Back to Hotel Strategic Management 101: An examination of hotels’ implementation of Porter’s generic strategy in China

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ABSTRACT

The market-position view (MPV) of the firm in Porter’s generic strategy hypothesizes that the exploitation of differentiation and cost-leadership can create competitive advantage for a firm, which then has a better chance of outperforming other firms in a homogeneous industry. However, this notion has not been tested in the Chinese hotel industry. In response to this gap, this study empirically examines the relationships between the generic strategies of differentiation and cost leadership and hotels’ organizational performance. The results suggest that differentiation is the only significant generic strategy that influences customer satisfaction in the Chinese hotel industry. These findings have important academic and practitioner implications, which are then discussed.

Keywords: Competitive Strategy, Customer Satisfaction, Hotel Performance, Market Positioning

INTRODUCTION

There has been a great deal of discussion in the literature about the impressive hotel development in China in the past 20 years (Derbaix & Pham, 1998; Devonport, Biscomb, & Lane, 2008; Echtner & Ritchie, 1993; Fakeye & Crompton, 1991; C Fornell, 1992; Foxall & Goldsmith, 1994; Pine, 2002; Yu & Gu, 2005). Specifically, many interesting issues have become the favorite topics of researchers in this field, including international hotel franchising (De Ruyter, Wetzels, Lemmink, & Mattson, 1997; Devonport, et al., 2008), state-owned hotel management (de Rojas & Camrero, 2008; Tang, Xi, Chen, & Wang, 2006), and hotels’ service quality (Dimanche & Moody, 1998; Ekinci, 2004; Enright & Newton, 2004). However, most of this research has provided only one frame of the picture and a brief description of the history of the Chinese hotel industry. The difficulties of conducting empirical research in China have been exacerbated by the poor quality of data and the low response rate caused by cultural barriers (Peng & Luo, 2000). Using some basic research methods, this study focuses on a simple but fundamental question regarding the Chinese hotel industry: Does a competitive strategy really work for the hotel industry in China?

The Chinese Hotel Industry

China’s open-door policy and its economic reform have accelerated the development of its hotel industry over the past three decades. The Chinese hotel industry is one of the accentuated sectors that the Chinese government has promoted to world investors (Pine, 2002). The warm welcome of international tourists and investors presents a metaphor of Chinese hospitality to the world and is a successful demonstration of its open-door policy. The World Tourism Organization (WTO) expects China to become the “world tourism destination” in 2020, and many international hotel groups have already gained a foothold in this massive game. The Chinese hotel industry grew from no tourist hotels in 1978 to 12,751 tourist hotels by the end of 2006 (China National Tourism Administration, 2007). The entry of international hotel companies has brought in not only managerial know-how and technologies, but also market competition. In response to the global financial crisis, annual tourist arrivals increased by only 2% in 2008, which ended the history of four years of consecutive growth in tourist arrivals of over 7% since 2003 (Gallarza & Saura, 2006). The question of how to simultaneously survive and be competitive in the industry is an ongoing issue for both managers and academics.
Market Position View

The foundation of MPV is rooted in a famous economic theory, Industrial Organization (IO). IO argues that the behavior of a firm is constrained by the critical determinants of its performance (Bain, 1959; Mason, 1949). Based on the theory of IO, Porter (1980) developed a framework to explain industry structure based on the threat of new entrants, the threat of substitutes, the bargaining power of suppliers and buyers, and the intensity of rivalry. Firms in any particular industry need to realize their relationships with these five key drivers to achieve sustainable profit.

Significant empirical research in the field of MPV has examined the relationship between structural characteristics and economic performance in an industry. Extant research finds that industry concentration, product differentiation, and industry growth rate are the three most common and important determinants to examine in relation to an industry’s profitability (Bain, 1956; Caves, 1972; Comanor & Wilson, 1967; Dean & Meyer, 1996; Harrigan, 1981; Kunkel, 1991; Marshall & Buzzell, 1990; McDougal, 1987; A. Miller & Camp, 1985; Sandberg, 1986).

