Being Boutique in a Hotel Cluster: The Benefits and Threats of Agglomeration

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Drawing on the agglomeration and hotel management literature, this paper identifies the benefits, threats and opportunities of being boutique in a hotel cluster. According to the literature on agglomeration, firms that pursue differentiation strategies are more likely to enjoy the benefits of agglomeration rather than suffer from the threats of agglomeration. Being boutique is a classic differentiation strategy in the hotel business. The rise of Airbnb threatens the operational model of a boutique hotel. The author proposes that strategic human resource management may allow the boutique hotel to enhance its differentiation advantage by pairing unique features with superior service.

Keywords: Agglomeration, boutique hotel, strategy, strategic human resource management

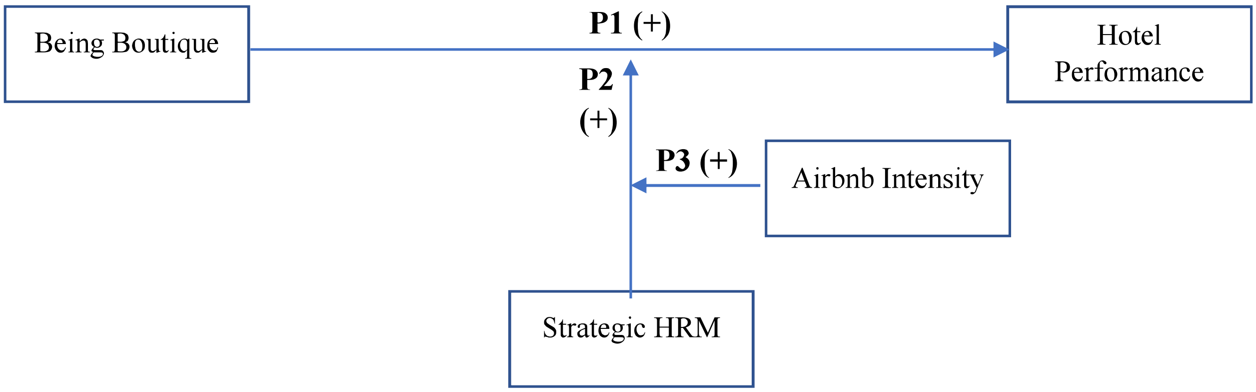
INTRODUCTION

According to the literature of agglomeration, firms with similar businesses locate near to each other. This agglomeration effect can enhance firm performance in three ways: First, agglomerated firms can obtain knowledge spillovers from their competitors; Second, agglomerated firms can reach a specialized labor pool; finally, agglomerated firms can access a specialized supplier pool (Marshall, 1920). However, agglomeration may reduce firm performance because Shaver and Flyer (2000) found that firms not only benefit from agglomeration but also contribute to it. To benefit from agglomeration and avoid potential threats or loss, Alcácer and Zhao (2012) recommended that firms develop strong internal linkages. These internal linkages can increase a firms' ability to internalize knowledge and decrease a firm's risk of knowledge outflows toward competitors.

Because of demand externality, agglomeration is popular in the hotel industry (Baum & Haveman, 1997; Baum & Mezias, 1992). The agglomeration effect (gaining or losing) is sensitive to the hotel's composition and size, the distribution of other hotels in an area, and the variance across differentiated hotels in that area (Freedman & Kosová, 2011; Yang, Luo & Law, 2014). Researchers found that independent hotels and smaller hotels gain the most in a hotel cluster because they are pursuing different goals and strategies compared to large chain hotels (Chung & Kalnins, 2001; Tsang & Yip, 2009). According to the hotel management literature, boutique hotels reflect differentiation strategies of hotel owners, because they try to provide customers outstanding and different room experiences.

The following sections integrate the literature on agglomeration and hotel management, aiming to explore why and how boutique hotels may have a competitive advantage over other types of hotels in the same hotel cluster and what boutique hotels could do while facing the threat of Airbnb. See Figure 1 for proposed testing model.

FIGURE 1
PROPOSING MODEL



LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

According to classic economic theory, firms tend to have lower average performance when facing a higher degree of competition. If so, firms should locate far away from their competitors in order to maximize their profits and to minimize threats from competitors. However, this argument contrasts with much empirical evidence. Silicon Valley is the home to many of the world's largest technology companies including Apple, Google, Facebook, Intel, etc. (Semerda, 2011). Similarly, Wall Street is the location of many leading financial service companies and stock exchange markets (Jones, 2018). Las Vegas has a large number of hotels with over 152,000 hotel rooms (Perena, 2017). These contradicting findings raise a question: why would competitors locate close to each other?

This question can be answered by demand externalities, (notably the desirability of the location, natural beauty, a busy airport, etc.) as well as the agglomeration effect. Agglomeration can save cost from the colocation of complementary economic activity (Markusen, 1996) and create greater economic performance, increasing returns, and economic development (Krugman, 1991). Marshall (1920) describes two gaining mechanisms of the agglomeration effect. The first mechanism is production enhancements (supply-related externalities). Information exchange among firms allows firms to obtain technologies or resources and update their products or services. The second mechanism is heightened demand (demand-related externalities). Agglomeration can enhance customer demand by reducing searching costs of spatial separation. In the current literature, more and more researchers tend to apply both supply-related agglomeration and demand-related agglomeration when explaining firm location decisions (Alcácer & Chung, 2014), because supply-related agglomeration and demand-related agglomeration are interdependent and overlap with each other (McCann & Folta, 2009).

