

7th International Conference on Intercultural Education “Education, Health and ICT for a Transcultural World”, EDUHEM 2016, 15-17 June 2016, Almeria, Spain

## The effect of leadership and innovation on differentiation strategy and company performance

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### Abstract

This study examined the effect of leadership and innovation on differentiation strategy and company performance of hotels in Surabaya, Indonesia. The study used quantitative research methods and data was collected by distributing questionnaire to respondents having level of position from supervisor up to CEO within the organization. Descriptive statistical analysis was performed using SPSS, whereas hypotheses testing used SEM (Structural Equation Modelling) and Partial Least Square (PLS). The results showed that leadership affect the performance of hotels, either directly or indirectly through innovation and differentiation as an intervening variable. While leadership does not affect directly differentiation strategy, but it affects indirectly through innovation.

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Peer-review under responsibility of the organizing committee of EDUHEM 2016.

*Keywords:* Leadership, Innovation, Differentiation, Company Performance

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### 1. Background

Leadership is an important role which affects the success or failure of an organization. The need of good leadership is increasing, especially in facing the global competition. As it might be noticed that globalization supported by advanced technology has allowed the entry of new competitor into different country and at the same time also enabled the introduction of imitation product. As a result, products tend to be more comoditized since there was no more any uniqueness among the product and consequently competition is only based on the price (Kim & Mauborgne, 2005).

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However, since the financial crisis in the year of 2008 particularly for developing countries, many global companies have been switching their competitive strategy from low cost strategy based on price competition, to differentiation strategy (Gehani, 2013). Moreover, focus on only cost leadership strategy is no longer suitable to accommodate the diverse needs of the customer (Parera & Poole, 1997).

Basically, differentiation is the act of designing a set of meaningful differences to distinguish the company's offerings from competitors' offerings (Kotler & Armstrong, 2003). Companies that use a differentiation strategy consider the first entry into the market as a top priority. Being the first in the market, the company has the discretion to set prices, and exploit the wide market segment in the pursue of achieving high profit and growth. Advantages through differentiation strategy can be achieved through good product quality and emphasis on innovation as the spearhead of the company. According to Porter (1990), innovation is the only way for companies to gain a sustainable competitive advantage and improve performance. Keywords of innovation is creativity in making changes and commercial value. Creativity will be required to exploit an existing product as well as in creating a new product. However, commercial value of the product is also needed in order for a new discovery can be called innovation.

Beside the potential growth, innovation also could bring the company into the market failure causing harm to the company. Such failures might be due to a lack of understanding on the consumers need when innovation does not conform to the market. Leadership supports the creation of innovation through the creation of an environment that fosters creativity, as well as the allocation of resources both in generating accurate market research and the creation of innovations that are acceptable to the market. When leaders see innovation as optional and focus on the company's daily operational (day-to-day operations), the emergence of innovation is inhibited, consequently it results in failure in innovation performance. Therefore, it requires strategic leadership to balance between the short-term and long-term needs of the company, such that both innovation and the company daily operations run well.

Addressing the need of strategic leadership in the hotel industry in Surabaya might be examined from the following data. Since the year 2013 to 2015, the number of hotels in Surabaya has grown highly. In 2014, the number of hotel in Surabaya increased five (5) new hotels which means total industry number of room available increased to 724 rooms while in 2015 an additional of 29 new hotels have been built and ready for services. This growth is predicted to continue in 2016, with additional five new hotels by which, a cumulative of 879 rooms will be available (Prasojo, 2015). This growth is a response to an increasing number of foreign and domestic tourist arrivals in Surabaya. In the period of January-April 2014, the number of foreign tourists who visit Surabaya through the Juanda International Airport increased 1.3 percent compared to the same period in 2013 (Alexanders, 2014). Unfortunately, this growth in number of tourists, did not lead to an increased in occupancy rate of the hotel in Surabaya. On the contrary the occupancy rate has declined since 2013. This situation plus the increase in operating cost such as electricity, food and wages has forced the management of hotels to create a variety of strategies and activities that create a competitive advantage in the pursue of company performance. This study will examine the relationship of leadership, innovation, differentiation strategy and company performance.

## 2. Literatures review

Leadership is an individual ability to lead and direct a group of people in order to achieve certain goals (Nejad & Rowe, 2009). Strategic leadership is the ability to influence others to voluntarily make everyday decisions in the sense of growth in the short term and long term, as well as the existence of the company (Nejad & Rowe, 2009). Strategic leadership is a combination of the two types of leadership. The most important aspect of strategic leadership is their values and a clear vision, allowing employees to make operational decisions and leaders can focus on the company's strategic decisions. Strategic leaders encourage innovation in the face of environmental change and move forward as well as aware of the capabilities of the organization so as to benefit the company in both the short and long term. This study focus on strategic leadership due to its nature that encourages the creation of innovation which lead to better financial performance achievement. The empirical indicators of strategic leadership used on this research consisted of strategic direction, exploitation and maintainance of core competencies, development of human capital, maintaining of effective corporate culture, emphasizing of ethical practices and establishment of strategic control (Hitt, Ireland, & Hoskisson, 2005).

Differentiation is the act of designing a set of meaningful differences to distinguish the company's offerings from competitors' offerings (Kotler & Armstrong, 2003). A company can differentiate itself in various ways, such as offering

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