

# **Strategic match of cost leadership, competitor orientation and process innovation on performance**

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## **Abstract**

This study examined the strategic matching of cost leadership, competitor orientation and process innovation on performance of hotels in Malaysia. This study has four hypotheses. A total of 475 questionnaires were distributed to three to five star hotel managers in Malaysia and only 11% of them, which is 54, were usable. The findings supported all the four hypotheses. Specifically, this study found a causal relationship among cost leadership, competitor orientation and process innovation. Importantly, this research discovered competitor orientation and process innovation mediating the cost leadership and performance nexus. This research shows the importance of cost leadership, competitor orientation and process innovation which have received little attention in current strategic management literatures. Finally, managerial and theoretical implications are highlighted.

**Keywords:** cost leadership; competitor orientation; process innovation; performance

## **INTRODUCTION**

Malaysian hotel industry has gained an increasing amount of attention among academicians and practitioners as the contribution of this industry is significant to the nation's economic growth (Hilman & Kaliappen, 2014; Awang, Ishak, Radzi & Taha, 2008; Razalli, 2008). This can be proven where accommodation and food service sector's gross domestic product (GDP) is nearly 2.48%, productivity growth is 5.29% and employment growth is 2.5% in the year 2013 (Productivity Report, 2013/2014). However, in the current hyper-competitive business environment, it is getting more challenging for hoteliers to survive and compete successfully.

Hence, this research has investigated the causal relationship of cost leadership strategy, competitor orientation and process innovation on performance of Malaysian hotel industry. The understanding of cost leadership strategy, competitor orientation and process innovation will create best strategic fit and strategic direction as well as has potential to curb the challenges faced by the hoteliers in the current economic situation. This study proposed that cost leadership as business strategy, competitor orientation and process innovation as functional strategies that would generate better performance for Malaysian hotels. Hence, this research endeavours to examine how cost leadership strategy would lead to superior organizational performance with competitor orientation and process innovation as mediators.

## OVERVIEW OF MALAYSIAN HOTEL INDUSTRY

The performance of Malaysian hotel industry is influenced by both internal and external factors (Naqshbandi & Idris, 2012). Therefore, Malaysian government plays vital role in promoting this industry by deriving various comprehensive policies, procedures and agendas (Kaliappan & Hilman, 2014). In general, the hotel industry has shown encouraging growth rate. The industry recorded a significant growth in tourist arrivals which recorded 25.7 million in 2013 compared to 25.3 million in the year 2012 (Tourism Malaysia, 2014).

Furthermore, there was also significant growth in total tourist receipts which is 65.44 billion in 2013 compared to 60.6 billion in 2012. As of 2013, there were 475 three star and above hotels in Peninsular Malaysia, Sabah and Sarawak. The total number of one to five star rated hotels is 1046 with 149,195 rooms until May, 2014 (Ministry of Tourism and Culture Malaysia, 2014). The average occupancy rate also shows an increase, ranging from 59.3% to 62.6% for the year 2010 to 2013. The Malaysian government under the National Key of Economic Areas (NKEA) agenda is targeting to generate 5.5 billion revenues and 64 thousand jobs in the year 2020 (NKEA Report, 2011).

## THEORETICAL BACKGROUND

The notion of Dynamic Capabilities (DC) can be seen in research conducted by Teece, Pisano & Shuen (1997), where the authors suggested that firms can grow their capabilities to adapt and capitalise in the fast changing business environment. DC provides valuable practices in rapidly changing environment by identifying new opportunities and reconfiguring organization's internal operations process to gain sustainable competitive advantage (Ambrosini, Bowman & Collier, 2009; Wang & Ahmed, 2007). This explains how the organizations leverage their strategies with capabilities to obtain better performance. In addition, DC answered why certain firms succeed in a dynamic competitive environment while rest fail (Arend & Bromiley, 2009).

