

**THE RELATIONSHIP BETWEEN INNOVATION CAPABILITY
AND INNOVATION PERFORMANCE IN SERVICE FIRMS**

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THE RELATIONSHIP BETWEEN INNOVATION CAPABILITY AND
INNOVATION PERFORMANCE IN SERVICE FIRMS

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I dedicate my dissertation work to my family; for their endless love, support and encouragement.

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ABSTRAK

Sebagai sumbangan penting kepada kejayaan jangka panjang firma, inovasi telah pecah sebagai salah satu penentu paling penting prestasi organisasi. Peranan penting dalam inovasi dalam kejayaan perniagaan firma telah menyebabkan kemunculan penyelidikan yang luas mengenai perkara ini. Walau bagaimanapun, dalam kebanyakan kajian lepas mengenai isu inovasi, tumpuan adalah pada inovasi dalam firma-firma pembuatan dan kurang perhatian telah dibayar kepada syarikat-syarikat perkhidmatan. Objektif kajian ini adalah untuk melakukan kajian ke atas firma-firma perkhidmatan dan cuba untuk meneroka faktor-faktor yang membentuk keupayaan inovasi dalam syarikat-syarikat perkhidmatan dan mengkaji hubungan antara faktor-faktor dan prestasi inovasi. Lima faktor yang telah dikenal pasti, iaitu inovasi perkhidmatan, inovasi pasaran, inovasi strategik, proses inovasi dan inovasi tingkah laku. Melalui soal selidik yang diedarkan oleh tangan, data yang dikumpulkan daripada hotel-hotel di Kuala Lumpur, Malaysia. Sebanyak 57 borang soal selidik berkenaan telah dikumpulkan daripada 60 soal selidik yang diedarkan, menunjukkan kadar 95% pulangan. Regresi berganda dan analisis Korelasi Pearson digunakan untuk menganalisis data. Analisis data menunjukkan bahawa inovasi perkhidmatan, inovasi pasaran dan inovasi tingkah laku mempunyai hubungan yang signifikan dengan prestasi inovasi dalam industri hotel. Walau bagaimanapun, inovasi strategik dan proses inovasi tidak didapati mempunyai hubungan yang signifikan dengan keupayaan inovasi. Hasilnya adalah konsisten dengan kajian sebelum ini, yang mendapati bahawa organisasi yang mempunyai inovasi yang lebih tinggi mempunyai prestasi inovasi yang lebih baik.

ABSTRACT

As a significant contribution to a firm's long-term success, innovation has burst as one of the most important determinants of organizational performance. The important role of innovation in the success of firms' business has resulted in the emergence of an extensive research on this subject. However, in most of the past studies on the issue of innovation, the focus was on innovation in manufacturing firms and less attention has been paid to service firms. The objective of this study is to do research on service firms and tries to explore factors that make up innovation capability in service firms and examine the relationship between those factors and innovation performance. Five factors were identified, that is service innovativeness, market innovativeness, strategic innovativeness, process innovativeness and behavioral innovativeness. Through questionnaires distributed by hand, data was collected from hotels in Kuala Lumpur, Malaysia. A total of 57 applicable questionnaires were collected out of 60 questionnaires distributed, indicating a 95 % rate of return. Multiple regression and Pearson Correlation analysis was used to analyze the data. Data analysis revealed that service innovativeness, market innovativeness and behavioral innovativeness have a significant relationship with innovation performance in hotel industry. However, strategic innovativeness and process innovativeness were not found to have a significant relationship with innovation capability. The result is consistent with previous studies, which found that organization with higher innovativeness have better innovation performance.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

In today's dynamic business environment, firms need to enhance innovation as an essential source of sustainable competitive advantage (Tidd and Bessant, 2011). Moreover, globalization of markets and extremely fast growth of technology put pressure on companies to look for new ways to compete and survive (White, 2007). Therefore, there is a need for innovative solutions to the emerging novel demands of organizations in order to survive in the highly complex business competition.

