack of studies which analyze the impact of innovation activities perceived by consumers on the market price of

rooms, even though the analysis of prices in the hotel industry is a popular research topic.

The main problem that this type of study faces is the availability of information on the explicit innovation activities undertaken by firms. Exceptionally, it is true that some countries have some surveys on innovation that cover the hotel industry. Nevertheless, we have to recognize that these surveys are often designed from the point of view of the manufacturing firm, where innovation activities are more explicit (Hong, Oxley, & McCann, 2012). Moreover, innovation in the service sector is more difficult to identify in a direct way (i.e., by means of surveys that introduce specific questions on the innovation activities undertaken by the firm). Thus, it is possible to apply an indirect mechanism: designating innovations that are more recent and scarce in the hotel industry worldwide as innovative attributes; establishing links between recognizable attributes and innovative activity in the countries where this is possible and transferring these relationships to other economies; or, finally, combining the previous practices with the analysis of the specific context. This indirect approach involves some error whose magnitude depends on the accuracy of both the definition and the selection of the attributes. Nonetheless, this procedure has some advantages in terms of the problems associated with the identification and recognition of innovation activities by firms.

In this regard, Cuba is an interesting economy for which to assess these effects of hotels' innovative activities. With almost three million tourists in 2014, Cuba is located in a geographical area of strong traditional expertise in this sector: the Caribbean. However, the strong commitment of Cuba to mass tourism originated in the late 1980s, when a major economic crisis occurred following the disintegration of the USSR and the socialist bloc, with which Cuba conducted more than 75% of its foreign trade. This situation precipitated major economic transformations that placed the tourism sector as one of the economic bases of the country (Martin de Holan & Phillips, 1997). In fact, it was in 1994 when the Ministry of Tourism (MINTUR) was created and issued an explicit tourism policy. Although this policy has had different orientations, the tourism sector has always been tightly controlled by the government. Nowadays, all hotels are state-owned. However, many of them are part of international chains operated by joint ventures or transferred through leases or franchises, while others are still managed by state chains. In addition, the relative importance of each management model differs in the three tourist markets that can be identified. Foreign-managed hotels dominate in the case of sun and beach tourism, fully integrated in the international market. The situation is quite balanced in the segment of the cultural-urban tourism that occurs around Havana and Santiago de Cuba. Finally, national management dominates inland tourism. This composition allows for the evaluation of the extent to which internationalization involves the introduction of a different conception in the provision of hotel services, and also a way of absorbing foreign technology and innovative distribution channels for this industry in Cuba.

Unfortunately, there is not any public innovation survey on the hotel industry available at firm or establishment level in the case of Cuba. This is the main reason why we need to use an indirect way to identify innovation activity and assess its effect on prices. Specifically, in this article, we are going to review the studies that have analyzed the relationship between innovative activity and the characteristics or attributes of the hotels. We then properly contextualize this relationship in the Cuban case to first identify the innovative attributes and, subsequently, assess their impact on room rates.

Therefore, it seems that this is the proper context to use the hedonic price theory, which has been widely used in the analysis of the prices of numerous goods and services. Especially important has been its use in the case of real estate. As Andersson (2010)

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