In the context of this study, the effect of cost leadership is viewed as an organization's strategy that will enable it to translate into marketing and innovation capabilities (competitor orientation & process innovation) where the functional capabilities are created to ensure continuous improvement to be made and this will be reflected on organizational performance. Furthermore, this study also used the notion of hierarchy of organizational strategies, which emphasised on the strategic alignment concept. Therefore, this study examined the matching of business level strategy (cost leadership) with functional level strategies (competitor orientation & process innovation) towards performance.

## LITERATURE REVIEW

### Cost leadership strategy

Cost leadership is about gaining cost advantage by producing goods and services at lower cost than rivals (Mohamed, Ann & Yee, 2014; Hilman, 2009; Allens & Helms, 2006). Firms could make forward, backward and horizontal combination of strategies to gain cost advantage (Hilman, Mohamed, Othman, & Uli, 2009).

Cost leaders involve in high capacity utilization, exact demand prediction, economies of scale, learning / experience curve, technology progression and outsourcing activities (Bordean, Borza, Nistor & Mitra, 2010; Porter, 1985). Hotels with distinctive competencies in managing their resources and production process able to implement effective cost leadership strategy (Lo, 2012; Lewis & Chambers, 2000). Prior literatures show that hoteliers could make cost minimization in their operational activities by making process innovation (Lo, 2012; Frohwein & Hansjurgens, 2005; Porter, 1980). Hotels are only able to pursue the cost leadership strategy when the guests are price sensitive and do not give much importance to brand (Hilman et al., 2009; Allens & Helms, 2006; Venu, 2001; Porter, 1980).

### Competitor orientation

Competitor orientation is assisting the firms to observe the rivals thoroughly, recognising their strengths, weaknesses, capabilities and strategies of present and possible rivals (Narver & Slater, 1990; Grawe, Chen & Daugherty, 2009). Additionally, competitor orientated firms emphasise on cost reduction by simply imitating their competitors rather than developing innovative products and services to attain industry equilibrium (Kumar, Jones, Venkatesan & Leone, 2011; Zhou, Brown & Dev, 2009). Mueller, Walter & Gemuenden (2001) stated that competitor orientation assists organization to recognise the competitive market conditions by obtaining information about competitors, competitor's activities, offerings and market capabilities. Additionally, Miller (1989) as cited in Kumar et al. (2011) said competitor orientation is necessary for an organization which pursuing cost leadership in order to obtain new ideas for greater efficiency. Frambach, Prabhu & Verhallen (2003) empirically found linkage between cost leadership and competitor orientation. This shows that cost leadership and competitor orientation have similar characteristics where both strategies put emphasis on cost reduction and better efficiency than competitors.

### Process innovation

Valuable changes in production systems, management approaches and technology to invent the production and management practices are referred as process innovation (Wang & Ahmed, 2004; O'Sullivan & Dooley, 2009; Hilmi, Ramayah, Mustapha & Pawanchik, 2010). To advance the quality of offerings and delivery methods firm should relate the process innovation to all its functional activities (O'Sullivan & Dooley, 2009). Furthermore, process innovation lessens the production cost and delivery along with enriched quality features (Gunday, Ulusoy, Kilic, & Alpkhan, 2011). Hotels are able to make process innovation in the management process, core process and support process for cost reduction, larger market share attainment and superior competency than rivals (Drljaca, 2006; Qin, 2007). This clearly shows similar features between cost leadership and process innovation where both strategies put emphasis on cost reduction and achieves better efficiency than competitors.

### Organizational performance

The non-financial indicators are known as prominent indicators of performance while financial indicators considered as lagging indicator (Paranjape, Rossiter & Pantano, 2006; Niven, 2002; Kaplan and Norton, 1992, 1996). Kaplan & Norton (1996, 2001) and MacDougall & Pike (2003) have suggested both financial and non-financial measurements as very important performance measures. Therefore, Balanced Scorecard (BSC) has financial, customer, internal process and learning and growth measures (Kaplan & Norton, 1992, 1996).

It is widely recognized and applied evaluation instrument (Jusoh & Parnell, 2008; Paranjape et al., 2006; Evans, 2005; Olson & Slater, 2002).