The important role of innovation in the success of firms' business has resulted in the emergence of an extensive research on this subject. However, in most of the past studies on the issue of innovation, the focus was on innovation in manufacturing firms (Yam *et al.*, 2010; Lau *et al.*, 2010) and less attention has been paid to service firms. Therefore, this study attempts to do research on service firms and tries to explore factors that make up innovation capability in service companies and examine the relationship between those factors and innovation performance. In this dissertation, we provide survey research on hotels in Kuala Lumpur, Malaysia.

This chapter is organized as following. First, the research background and the statement of problem are being expressed. Then, the research questions and objectives are presented followed by the scope of the study as well as significance of the research and the limitations of this study will be discussed next.

1.2 Research Background

1.2.1 Innovation in Service Industry

The important role of innovation in the success of business is widely demonstrated by scholars (Tomala and Senechal, 2004; Cormican and O’Sullivan, 2004). Today, innovation has become imperative for firms in order to remain competitive. Drucker (2006) stated that innovation is much more important than labor, capital and land, and it is the key to business survival and growth. Innovation is the solution for organizations to convert changes to opportunities and succeed (Huse *et al.*, 2005).

Service innovation is becoming of crucial importance as economies are increasingly driven by services (Dotzel, 2010). Firms in both service and manufacturing industries are trying to introduce new services to create value and achieve competitiveness (Berry *et al.* 2006). Today, firms prefer to compete based on their new services rather than compete on products since service has become a major source of competitive advantage (Xin *et al.*, 2006). A continuous generation of new products, new delivery methods, new marketing strategies and new organizational forms is critical

since unique selling points are to link with higher level customer needs fulfillment (Hjalager *et al.*, 2011)

The importance of service innovation in today's economy has led to considerable attention paid by managers to know more about that concept. However, innovation itself is not enough for achieving competitiveness (Balan and Lindsay, 2010). Managers need to know that in order to reach the sustainable competitive advantage goal they have to have the potential and capability to innovate (Zheng, 2009). Innovation capabilities describe the attributes in terms of skills in which the firm is superior to its competitors, and each firm should possess to support innovation (White and Bruton, 2007; Balan and Lindsay, 2010). Firms need to have the ability and capability to innovate continuously. This is a challenge for organizations to how to arrange their organization to deliver innovation performance up front.

Prahalad and Hamel (1990) stated that firms compete on the capacity to develop new products rather than competing on new products. Innovation capability is an essential source of innovation that could not be easily duplicated by competitors (Hogan *et al.*, 2011). Thus, understanding the elements and factors that build up innovation capability helps firms enhance their ability to innovate and as a result, it leads to innovation performance (Terziovski and Samson, 2007).

As Ibrahim *et al.* (2009) stated most of the past studies regarding innovation capability, investigate particular perspectives of innovation capability and less attention has been paid to validate the overall innovation capability of firms, especially Malaysian firms. The need to better understand innovation capability and its effect on innovation performance in service firms formed the motivation for this study. In this study,

dimensions of innovation capability are being explored and the relationship between those factors and innovation performance is being examined.

1.2.2 Hotel Industry in Malaysia

Malaysian service sector has become important since Malaysian government decided to shift the economy from a production-based to a service-based and knowledge-based economy in 2002 (Bank Negara Malaysia, 2002). Hotel industry is a sub-sector of Malaysian service industry that has gained great development (Tourism Malaysia, 2007). It plays an important role in supporting Malaysian's tourism industry and economy.

The development of hotel sector in Malaysia has been encouraging (Tourism Malaysia, 2007). For example in 1987 the tourism industry in Malaysia ranked fifth in terms of earning potential of foreign exchange. By 1992, this position increased to number three. The statistic by the Immigration Department of Malaysia showed that there were 16.43 million tourists from around the world visited Malaysia in the year 2005 compared to only 7.93 million in 1999 (Tourism Malaysia, 2007). The Malaysian tourist receipts had also been increasing from RM 12,321.3 million in 1999 to RM 31,954.1 in 2005. The similar trend can be seen in the number of hotels and hotel rooms. Since 1980, the number of hotel rooms had increased from 26,173 to 45,032 in 1990 (Goldsmith & Mohd Zahari, 1994). By 2004, there were 151,135 rooms available in Malaysia (Tourism Malaysia, 2007). In terms of number of hotels available, there were 2,224 hotels in 2004 compared to 1,404 hotels in 1999 (Tourism Malaysia, 2007). This statistics shows that the hotel industry in Malaysia is growing.