Prior studies have found that industry concentration has a positive relationship with profitability (Bain, 1956; Mann, 1966). This effect is stronger in a highly centralized industry. A high degree of differentiation in an industry can serve as an important deterrent to entry into an industry. However, there are no significant differences in profitability between the moderate and low-level concentrated sectors (Bain, 1956; Demsetz, 1973; Harrigan, 1981; Yadong Luo, 1999; McGee, 1988).

Porter (1985) stressed that although the profitability of a firm cannot be fully explained by its industry structure, the five forces noted above have a primary impact on the success of a firm. He also explained that when the industry structure is held constant, a successful firm is one that possesses an attractive relative position (Porter, 1991), where it is emphasized that this position is the outcome of its conduct, not the cause.

In other words, the MPV perspective postulates that the strategic choice of market positions influences the organizational performance of a firm. To attain superior performance in a given industry environment, a firm has to achieve one of the basic competitive advantages: maintaining a lower cost than its rivals or commanding a premium price through product and service differentiation (Porter, 1980, 1985, 1991). Porter (1980) suggested that a firm can create a defensible position and outperform competitors in a given industry by successfully implementing one of the generic strategies. He suggested that a firm that fails to pursue one of these strategies is “almost guaranteed low profitability” (Porter, 1980, p. 41, p.41). Schile (1985) further explained that the positioning of the firm can be differentiated by adopting a variety of marketing strategies, such as superior product quality, low price, superior availability, better customer service, more attractive image, and greater levels of product awareness.

Several empirical studies have shown contradictory results that directly affect the validity of these generic strategies. Dawes and Sharp (1990) analyzed various generic strategy clusters and concluded strongly that Porter’s model does not describe or fit empirical reality. They also suggested that these generic strategies were not the routes by which a firm could create a superior profit. Furthermore, Aktouf, Chenoufi, and Holdord (1986) also criticized the epistemological basis of Porter’s theories, suggesting that they were based on imprecisely developed concepts, and generalizations from them were thus forced based on particular competitive situations.

In the context of small Turkish firms, Alpkan, Bulut, and Mert (1994) revealed that the generic strategies are not alternatives to one another. However, using previous studies, their results demonstrated and confirmed that differentiation and low cost strategies can simultaneously facilitate a firm’s profitability (Grewal, Monroe, & Krishnan, 1998; Gronroos, 1994, 1997; Groth, 1995a, 1995b; Gupta, 1995; D Miller, 1992; D Miller & Friesen, 1986; Wright, 1987; Wright, Kroll, Tu, & Helms, 1991).

Despite criticisms and limitations, Porter’s model provides valuable tools that enable managers to analyze the competitive market environment and to sketch an effective strategy (Heckman & Guskey, 1998). As Okumus (2007) stated, strategic management research in the hospitality industry should be generally similar to that in other industries. Given the possible value of testing Porter’s competitive strategy in emerging countries such as mainland China, this study helps to enrich the hospitality literature in the field of rivalry studies (Gunn, 1988; Heskett, Sasser, & Schlesinger, 1997; Heung & Cheng, 2000; Ho & Cheng, 1999), and the results may provide new perspectives for managers in this area.
**The Strategy of Differentiation**

The purpose of pursuing a differentiation strategy is to offer unique products or services to customers so as to obtain a price premium. This facilitates a firm’s erection of entry barriers and reduces buyers’ bargaining power through customer loyalty and price inelasticity (Porter, 1980). In other words, by implementing differentiated customized services or personalized products, a firm can build its customer loyalty when substitute products or services are unavailable in the market (Aaker, 2001; Allen & Helms, 2006; Anderson & Dubinsky, 2004; D Miller, 1988; Porter, 1979, 1980, 1985, 1987, 1991, 1996). These characteristics of the products and services in this industry enable firms to charge their customers a higher price than their rivals based on the cost of the delivery system, service quality, and the distribution channels involved in creating or producing their unique products and services (Akan, Allen, Helms, & Spralls III, 2006; D Miller & Friesen, 1986; Venu, 2001).