Recently, Mohammad, Rashid & Tahir (2013) and Razalli (2008) used BSC measurement to evaluate the performance of Malaysian hotels. Thus, this study evaluated the hotel's performance with BSC setting based on subjective approach.

## **HYPOTHESES DEVELOPMENT**

Limited past researches have empirically established the significant relationship exist among cost leadership, competitor orientation and process innovation. So that, the researchers synthesised the characteristics of these three strategic factors from different levels and found that these three strategies have similar kind of characteristics. Thus, this study has a reason to believe that competitor orientation and process innovation play a role as mediators between cost leadership and performance nexus. In the context of this study, cost leadership is conceptualised as business level strategy which emphasises on firm's ability to produce goods and services at lower cost than its rivals. Hotels that pursue cost leadership experienced high capacity utilization, economies of scale, learning curve effect, technology advances and outsourcing (Enz, 2011).

Prior research findings showed significant relationship between cost leadership, competitor orientation and process innovation and performance (Koseoglu, Topaloglu, Parnell & Lester, 2013; Hilman, 2009; Mueller et al., 2001; Rosli & Sidek, 2013) but it has been tested separately. Therefore, this study tests the causal impact of these three strategies on performance in one equation. Based on the literatures, this study proposed four hypotheses.

H1: Cost leadership strategy has causal link on competitor orientation and process innovation.

H2: Competitor orientation and Process Innovation have causal link on organizational performance.

H3: Cost leadership strategy has causal link on organizational performance.

H4: Competitor orientation and process innovation mediated the causal link of cost leadership strategy and organizational performance.

Figure 1 depicts the framework and the causal link among the variables. In this study, the dependent variable is organizational performance, which measures the performance of hotels in Malaysia. The independent variable is cost leadership strategy and the mediating variables are competitor orientation and process innovation.

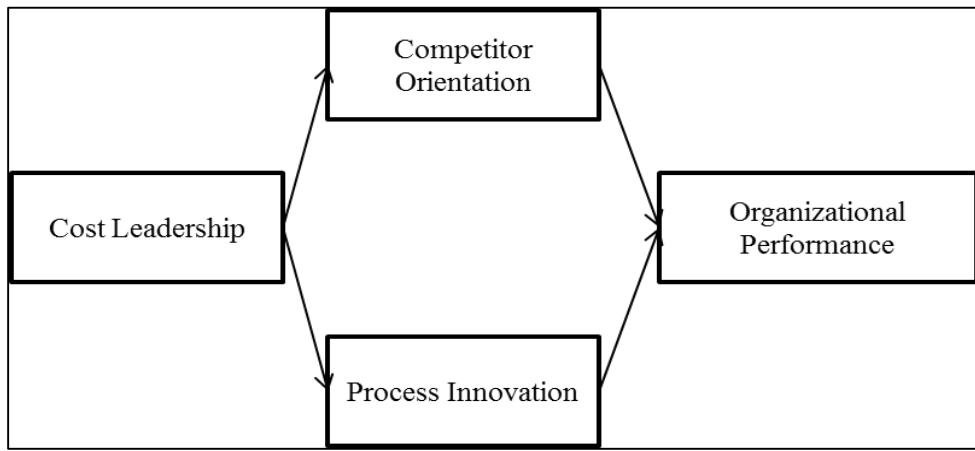


Figure 1. Theoretical Framework

## RESEARCH METHODOLOGY

This study used census method to collect the data. A total of 475 questionnaires were distributed to three to five rated hotel managers in Malaysia and only 54 or 11% of them replied. This study used adapted instrumentation which has strong validity and reliability. 7 items were adapted from Auzair (2011) and Kasim & Minai (2009) for demographic profiles. The questionnaire used a seven-point Likert scale ranging from 1- strongly disagree to 7- strongly agree whereas for performance the Likert scale ranged 1- decrease significantly to 7- increase significantly. This study has 19 items. Measures for cost leadership were adapted from Auzair (2011). Measures for competitor orientation were adapted from Grawe et al. (2009). Measures for process innovation were adapted from Hilmi et al. (2010). Measures for performance were adapted from Hilman (2009) and Kaplan & Norton (1996). The cronbach alpha values of all the variables were greater than 0.80 (Hair, Black, Babin & Anderson, 2010).