Agglomeration Effect (Supply-related View)

Marshall (1920) listed three main reasons that explain how agglomeration externalities can influence firm performance: access to knowledge spillover, pool of specialized labor, and pool of specialized suppliers. These ideas have been empirically supported. Martin & Ottaviano (2001) established that regional economic agglomeration can reduce other firms' innovation and transaction costs. Potter and Watts (2010) found that local pools of skilled labor, local supplier linkages, and local knowledge spillovers are the key reasons why agglomeration can benefit firms. Moreover, Cohen, Coughlin & Paul (2019) demonstrated that the agglomeration effect can enhance the growth and development of firms, industries, regions and cities.

Although agglomerated firms may enjoy better financial performance, returns, and development (Krugman, 1991), researchers have expressed concerns about the agglomeration effect. Porter (1996) pointed that internal competition among an agglomeration region is high. Shaver & Flyer (2000) argued that agglomeration reflects adverse selection. Only firms who perceive benefits by locating close to competitors tend to agglomerate. However, best-performing firms may decide not to cluster to avoid their net contributions (over benefits) to the agglomeration economies. Using a sample of foreign direct investment activities, Shaver & Flyer (2000) empirically supported the previous ideas. Similarly, Kim, Pickton and Gerking (2003) found that the cost of skilled labor is high because of the agglomeration effect. Besides, employee mobility is another big concern in an agglomeration region (Faggian & McCann, 2009).

The agglomeration effect is a double-edged sword. What can firms do to benefit from agglomeration without its associated threats? Alcácer and Zhao (2012) explored agglomeration from firm internal elements. They found that firm internal linkages not only enhance tight control over firm innovation but also reduce the risk of knowledge spillover that benefits local competitors. Similarly, Alcácer & Delgado (2016) found that both external agglomerations and internal agglomerations influence firm location decision, value chain activities, and performance. In addition, the location of subsidiaries and same-role geographic proximity a drive firm's location decisions. Furthermore, some researchers examined the effect of agglomeration in a contingent view. For instance, knowledge spillover within one cluster provides an opportunity for freeriding, especially in term of training and development or R&D activities. Lamin & Ramos (2016) demonstrated that the freeriding problem is more severe for local firms than foreign firm in emerging markets.

Agglomeration Effect (Demand-related Integrative View)

Markusen (1996) believed that agglomeration effects have the strongest influence on high-tech, knowledge-based, and innovation-driven industries. It is important to note that the agglomeration effect exists not only in manufacturing industries but also in service industries. Demand-related agglomeration has been discussed mainly about auto-dealerships and hotels. For a hotel, the location decision highly depends on agglomeration, which reflects demand externalities, which reduces the searching cost of customers and reflects the strength of customer demand. Baum and Mezias (1992) found that locating closer to other hotels increases a hotel's survival chances. Baum and Haveman (1997) demonstrated that spillovers from adjacent competitors pull firms close to similar competitors. New hotels tend to locate close to other hotels with similar room prices, aiming to benefit from agglomeration effect. Similarly, Adam and Mensah (2014) found that spatial agglomeration significantly influences the tendency of hotels' location choices.

Nonetheless, the benefits of agglomeration effects are followed by concerns. Agglomeration creates a greater density of competitors. Luo and Yang (2016) demonstrated an inverted-U-shaped relationship between hotel incumbent concentration and location probability. Despite the gaining of demand externalities, on average, hotels tend to maintain lower average prices with less dispersion of local prices (Balaguer & Pernías, 2013; Marco-Lajara, Claver-Cortés, Úbeda-García & Zaragoza-Sáez, 2016). Unlike in other industries, agglomeration in the hotel industry provides an opportunity for spillover and free riding. Kalnins and Chung (2004) found that entrants will locate near others possessing resources that can spillover but will avoid locations where existing firms will exploit spillovers without contributing. Meanwhile, owners of upscale hotels try to avoid markets with hotels without similar resources.

Lee and Kang (2015) proposed that hotel agglomeration effects may be different under different types of market, demand, and locations. They found that undifferentiated agglomeration externalities were more favorable to hotels' average operating performance than differentiated agglomeration externalities were.

Examining both the positive and negative influences of agglomeration in the hotel industry, researchers started to explore heterogeneity across different hotels. Chung and Kalnins (2001) found that chain hotels and larger hotels contribute to positive externalities and that smaller hotels gain the most. Similarly, Tsang and Yip (2009) empirically supported that only high star-ranking joint venture hotels contribute to heightened demand while all other ranking hotels benefit similarly from agglomeration. Canina, Enz and Harrison (2005) found that agglomerated firms benefit from competitors' differentiation without making similar differentiating investments themselves. However, agglomeration with low-cost strategic oriented hotels reduces the performance of hotels that pursue high levels of differentiation.