Miller (1986) further categorizes differentiation strategies into product-innovation differentiation and market differentiation. He also explained that, in a product-innovation differentiation strategy, a firm aims to outperform its competitors by emphasizing the production of creative, up-to-date, and attractive products, as well as service quality, efficiency, new product development, design innovations, and fashion or style (Campbell-Hunt, 2000; Finney, Campbell, & Powell, 2005; D Miller, 1988; Nayyar, 1993). There are a few obvious examples in the hotel industry, such as designer hotels, boutique hotels, and W hotels.

Product innovation is one kind of differentiation. Marketing differentiation uses marketing tools to establish a unique image for its products and services through marketing practices such as market segmentation, prestige pricing, branding, advertising, and product or service promotion (Akan, et al., 2006). In the hotel industry, a market differentiation strategy has been widely adopted. It is hard to find a successful hotel that does not employ price fences, segmentation, or branding. The foregoing discussion leads to the following hypotheses:

**H1a:** The strategic position of differentiation positively influences the financial performance of Chinese hotels.

**H1b:** The strategic position of differentiation positively influences customer satisfaction with Chinese hotels.

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**Strategy of Cost Leadership**

The core of a cost-leadership strategy emphasizes that a firm’s competitive advantage can be generated when it achieves low cost within its industry (Allen & Helms, 2006; Anon, 1998; Bauer & Colgan, 2001; Davidson, 2001; Hyatt, 2001; Malburg, 2000; Porter, 1980, 1985, 1987, 1991). Researchers and scholars in the fields of marketing and strategic management have suggested numerous approaches by which firms can achieve cost-leadership. These include using mass-production techniques, achieving economies of scale, adopting technology, achieving mass distribution and effective product design, reducing input costs, achieving at-capacity utilization of resources, and improving access to raw materials (Akan, et al., 2006; Campbell-Hunt, 2000; O’Farrell, Hitchens, & Moffat, 1993). Lewis and Chambers (2000) noted that a cost-leadership strategy is effective in the hotel industry when a hotel has a distinctive competency in the management of the materials and production process. The examples they provide are economy hotels, such as Microtel in the United States and Formula 1 in France. Both of these economy hotel chains have successfully implemented a cost-leadership strategy through efficient cost-saving hotel designs and effective operational cost reduction. Based on this section we propose the following hypotheses:
H2a: A strategic position of cost leadership positively influences the financial performance of the Chinese hotel industry.

H2b: A strategic position of cost leadership positively influences customer satisfaction in the Chinese hotel industry.

**Organizational Performance in the Hotel Industry**

In strategic management terms, competitive advantage is a universally used term to describe the relative performance of rivals in a given market environment (Peteraf & Barney, 2003). Given the wide use of this term in the field, competitive advantage is generally defined as the superior financial performance of the firm (Winter, 1995). However, the term has been defined by an assortment of scholars in the disciplines of business strategy, management and economy, as above normal returns, economic value creation, and high quasi-rents.

The reason one firm performs better than others is the central question in strategic management (Barney, 1991; Levinthal, 1995; Peng, 2002; Porter, 1980; Rumelt, 1991). Many strategic scholars have claimed that a firm’s success may not depend on a single set of factors alone (e.g., Peteraf & Barney 2003; Porter 1991). Likewise, organizational performance should not be defined by a firm’s financial performance alone. A broader view of organizational performance should be adopted, in which the financial, operational, and market performance domains of the firm are also considered (Day & Wensley, 1988; McMillian & Joshi, 1997; Venkatraman & Ramamurthy, 1986).

A review of previous strategic management research reveals that organizational performance has been viewed from the perspectives of the firm’s objective of financial performance (Combs & Ketchen, 1999; Knott, 2003; Maijoor & van Witteloostuijn, 1996; Makadok, 1999; Robins & Wiersema, 1995), subjective financial performance (Powell, 1992a, 1992b, 1995; Powell & Dent-Micaleff, 1997), and non-financial performance (Combs & Ketchen, 1999; Henderson & Cockburn, 1994; Markman, Espina, & Phan, 2004; Yeoh & Roth, 1999). This study intends to examine the definition of the organizational performance of a hotel as it impinges on such financial performance variables as profitability, growth in sales, and return on investment, as well as on non-financial performance relating to such customer satisfaction variables as the service quality and customer satisfaction of a hotel.