In 2008, MYR49.6 billion [approximately USD14.2 billion] from tourists was recorded, with 31.2% of the total tourist expenditures coming from travel accommodations (Tourism Malaysia, 2010). Malaysian hotels accommodated 68,886,154 guests in 2008 and had an average occupancy rate of 66%. The number of rooms supplied during 2008 increased by 3.4% (total of 165,739 rooms), while the number of hotels increased by 0.6% (total hotels 2,373) as compared to 2007 data. The increasing numbers of rooms and hotels present challenges for hoteliers in attracting guests away from their competition (Sumarjan and Arendt, 2011). These challenges make Malaysian hotels engage in innovation activities to compete in today's business environment.

1.3 Statement of Problem

Research about innovation has been conducted mostly on firms that produce manufacturing products. Consequently, theories of innovation have been developed on the basis of manufacturing sector rather than the service sector (Sundbo, 1997). Since there are great differences between the process of producing tangible goods and the process of producing intangible services (Storey and Easingwood, 1998), innovation in service firms is not similar to that in manufacturing firms.

As Hipp and Grupp (2005) stated, it is not easy to transfer the well-established concept of innovation in manufacturing sector to the service sector. It is also suggested that innovation capability may differ across service sectors (Balan and Lindsay, 2010). Empirical studies support the conclusion that hospitality industry has shown

differentiated innovative behavior from other service firms (Camisón and Monfort-Mir, 2012).

The number of studies on the subject of service innovation has increased in recent years. Research has been conducted on service innovation from different aspects. For example, McGrath and Percival (2011) investigated factors affecting innovation output in the Canadian service sector. Chamberlin *et al.* (2009) conducted research on Canadian service firms to find the relationship between innovation and business success factors. Tseng *et al.*, (2008) examined the relationship between innovation configuration and performance based on three main clusters of innovation configurations, which are technical, human capital and organizational innovations.

Ottechanber (2007) investigated the relationship between new service development and innovation performance in German hotel industry. Camisón and Monfort-Mir (2012) discussed about measurement of innovation in the tourism industry at the company level from the Schumpeterian perspective. In addition, some models for service innovations have been proposed by past studies (Hertog and Bilderbeek, 1999; Hertog *et al.*, 2003). However, knowledge related to the internal structure of innovation, diffusion of organizational and marketing innovative activity is limited to recent studies (Orfila Sintes and Mattsson, 2009; Tseng *et al.*, 2008). Nevertheless, most of the previous studies conducted on service innovation were descriptive and qualitative studies done within a limited scope.

Innovation in service firms is as essential as innovation in manufacturing firms to achieve competitive advantage. However, as Camisón and Monfort-Mir (2012) stated the rate of innovation in hotel industry is relatively lower than manufacturing and other services companies. This study suggested that the low official rate of innovation

measured in tourism industry can be explained by a great number of hidden innovations distinguished between actual and measured innovation. Hospitality industry develops innovation for both financial and non financial performance objectives; unlike service innovations, which often develop innovation for financial reasons. (Ottenbacher and Gnoth, 2005; Griffin and Page, 1993; Storey and Easingwood, 1998).

There are nondirect benefits from innovation besides traditional financial benefits has found in research such as, enhanced customer loyalty, improved image and the ability to attract new customers (Storey and Easingwood, 1998; Ottenbacher and Gnoth, 2005). A great number of researches measure service innovativeness by financial measures (Ghalayini & Noble, 1996; Montoya-Weiss and Calantone, 1994), but the performance within the hotel industry cannot be measured by a single factor (Storey and Easingwood, 1999).

A few studies explored innovation capability construct or the relationship between specific dimensions of innovation and performance, and none of these studies explored the relationships between innovation capability and innovation performance by measures, which fits into hotel industry. (Tseng *et al.*, 2008; Balan and Lindsay, 2010; Ottenbacher, 2007; Camisón and Monfort-Mir, 2012). Hence, there is a gap in empirical research on the relationship between innovation capability and performance by a measurement fitting the hotel industry.

