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# The effect of innovation on hotel market value

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ABSTRACT

The purpose of this article is to analyze the effect of hotel innovations on firm value. Specifically, this study fills a research gap in the previous literature by examining this effect through market value and by distinguishing the potentially different impacts of distinct innovation types: product, process, organization and marketing. This research contributes to consolidating the empirical evidence of hotel innovation and performance by analyzing whether distinct types of innovation lead to different levels of results. The findings show that innovations are perceived to have a positive impact on the future sales of the company: in a four-day period (0,+3), there is an increase in stock exchange returns of 1.53%. In terms of innovation types, process and marketing innovations are found to have a higher positive effect on hotel market value than product and organization innovations; which is explained by potential cost differences among innovations.

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## 1. Introduction

This article analyzes the effect of innovation on the firm value of hotels. Innovation is a critical element in today's tourism companies (Sundbo et al., 2007; Martínez-Ros and Orfila-Sintes, 2009). It certainly helps firms reach and keep higher competitiveness standards (Aldebert et al., 2011; Hjalager, 2002; Kumar et al., 2008; Pulido et al., 2011; Rodgers, 2007; Zach et al., 2010) as well as growth (Love et al., 2011). In the context of hotel management, Chen (2011) points out that "innovation appears to be the only means for an organization to convert change into opportunities and thus succeed". In a recent article, Hjalager (2010) describes innovation research in tourism as a young phenomenon, suggesting several research gaps that should be tackled in order to get further insights that contribute to consolidating the theoretical underpinnings of tourism innovation. Specifically, this author, among others, points out a research gap in tourism innovation that should attract more analysis: the relationship between innovation actions and their economic performance. This author explicitly raises the question of examining "what types of innovation produce what level of results". In an attempt to add to the extant body of knowledge on the topic, this article analyzes the effect of different types of innovations on the hotel industry's market value.

With this objective, the subsequent sections of the article are arranged as follows: Section 2 presents the literature review of innovation in the hotel industry and justifies the hypotheses; Section 3 outlines the methodology and data employed; Section 4 describes the results; and Section 5 presents the conclusions.

## 2. Innovation in the hotel industry

According to Hjalager (2010), the analysis of innovation in tourism helps us to understand its economic dynamics and, in this regard, several authors have studied different facets of hotel innovation: Jacob et al. (2010) examine environmental innovation as a competitive factor, Pulido et al. (2011) identify the critical external factors that influence innovation, González and León (2001) describe the determinant factors of environmental innovations, Hashim et al. (2010) explore the relationship between hotel characteristics and Internet adoption, Orfila-Sintes et al. (2005) show the characteristics that lead hotels to innovation, and Chang et al. (2011), Chen and Cheng (2012), Davidson et al. (2006) and Martínez-Ros and Orfila-Sintes (2012) analyze innovation through human resource management practices.

In general terms, four problems affect innovation management and its current practice (Van de Ven, 1986): the human problem of managing attention, the process problem of managing ideas into good currency, the structural problem of managing part–whole relationships, and the strategic problem of institutional leadership. Interestingly, these problems are still to be disentangled today; in a more recent publication, Van de Ven and Engleman (2004) still consider them to be core aspects in managing corporate entrepreneurship and innovation. These issues can be summed up as follows: (1) the human problem of managing attention. People are so focused on their daily activities in the company that

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they do not pay great attention to the development of new ideas. The question here is that, unless there is leadership intervention, organizational members focus their attention on routine, rather than innovative activities. (2) The process problem of managing ideas into good currency. While conception of innovative ideas may be an individual activity, innovation (implementing new ideas) is a collective effort of pushing those ideas into good and wider acceptance. (3) The structural problem of managing part–whole relationships. Ideas can come from different areas of the firm, and multiple functions and resources are needed to transform an innovative idea into reality, so the question is how to put together all the "parts" to form a "whole". (4) The strategic problem of institutional leadership. There is general agreement that institutional leadership is needed for organization innovation, particularly when a firm has to consider alternative ways of doing things.

Underlying all these issues is the relationship between innovation and performance: how can managers measure the effectiveness of the solutions to the above issues?

Innovation has been proven to be one of the most important determinants of organizational performance. Certainly, innovation activities are carried out to achieve, among others, production and marketing goals such as enhancement in product quality, production cost control, market share reinforcement, reaching new markets, production flexibility or improvement in management performance (Quadros et al., 2001; Walker et al., 2011), but innovative actions also foster an organizational learning climate with an enhancement-oriented approach with ongoing efforts aimed at reaching improvements, renewals and even learning from unsuccessful strategies (Gunday et al., 2011); note that the integration of technical and/or administrative changes into the organizational structure permits, first, adaptation to a competitive environment in which the only thing guaranteed is that "change is a constant" (Gunday et al., 2011), and second, improvement of the level of goal achievement (Damanpour and Evan, 1984). Not for nothing, Han et al. (1998) show that innovative activities lead to organizational growth and profitability, as they allow the firms to get synergies from the combination of technical and administrative innovations.