**Customer Satisfaction in the Hotel Industry**

It has been argued that in the service industry, non-financial measures, such as customer satisfaction and service quality, provide better indicators of organizational performance than does financial performance (Ittner & Larcker, 2003). The primary reason behind this argument is that non-financial measures are more valuable in evaluating and motivating managerial performance, which complements short-run financial figures as an indicator of progress toward a service firm’s long-term goals and is more reflective of the overall corporate strategy (Banker, Potter, & Srinivasan, 2005; Johnson & Kaplan, 1971).

As part of the service sector, the hospitality industry also inherits the unique characteristic that service is an inseparable product (Bowie & Buttle, 2004). Hence, a successful hotel is not only limited to delivering services and products to its customers, but must also strive hard to maintain and increase customer satisfaction and to provide quality service that ensures the long-lasting survival and improvement of profitability (Ramsaran-Fowdar, 2007).

Previous research has shown that customer satisfaction and service quality have a positive influence on improved market share, return on investment, and lower production cost (Garvin, 1983; Mueller & Bedwell, 1993; Philips, Chang, & Buazzell, 1983; Reichheld & Sasser, 1990). Thus, customer satisfaction is the cornerstone of a hotel’s success and is perceived as a key factor in acquiring and sustaining competitive advantage (Hampton, 1993; Ramsaran-Fowdar, 2007; Sheardon, 1988).

The results of previous empirical studies in the hotel and service industry (Barsky & Nash, 2003; Garvin, 1983; Hampton, 1993; Mueller & Bedwell, 1993; Philips, et al., 1983; Reichheld & Sasser, 1990; Sheardon, 1988) have found that customer satisfaction plays a positive role in achieving customer loyalty and, hence, a hotel’s profitability.

Overall, the study predicts a significant connection between MPV constructs and organizational performance constructs and expects to find a positive relationship between a hotel’s customer satisfaction and its financial performance. Consequently, our last hypothesis is

H3: Customer satisfaction has a positive influence on the financial performance of the Chinese hotel industry.
METHODOLOGY

Sampling
In the Chinese hotel industry, hotels with a low-star rating are less willing to cooperate in academic research than are more highly ranked hotels (De Ruyter, et al., 1997; Pine, 2002). Therefore, this study sampled tourist hotels rated at three stars or above. Given concerns over budget and time, I elected to draw the sample from two cities in the North of China: Beijing and Shenyang. These two cities were chosen for two reasons. First, Beijing is the most competitive tourist destination in China in terms of the numbers of hotels within the industry, its contribution to Chinese tourism income, and the international recognition attained from the Beijing Olympic Games. Second, from a practical point of view, research connections exist with institutes in Shenyang. According to the Municipal Bureau of Tourism in both these cities, a total of 411 hotels met the sampling criteria: 335 in Beijing and 76 in Shenyang.

Data collection
The questionnaire was administered between April and September 2007. The hotels were selected using census sampling. The survey targeted the senior managers of tourist hotels in Beijing and Shenyang. Managers are the most appropriate candidates to comment on financial performance and customer satisfaction (Bagozzi, Yi, & Phillips, 1991). A member of the top management team represented each hotel, and this enhanced the accuracy and precision of the sampling. To reduce sampling bias, the single-informant method was used.
A total of 254 responses were received. After invalid responses were removed, 228 questionnaires were available for analysis (i.e., a general response rate of 45%), including 183 responses from Beijing (55% response rate) and 45 from Shenyang (59% response rate).