Furthermore, a group of professionals and practitioners were referred to ensure the face and content validity. Exploratory factor analysis with principal component analysis was used to determine the dimension of each construct. The Kaiser-Meyer-Olkin (KMO) indicated the range of 0.729 to 0.825. All the items were loaded greater than 0.50, so the validity of the scale is established. Table 1 shows the findings of factor analysis and reliability test analysis. Table 2 shows the respondents' demographic profiles.

**Table 1 Factor analysis and reliability test analysis**

<b>Construct</b>	<b>No of items</b>	<b>Factor loadings</b>	<b><math>\alpha</math></b>
Cost leadership strategy	4	0.804-0.828	0.83
Competitor orientation	5	0.660-0.827	0.84
Process innovation	4	0.814-0.884	0.87
Organizational performance	6	0.645-0.824	0.84

**Table 2 Respondents' demographic profiles**

<b>Variables</b>	<b>Frequency</b>	<b>(%)</b>
Position		
Top management	30	55.6
Middle management	24	44.4
Hotel rating		
3 star	40	74.1
4 star	9	16.7
5 star	5	9.3
Rooms		
< 100	15	27.8
101-200	29	53.7
201-300	10	18.5
Occupancy rate		
< 50%	10	18.5
51%-60%	14	25.9
61%-70%	18	33.3
71%-80%	11	20.4
>80%	1	1.9
Location		
City / town	52	96.3
Beach	1	1.9
Hill	1	1.9
Employees		
< 100	30	55.6
101-200	24	44.4
Years of operation		
< 5 years	17	31.5
5- 6 years	12	22.2
10-15 years	13	24.1
>15 years	12	22.2

## **FINDINGS**

To investigate the dual mediating effects of competitor orientation and process innovation on cost leadership and performance nexus, this study used Multiple Mediation Procedure by Preacher & Hayes (2008). Table 3 displays the outcomes of the analysis. Table 4 shows the bootstrapping test results.

Table 3 Mediation effects of competitor orientation and process innovation on cost leadership and performance

	<b>Coefficient</b>	<b>se</b>	<b>t</b>
<b>a paths</b>			
Competitor Orientation	1.009	0.018	55.440**
Process Innovation	1.052	0.022	48.921**
<b>b paths</b>			
Competitor Orientation	0.363	0.121	2.992**
Process Innovation	0.343	0.103	3.344**
<b>c path</b>			
Cost leadership strategy	1.245	0.021	59.068**
<b>c' path</b>			
Cost Leadership strategy	0.519	0.093	5.583**

\*\* $p < 0.01$ , \* $p < 0.05$

Table 4 Bootstrapping test result

<b>Indirect effect</b>	<b>Mean</b>	<b>S.E</b>	<b>LL95CI</b>	<b>UL95CI</b>
0.7262	0.7217	0.1126	0.4943	0.9606

Cost leadership strategy is linked to the competitor orientation and process innovation. The outcome of unstandardized regression coefficient ( $B = 1.008$  and  $B = 1.052$ ) indicated that the cost leadership strategy affect the competitor orientation and process innovation significantly ( $p < 0.01$ ). H1 is supported. Competitor orientation and process innovation are associated to the organizational performance. The outcome of unstandardized regression coefficient linked with the competitor orientation and process innovation on organizational performance were significant ( $B = 0.363$ ,  $p < 0.01$  and  $B = 0.343$ ,  $p < 0.01$ ). H2 is supported. Cost leadership strategy is linked to the organizational performance.