Moreover, studies have shown that like innovation in manufacturing firms, the success rate of service innovation is low (Xin *et al.*, 2006). Oke (2004) declared that innovation in service firms has achieved less success compared to that in manufacturing firms. In fact, 40 percent of innovations in service firms fail in the marketplace (Griffin,

1997). It is suggested that the rate is even higher in hospitality since the great number of hotel concepts fails every year (Kotler *et al.*, 2009a).

A possible explanation of the high rate of failure with hospitality innovation might be limited knowledge about achieving success. As a result, hotel managers develop a personal favorite idea relied on their inner sense, speculation and limited experience without conducting market research about innovation success. However, hospitality firms have to innovate despite the limited knowledge of innovation success and high risk of failure (Ottenbacher, 2007). As Zheng (2009) stated innovation by itself is not sufficient and does not guarantee the success of the business unless managers know what skills and capabilities are needed for innovation.

There exists a significant gap in the literature on the measurement of innovation capability in service firms (Adams *et al.*, 2006). So far, research on service innovation has largely focused on definition and concept of service innovation (Oke, 2007; Hipp and Grupp, 2005) or comparing service innovation to product innovation and finding the similarities or differences between these two types of innovation (Zhang, 2011; Ettlie and Rosenthal, 2011).

Most of the past studies on the subject of innovation capability attempted to draw out the variety of dimensions of innovation capability from the literature (Hogan *et al.*, 2011; Ibrahim *et al.*, 2009; Lawson and Samson, 2001; Wang and Ahmed, 2004; Balan and Lindsay, 2010) and few studies explore the influence of and the relationship between each dimension of innovation capability and innovation performance, especially in service firms (Romijn and Albaladejo, 2002; Yam *et al.*, 2010) and none of these studies specifically focus on service innovation in hotel industry.

Thus, empirical studies attempting to explore the innovation capability in service firms are missing from the literature. Particularly, research on innovation in the hotel industry is very limited in the literature (Balan and Lindsay, 2010). In addition, there is a paucity of research on the influence of innovation capability dimensions on innovation performance in hotel industry (Balan and Lindsay, 2010).

Previous studies have only found evidence that firm innovation truly affects firm performance. However, performance and innovativeness are not defined by a single factor. No research answered the question of whether hotel industry needs different innovation management approaches based on their objective for each innovation project (Ottenbacher, 2007). The need to investigate about which dimension of innovation capability and performance are related together and which dimension of innovation capability maximizes firm performance cannot be neglected. In addition, there is no empirical research on which dimensions of innovation capability are dominant in the context of hotel industry in Malaysia.

Therefore based on the literature there exist a significant gap in relationship between innovation capability and innovation performance dimensions from different aspects, first innovation capability evaluation was not done through a construct devised to measure innovativeness in service firms. Second, there is a paucity of empirical research on measuring the innovation performance by a measurement fitting the hotel industry. Third, which dimension of innovation capability maximizes firm performance.

Therefore, based on this problem and the gap found in the literature, we do this research to investigate innovation capability in the service sector, particularly in hotel industry and to explore its relationship with innovation performance.

The above mentioned discussion led us to development of the following research question posed in this study.

1.4 Research Questions

Q1: What factors make up innovation capability on hotels in Kuala Lumpur, Malaysia?

Q2: What is the relationship between those factors and innovation performance on hotels in Kuala Lumpur, Malaysia?

Q3: What is the effect of innovation capability on innovation performance on hotels in Kuala Lumpur, Malaysia?

1.5 Objectives of the Study

1: to identify factors make up innovation capability on hotels in Kuala Lumpur, Malaysia.

2: to examine the relationship between those factors and innovation performance on hotels in Kuala Lumpur, Malaysia.

3: to examine the effect of innovation capability on innovation performance on hotels in Kuala Lumpur, Malaysia?

1.6 Scope of the Study

There is a diversity of service firms in service sector and it is difficult to estimate a precise quantity of service firms in Kuala Lumpur, Malaysia. Therefore, this study attempts to focus only on service innovation on one particular service sector- hotel sector. To do our research we concentrate on hotels located in Kuala Lumpur, Malaysia.