Measure
All the main questionnaire items used a seven-point Likert scale that ranged from 1 (strongly disagree) to 7 (strongly agree). The process of gathering objective performance data from questionnaires is well known from previous research (G. Dess & Robinson, 1984; Powell, 1992a; Powell & Dent-Micallef, 1997; Robinson & Pearce, 1988). Organization performance was measured with a self-report construct that ranged from 1 (much lower) to 7 (much higher). Instead of providing actual financial figures in the questionnaire, the respondents were asked to compare their financial performance and their degree of customer satisfaction with those of their competitors. Previous studies have shown that self-reporting performance measurements are more desirable for data gathering, particularly when the country’s culture tends to be more conservative (Chandler & Hanks, 1993; Y Luo, 1997; Y Luo & Peng, 1998, 1999). Thus, four items for financial performance and two items for customer satisfaction were adopted from previous research.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Number (%)</th>
<th>Variable</th>
<th>Number (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participating hotel</td>
<td>Years of experience in the Chinese hotel industry</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 star</td>
<td>46 20.2</td>
<td>1–4 years</td>
<td>43 18.9</td>
</tr>
<tr>
<td>4 star</td>
<td>95 41.7</td>
<td>5–9 years</td>
<td>69 30.3</td>
</tr>
<tr>
<td>3 star</td>
<td>87 38.2</td>
<td>10–14 years</td>
<td>66 28.9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>15–19 years</td>
<td>31 13.6</td>
</tr>
<tr>
<td>State-owned</td>
<td></td>
<td></td>
<td>19 8.3</td>
</tr>
<tr>
<td>Non state-owned</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>119 52.2</td>
<td>20+ years</td>
<td>109 47.8</td>
<td></td>
</tr>
<tr>
<td>International brand</td>
<td>Position held</td>
<td></td>
<td></td>
</tr>
<tr>
<td>58 25.4</td>
<td>General manager/ Deputy managing director</td>
<td>93 40.8</td>
<td></td>
</tr>
<tr>
<td>Regional brand</td>
<td>Residential manager</td>
<td>49 21.5</td>
<td></td>
</tr>
<tr>
<td>Independent brand</td>
<td>Sales manager</td>
<td>94 41.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Front office manager</td>
<td>40 17.5</td>
<td></td>
</tr>
<tr>
<td>International management company</td>
<td>Executive assistant</td>
<td>62 27.2</td>
<td></td>
</tr>
<tr>
<td>Local management company</td>
<td></td>
<td>26 11.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>98 43.0</td>
<td></td>
</tr>
</tbody>
</table>
Nayyar (1993) developed the MPV measurements that have been adopted by many strategic management researchers (Finney, et al., 2005; Narver & Slater, 1990; Spanos & Lioukas, 2001; Spanos, Zaralis, & Lioukas, 2004). The original MPV measurement contained 25 items. This study eliminated the items related to the focus construct (seven items) and also those items that either cross-loaded or had a loading of less than 0.5 on the confirmatory factor analysis. This process resulted in seven items for further analysis.

**Data Analysis**

The study employed covariance-based structural equation modeling (SEM) for data analysis because it was appropriate to the psychometric properties of the scales adopted. The maximum likelihood estimation method was applied to the sample data via the linear structural relational model (LISREL ver. 8.72), and missing data were managed via list-wise deletion.

**Table 2: Construct Reliability Results**

<table>
<thead>
<tr>
<th>Construct</th>
<th>Indicator</th>
<th>Lambda</th>
<th>Squared multiple correlation</th>
<th>Cronbach’s alpha</th>
<th>Composite reliability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Differentiation</td>
<td>Our product / services provides many features</td>
<td>0.66</td>
<td>0.43</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Marketing innovation is well supported in our hotel</td>
<td>0.60</td>
<td>0.36</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Our hotel provides extensive customer services / products</td>
<td>0.67</td>
<td>0.46</td>
<td>0.811</td>
<td>0.812</td>
</tr>
<tr>
<td></td>
<td>New service development is well supported in our hotel</td>
<td>0.75</td>
<td>0.57</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Our hotel has a powerful influences on our distribution channels</td>
<td>0.72</td>
<td>0.52</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost control and operating efficiency is well managed in our hotel</td>
<td>0.83</td>
<td>0.69</td>
<td>0.742</td>
<td>0.746</td>
</tr>
<tr>
<td>Cost Leadership</td>
<td>Managing raw materials cost and availability is a major concern in our hotel</td>
<td>0.71</td>
<td>0.50</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Overall organizational performance</td>
<td>0.77</td>
<td>0.59</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Performance</td>
<td>Profitability</td>
<td>0.88</td>
<td>0.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Growth in sales</td>
<td>0.77</td>
<td>0.59</td>
<td>0.891</td>
<td>0.894</td>
</tr>
<tr>
<td></td>
<td>Return on investment</td>
<td>0.87</td>
<td>0.75</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>Customer satisfaction</td>
<td>0.79</td>
<td>0.62</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Quality</td>
<td>0.90</td>
<td>0.80</td>
<td>0.828</td>
<td>0.834</td>
</tr>
</tbody>
</table>