The outcome of unstandardized regression coefficient ( $B = 1.245$ ) indicated that the cost leadership strategy affect the organizational performance significantly ( $p < 0.01$ ). H3 is also supported. This regression also provided an estimation of connection between cost leadership strategy and organizational performance in path  $c'$  ( $B = 0.519$ ,  $p < 0.01$ ). Overall, the model summary for dependent model is  $R^2$  (0.981), Adj.  $R^2$  (0.979) and  $p < 0.01$ . H4 is supported.

The findings of bootstrapping test show above relationship lied between 0.4943 and 0.9606 with 95% confidence interval. Due to zero is not in the 95% confidence interval so; the mediation effect of competitor orientation and process innovation between cost leadership and organizational performance are significant at significance level of 0.05.

## DISCUSSIONS

This study has four hypotheses. The findings of this study supported all the four hypotheses. This study showed that cost leadership strategy has a causal link with competitor orientation and process innovation. These results supported the prior findings of Frambach et al. (2003); Qin (2007); Frohwein & Hanjurgens (2005). These three strategies possess similar attributes such as concentrating on internal efficiency, monitoring the rivals, making cost reduction, gaining larger market share and attaining economies of scale which create strategic matching among these strategies. Furthermore, this study established that cost leadership is an antecedent of competitor orientation and process innovation.

Thus, cost leadership strategy facilitates to cultivate competitor orientation and process innovation capabilities or functional competencies to recognise the competitive market, competitors' strength, weaknesses, capabilities and strategies and continuous process with innovative abilities. Competitor orientation and process innovation play a significant role as functional level strategies that improve hotel performance. The findings indicated that the causal relation of cost leadership strategy on performance was greater in the occurrences of competitor orientation and process innovation. This research shows that pursuing a cost leadership strategy with close coordination of competitor orientation and process innovation generated optimistic effects on performance.

#### Managerial implications

Cost leadership, competitor orientation and process innovation are crucial strategic factors for every hotel. In order to strive in the current economy, hoteliers must pursue cost leadership strategy as their business strategy where the prior empirical studies showed a significant link with organizational performance (Nandakumar, Ghobadian & Regan, 2011; Seedee, Sulaiman & Ismail, 2009). Hotels that follow cost leadership strategy are likely to improve their competitor orientation and process innovation capabilities and performance. It is highly recommended that managers who desiring to improve the performance of their hotels must strategically match their business strategy (cost leadership) with functional strategies (competitor orientation and process innovation) in their business plan.

This research also provided evidence that efficient competitor orientation and process innovation would have greater effects on performance. It is believed that managers in Malaysian hotel industry could benefit from the outcomes by realising the importance of strategic matching of cost leadership, competitor orientation and process innovation strategies. Knowledge gained from this study could provide enhanced ability to make strategic decisions for continuous improvement. This result has recommended that competitor orientation and process innovation should be matched as strategic tools to evaluate the benefit of cost leadership in the hotel industry.

#### Theoretical implications

The findings add to the cost leadership strategy literature by uncovering the causal effects of competitor orientation and process innovation on performance. This study emphasised that the use of competitor orientation and process innovation in a hotel should be compatible with the cost leadership strategy to ensure better strategic execution. It also adds to the DC literature by discovering empirical evidence to support this perspective. Certainly, the result strongly supports the notion of hierarchy of organizational strategies, by matching cost leadership (business strategy) and competitor orientation and process innovation (functional strategy) nexus. In short, this study explained how the cost leadership, competitor orientation and process innovation could be matched strategically to produce better performance.

## CONCLUSION

A vital aspect of strategic matching is the effective transmission of business strategy's objectives into functional strategies. Thus, this study presented how hoteliers could achieve their strategic business objectives by matching the functional activities or capabilities that in

turn enhance the performance. Therefore, this study found causal link among cost leadership, competitor orientation and process innovation.

Furthermore, the research established that competitor orientation and process innovation mediate the cost leadership and performance nexus. It can be said that, cost leadership strategy would improve better performance if the hotels execute efficient competitor orientation and process innovation as their capabilities or functional strategies.

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