Kuala Lumpur has been chosen because first, Kuala Lumpur is the most developed cities in comparison with other cities in Malaysia. Therefore service enterprises impart sufficient resources to be capable of innovation. Second, Since Kuala Lumpur is the capital of Malaysia, a large number of people travel from all over the

world every year to visit Kuala Lumpur. Hence we probe into what Kuala Lumpur can offer to travelers in term of tourist. And third, almost every international flight lands near Kuala Lumpur at KLIA or ICCT; thus, any international tourist who visits Malaysia stays a while at Kuala Lumpur because. In addition this study expected to provide useful information to expedite the development progress.

The hotel sector is an important part of Malaysian service industry. Hotel size is a relevant variable in innovation decisions since it affects profitability and implementation of these decisions (Orfila Sintes and Mattsson, 2009). Hotels with over 40 bedrooms were chosen as target population because it is common in hotel industry practice to use number of rooms or its equivalent as the indicator of hotel size (Baum and Mezias, 1992; Chung and Kalnins, 2001; Fernandez and Marin, 1998). There are 69 hotels with over 40 bedrooms located in Kuala Lumpur, Malaysia. So, the scope of this study is limited to Kuala Lumpur hotels.

The survey participants are managers, executives and business owners. The reason why hotel sector has chosen for the basis of this research is that it is highly competitive industry and is growing extremely fast. We select the respondents of our study from hotels with over 40 bedrooms in Kuala Lumpur and there is not any preference to a hotel based on its size, ethnicity of the participants or the type of the service they provide.

1.7 Significance of the Study

Services are in the center of economic activities in most of the industrialized countries, and innovation has been a driving force for economic growth (Ho *et al.*, 2011). Therefore, service innovation is essential for growth of economy in each country. Particularly, the ability to innovate on a continuing basis is critical for service firms to support innovation and develop competitive advantage.

Despite several researches on innovation from different aspects, limited number of studies on innovation capabilities, particularly on service firms has been conducted empirically (Hogan *et al.*, 2011; Silva *et al.*, 2009; Balan and Lindsay, 2010). Previous studies on innovation capability mostly focused on manufacturing firms and new-product development (Yam *et al.*, 2010; Lau *et al.*, 2010).

Moreover innovation capability evaluation was not done through a construct devised to measure innovativeness in service firms. A few studies explored innovation capability construct or the relationship between specific dimensions of innovation and performance, but studies which explore the relationships between innovation capability and innovation performance by measures, which fits into hotel industry are very limited in the literature. (Tseng *et al.*, 2008; Balan and Lindsay, 2010; Ottenbacher, 2007; Camisón and Monfort-Mir, 2012). Thus, conducting this study is significant to address this gap in the literature.

In this study, a comprehensive set of dimensions of innovation capability in service firms is being examined and fundamental elements that make up service innovation capability in hotels is explored. Then, we reevaluate the construct to measure the innovation capability in hotel industry scope and examine the relationship between

elements of innovation capability and innovation performance, which fits into hotel industry context. This study contributes to the literature by doing empirical research on hotel industry. The result from this study gives valuable information regarding the relationship between dimensions of innovation capability and innovation performance in hotel industry. Furthermore, it improves the understanding of which dimensions of innovation capability maximize performance. It also provides information on innovation capability of hotels in Kuala Lumpur, Malaysia.

The results of this study can help managers of hotels to understand what capabilities they need to possess in order to be innovative and achieve best innovation performance. In addition it provides valuable information for different innovation management approaches based on objectives for each innovation project. It is expected that the findings of this study enrich the existing literature on service innovation in Malaysia and provide managers of hotels with necessary information and knowledge about the required skills and capabilities for the long- term plans for innovation.

1.8 Research Limitations

The main limitation of this study is that the outcomes could not be generalized to other service companies and manufacturing firms. This study focuses only on hotel industry in Kuala Lumpur, Malaysia as a service industry that practices service innovation. It is not clear that service innovation in other service industries in Malaysia is being practiced the same.

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