**Measurement Model Evaluation**

All the Cronbach’s alpha coefficients were in the range from 0.742 to 0.891. This exceeds the level of 0.70 required for scale robustness (Getty & Thompson, 1994). The results attest to the high internal consistency of the instrument. Composite reliability shows whether a set of latent construct indicators are consistent in terms of their measurement. Reliability is the degree to which a set of two or more indicators share measurement of a construct (Ghartey, 1993; Hair, Black, Babin, Anderson, & Tatham, 2006). The composite reliability coefficients ranged from 0.746 to 0.894 (see Table.2), thus exceeding the recommended level of 0.6 (C Fornell & Larcker, 1981).

The test of construct validity is important because it stabilizes the measure’s dimensionality during measure development (DeVellis, 2003). As a measure of convergent and discriminant validity, the average variance extracted
(AVE) for each factor was calculated. Convergent validity is established if the shared variance accounts for 0.50 or more of the total variance. Discriminant validity is evident when the AVE for each construct is greater than the squared correlation between the construct and any other construct in the model (C Fornell & Larcker, 1981). Although the correlation coefficients between some variables in the present study were quite high (0.33 – 0.75), all constructs revealed AVE values between 0.61 and 0.721. Thus, the overall discriminant validity of the constructs was satisfactory.

Table 3: Construct Correlation and Discriminant Validity

<table>
<thead>
<tr>
<th>Construct</th>
<th>Differentiation</th>
<th>Cost Leadership</th>
<th>Financial Performance</th>
<th>Customer Satisfaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Differentiation</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost Leadership</td>
<td>0.75</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Performance</td>
<td>0.33</td>
<td>0.33</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>0.43</td>
<td>0.38</td>
<td>0.62</td>
<td>1.00</td>
</tr>
<tr>
<td>(Correlation)²</td>
<td>0.56</td>
<td>0.14</td>
<td>0.38</td>
<td>0.38</td>
</tr>
<tr>
<td>Discriminant Validity coef</td>
<td>1.09</td>
<td>5.19</td>
<td>1.77</td>
<td>1.87</td>
</tr>
</tbody>
</table>

Notes: All correlations are significant at the 0.001 level; diagonal element is average variance extracted (AVE) and should be larger than the square of the off-diagonal correlation coefficient. Convergent validity = AVE ≥ 0.5. Discriminant validity coefficient = AVE/(Correlation)²; Where (Correlation)² between factors of interest and remaining factors. AVE = average variance extracted = sum of standard loading² / (sum of standard loading² + sum of e). 

Structural Model Estimation

Following the established practice for structural equation modeling, the covariance matrices of the observed variables were used as input (Ghartey, 1993; Hair, et al., 2006). Results of SEM obtained for the theoretical model (see Table 4) showed chi-square = 108.84 (df = 59; p ≤0.001), GFI = 0.93, AGFI = 0.89, RMSEA = 0.061, NFI = 0.96, and CFI = 0.98. Although AGFI values exceeding 0.90 are preferable, a more liberal cut-off of 0.80 indicates good model fit (Hair, et al., 2006). Almost all the indices exhibited a high level of fit in terms of the structural model used in this study.