The central point is, therefore, how to measure the innovation–performance relationship. Critical decisions made by hotel managers, such as innovation investments, are obviously aimed at increasing the value of the company and, as a final objective, the creation of profits for investors. Consequently, a value-creating decision-maker must choose value-creating investments. When it comes to the analysis of the effect of innovation on tourism performance, research is limited (Hjalager, 2010).

The assessment of innovation on firm performance has been generally carried out through accounting measures, which rely on the figures that appear in the company's balance sheet and income statement. Even though these measures provide a historical record of the past and present situation of the firm, they can be insufficient because (Myers, 1972): (i) they do not incorporate investor expectations of future profits; (ii) they could lead to confusion due to the deficiencies inherent in their dependence on different conventions (e.g., rate of depreciation), which make comparisons difficult; (iii) they do not reflect all the opportunity costs supported by the firm; and (iv) they do not allow the adjustment of differences in performance for differences in the risk supported by firms.

Alternatively, Orfila-Sintes and Mattsson (2009) – following Álvarez et al. (2001) – measure performance through the average occupancy rate and attempt to explain it by employing historical data on innovation (specifically, an aggregated measure of innovation over the last three years). These authors attempt to identify the determinant factors that lead hotels to choose from four different types of innovations (service scope, back-office, management and external communication), and find that additional services on offer, booking made through tour operators, hotels being within a hotel chain and hotel ownership are explanatory factors of the types of innovation decisions. Additionally, they study the impact of innovation on performance. In this analysis, they test the effect of the aforementioned types of innovation on average hotel occupancy rate, finding that greater performance is achieved by hotels with a network of business relationships with both tour operators and chains, and whose ownership is in total control of outlays and new services (Orfila-Sintes and Mattsson, 2009). In general terms, they find, as expected, a positive impact of innovation on performance.

With a different approach, this article relies on market value. Market value has the advantage that it is based on growth prospects: assuming that shareholders behave rationally, share prices should reflect the present value of future cash flows and, therefore, it constitutes a good indicator to measure the impact of innovation activities on firm performance. Market value is defined as the product of the number of shares by the share price, which is considered to be the best unbiased estimate of the value of any investment. Market value analyses, such as the event study method, are founded, in the portfolio theory of financial economics, on the premises that stock markets are efficient and that a company's share price reflects its strategy (e.g., innovation). In an efficient stock market, share prices reflect all the available information on a company. In fact any information received by the market (e.g., on innovation activities) will be instantly incorporated into the share price. Likewise, any change to a company's share price will reflect, without bias, alterations to its future cash flows. Therefore, the introduction of new information on innovation allows an examination of share price behavior to explicitly analyze the underlying change to unbiased market predictions on future returns on the said innovation activity. This allows separation of returns derived from innovation activity by isolating them from the impact of other events. Accordingly, the use of market value facilitates the analysis of the effect of innovation on performance by estimating unbiased market predictions on future profits. As outlined later, market value is a forward-looking firm performance indicator that overcomes all the difficulties of the traditionally used backward-looking firm profitability (such as accounting measures).

Additionally, when measuring innovation effects, it is important to consider innovation variety. Martínez-Ros and Orfila-Sintes' (2009) emphasize the strong heterogeneity and wide array of complex and highly innovative activities conducted in services. Certainly, the distinction of innovation types is not a straightforward task, especially because some of them might be intertwined, resulting in a more complex combination of effects (Hjalager, 2010; Oslo Manual, 2005). The two most used classifications by far are incremental vs. radical innovations (Dewar and Dutton, 1986), and the Schumpeterian taxonomy (Schumpeter, 1934; Oslo Manual, 2005). The former distinguishes between incremental and radical innovation in such a way that *incremental* entails "linear, cumulative change in a process or product, representing minor improvements or simple adjustments in current technology" while radical is "non-linear, paradigmatic changes, representing significant departures from existing practice or knowledge". The latter encompasses product innovation, process innovation, organizational innovation and marketing innovation. According to Hjalager (2010), the Schumpeterian taxonomy has been more intensively used in tourism in order to look for innovation types and analyze their effects. For example, Hall's (2009) study complies with the OECD's four categories of innovation, in line with the Schumpeterian approach and Hjalager (1997) provides a basic categorization close to Schumpeter's original (product innovations, classical process innovations, process innovations in information handling, management innovations, and institutional innovations). Hjalager (2010) also indicates that distribution innovations and institutional innovations are attempts to incorporate specificities of innovation in tourism. Following this trend, this article focuses on the OECD's four categories,

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