Table 4. Measures of Model Fit and Reported Values for Structural Model

<table>
<thead>
<tr>
<th>Fit index</th>
<th>Recommended values</th>
<th>Model values</th>
<th>Degree of Model Fit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-square</td>
<td>p ≥0.05</td>
<td>108.84 (p &lt; 0.001)</td>
<td>Good fit</td>
</tr>
<tr>
<td>Chi-square/df</td>
<td>≤ 3</td>
<td>1.844 (df = 59)</td>
<td>Good fit</td>
</tr>
<tr>
<td>Goodness-of-fit index</td>
<td>≥0.9</td>
<td>0.93</td>
<td>Good fit</td>
</tr>
<tr>
<td>Adjusted goodness-of-fit index</td>
<td>≥0.9</td>
<td>0.89</td>
<td>Moderately fit</td>
</tr>
<tr>
<td>Root-mean-square error of approximation</td>
<td>≤0.08</td>
<td>0.061</td>
<td>Good fit</td>
</tr>
<tr>
<td>Normed-fit index</td>
<td>≥0.9</td>
<td>0.96</td>
<td>Good fit</td>
</tr>
<tr>
<td>Comparative-fit index</td>
<td>≥0.9</td>
<td>0.98</td>
<td>Good fit</td>
</tr>
</tbody>
</table>

DISCUSSION

Figure 2. shows that the $R^2$ and the path coefficients (loading and significance) provide support for the hypothesized model. The model explains a substantial portion of the variance for all the endogenous variables: 40% for financial performance and 19% for customer satisfaction. Only two of the five paths specified in the model are statistically significant. These paths reflect the impacts of differentiation strategy on customer satisfaction (Hypothesis 1b) and of customer satisfaction on financial performance (Hypothesis 3). The results show that a differentiation strategy leads to a diversity of services that directly enhance customer satisfaction. This indicates that customers are satisfied with the product and services mix in the Chinese hotel industry. Moreover, the significant path of H3 provides evidence that the Chinese hotel industry is similar to other service industries in the world, where the enhancement of a hotel’s customer satisfaction helps to generate superior financial performance.
In sum, the injection of international brand hotels has substantially influenced service standards and the product mix in the Chinese hotel industry. Exposure to international brand hotels influences local hotels’ training programs, operational systems, and service standards. However, the rapid expansion of international franchised hotels may create a dilemma for those Chinese hotels that want to use a differentiation strategy to improve their financial performance. In Beijing, numerous international hotels operate more than one property under the same hotel brand, such as Holiday Inn, Crown Plaza, Sheraton, or Westin. However, the oversupply of brand hotels may reduce customer demand and have a negative impact on hotels’ revenue and profitability.

On the other hand, the results of the study echoed the earlier study of Miller and Chen (2006) on the US airline industry, which found that in a competitive homogeneous market, firms that concentrated on only a few core strategic activities to compete with others saw a decline in their financial performance. The study also concurs with Yeung and Lau’s (1988) study on high tariff hotels in Hong Kong, which indicated that a hotel’s dependence on a narrow range of differentiated competitive actions cannot contribute positively to its performance.

Although the operational principle of the economy hotels is low cost, they were not included in this study. There are two possible causes that may explain why hypothesis 2, which had to do with the impact of cost leadership on hotels’ financial performance and customer satisfaction, was rejected. First, low labor costs in China have made it a global center for manufacturing. Access to low-cost raw materials and labor is not difficult for those in the Chinese hotel industry. Thus, given that any Chinese hotel can achieve a low-cost strategy, this is not an effective and sufficient approach to creating outstanding performance. Second, previous studies of the Chinese hotel industry (De Ruyter, et al., 1997; Derbaix & Pham, 1998; Pine, 2002) have noted that the majority of Chinese hotels are still owned by various states. Among these hotels, many of them do not operate for business purposes, but for other socio-economic reasons, such as government regulations regarding tourism development incentives and expansion of the assets of various states. Consequently, these hotels can ignore market economic principles because revenue management, cost control, and competition are not priorities for managing the hotel. Because the market economy does not dictate the rules by which they play, this Western strategic mechanism will not be effective in helping them to win this game.

**LIMITATION AND CONTRIBUTIONS**

A pertinent and perennial question for empirical studies is whether the empirical relationships acknowledged in the study can be explained by mechanisms other than those proposed by the authors (Gale, 1994). In this study, the greatest limitation was the need to ensure the quality of the questionnaire while simultaneously maintaining a significant response rate. Adopting the “door knocking” method was the author’s best choice for maintaining the quality of the data and increasing the survey completion rate. However, this data collection strategy worked effectively only for four and five-star hotels. Given the limitations of generalizing from two cities in China to represent the Chinese hotel

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**Figure 2: Path Coefficients for the MPV model**

Predictive power was examined by using $R^2$ for each endogenous variable. $R^2$ value for the structure model. * and ** indicate significance at the 0.05 and 0.001 levels, respectively. * $p < 0.05$; *** $p < 0.001$. 

![Diagram of Path Coefficients](image-url)
industry, future research is welcomed to test the MPV theory over a larger geographical range. Our optimistic view is that the challenges involved in data collection may become fewer as China’s economic development continues.

Empirical study has played a significant part in examining those areas that are still undergoing research. However, the difficulty of data collection in China has impeded researchers’ ambitions to explore further issues in strategic management (Peng & Luo, 2000). This study has overcome these barriers and has examined whether one of the solid Western strategic management theories is applicable to the Chinese business context for creation of competitive advantage. Although most of the hypotheses were rejected, the results have provided a preliminary answer in that a hotel’s differentiation strategy was the only strategic action that had an impact on customer satisfaction in China. The study contributes evidence in both the strategy management and the hospitality areas that a predominant strategic management theory cannot be generalized to all business contexts without regard for differences in culture, economy, institutional environment, and industry.

Given the reasons for which the industry environment keeps changing and market competition has become more intensive, and to enrich our existing knowledge about hotel strategic management, this study might serve as a wake-up call to academics to remind us that we should never feel comfortable with the existing literature. Challenging or reexaming predominant theories may provide more realistic results in modern society. Managers in the hospitality area should use the results of the study to inform the reevaluation and selection of their strategic activities. Perhaps they might have to step forward and rethink the question, “Is the old way really the right way to maximize performance?”

**CONCLUSION AND IMPLICATIONS**

Given that China’s macro-economic environment is continually changing, many scholars have predicted that the power of the market will increase along with a decrease in government power (Dann, 1977). In fact, after many years of transformation, the Chinese hotel industry has reformed in several ways, such as market expansion, product and/or service standardization, and the professionalization of staff (Gomezelj & Mihalic, 2008; Zhang, Cavusgil, & Roath, 2003). There is no doubt that the Chinese hotel industry has expanded rapidly, perhaps even too quickly. In order to survive, managers should stop using the low-cost model and should establish a path to service innovations and higher value-added products creation (Horng, Teng, & Baum, 2009).

Given that one of greatest criticisms of the generic strategy is its lack of consideration of different market environments (G. G. Dess, Ireland, & Hitt, 1990; Hambrick & Lei, 1985; Holbrook & Batra, 1987), we come back to the central question of this paper: does a generic strategy work in the hotel industry? From the results of this and a previous study (Gunn, 1988), the answer is: not really. The results of this study show that customers were satisfied with the diversity of hotels’ services and products in China. However, a generic strategy is limited in creating competitive advantage because its practical applications are too simple, too rigid, and too open to imitation by competitors (Day & Wensley, 1988; Holbrook & Hirschman, 1982; S. K. Hong, Lee, Lee, & Jang, 2009; W. C. Hong, 2009). Hotel managers spend considerable time planning their hotel’s strategic moves. For them, it is critical to be aware that the competitive strategy in the twenty-first century is different from that in Porter’s time. Typically, the structure of the industry has become more complex, and the competition is more intense. A good demonstration in this study has proved that market-based strategies cannot improve a hotel’s financial performance. Managers should start practicing and developing other hotel competencies that are both valuable and inimitable as their competitive advantage over rivals, such as a firm’s reputation and its organizational culture (Hall, 1993).

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