Similarly, Urtasun and Gutiérrez (2006) emphasized the importance of balancing agglomeration and hotel differentiation strategies. Overall, researchers believe that the agglomeration effect of hotels is sensitive to the composition and size distribution of other hotels in an area and varies in strength across differentiated hotels (Freedman & Kosová, 2011; Yang, Luo & Law, 2014). These ideas were empirically supported by a recent study. Sampling 90 urban hotel markets in U.S., Kalnins (2016) found both size-based and geographic-based localized competition.

Being boutique is one differentiation strategy of hotel owners. In the 1970s, international hotel companies dominated the industry with similar or identical designs (Rogerson, 2010; Teo & Chang, 2009). The prevailing hotel management rule was the box hotel concept, which emphasized the uniformity of core services and products (De Klumbis & Munsters, 2005). An example of this concept can be found in Holiday Inn's advertisement: "The best surprise is no surprise" (Rutes, Penner & Adams, 2001). Facing the competition of standardization, small or medium hotel owners developed the idea of boutique hotel as a differentiated and innovative product in the market (Albrecht & Johnson, 2002). With years of development, boutique hotels refer to contemporary and design-led hotels with up to 100 bedrooms. A boutique hotel is known for offering unique levels of personalized service and high-tech facilities (Agget, 2007; Mun Lim, & Endean, 2009). The emergence of boutique hotels is described as "one of the most interesting developments in the hospitality sector of the leisure industry" (Horner & Swarbrooke, 2005: 369).

Being Different as Boutique Hotels

The purpose of a boutique hotel is to differentiate itself from competitors (Forsgren & Franchetti, 2004). Unlike big chain hotels, boutique hotels aim to attract customers by offering friendly and personalized services (Răbonţu & Niculescu, 2009). Mun and Endean (2009) referred to boutique hotels as small hotels with intimate and individualistic atmospheres and styles. In the literature of boutique hotel management, researchers have widely discussed how to make boutique hotels successful. Buttle (1996) and Crompton and Mackay (1989) believed that service quality is multi-dimensional: Reliability refers to the ability to perform the promised service dependably and accurately; assurance refers to the knowledge and courtesy of employees and their ability to convey trust and confidence; tangibles refers to the appearance of physical facilities, equipment, personnel and communication materials; empathy includes the provision of caring, individualized attention to customers; and responsiveness reflects the willingness to help customers and to provide prompt service. Based on these categories, Aggett (2007) identified five key attributes location, quality, uniqueness, services provided, and the personalized levels of service offered. Similarly, Chu and Choi (2000) applied Importance–Performance Analysis to the Hong Kong hotel industry. They identified six hotel selection factors: service quality, business facilities, value, room and front desk, food and recreation, and security.

In certain industries, product innovation can only go so far. The advantage of product differentiation can only create so much competitive advantage, diminishing returns of additional product differentiation. In such circumstance, differentiation on the base of customer service may be the only true way to gain sustainable competitive advantage. In other words, in a given market, when products are already very differentiated, service differentiation is what works. Due to the friction involved with closing, moving, and reopening an operation, the location of a boutique hotel is less likely to change compared to other factors. Therefore, in the literature, there is much discussion of boutique hotel service management resulting in personalized customer service (Mcintosh & Siggs, 2005; Teo, Chia & Kho, 1998) by highly skilled and friendly staff (Callan & Fearon, 1997; De Klumbis, Sant, Esade & Munsters, 2010). The core idea is that boutique hotels need to make their guests feel special. Khosravi, Malek and Ekiz (2014) concluded that friendly and professional staff in a homey environment can enhance the positive connection between guests and boutique hotel staff. Following this idea, Wongsuchat and Ngamyan (2014) found that the boutique hotel is a value-added product, in which service quality significantly predicts customer satisfaction and loyalty. Similarly, Hussein, Hapsari and Yulianti (2018) found that the boutique hotel experience quality (physical environment and social interaction) positively enhances hotel image, customer perceived value, and customer loyalty.

Service is provided by front-line employees. Given the importance of service, researchers started to explore how to enhance service and hotel performance. Hartline and Jones (1996) found that the frequency of employee-customer interaction and the tangibility of employee performance are key drivers of hotel success. Front desk, housekeeping, and parking employee performance has a significant effect on customer perceived quality and value. Kim and Cha (2002) called for implementing relationship-based management with hotel employees to enhance customer satisfaction and hotel performance. They believed that (1) greater service providers' relational and customer orientation resulted in higher relationship quality; (2) better service providers' attributes resulted in higher relationship quality; and (3) higher relationship quality resulted in higher purchases and better relationship continuity and share of purchases. Similarly, Salanova, Agut and Peiró (2005) found that employee work engagement and performance positively associate with customer satisfaction and hotel performance. Chi and Gursoy (2009) demonstrated the strategic importance of employees in hotels. They found that employee satisfaction and performance lead to customer satisfaction, brand loyalty, and hotel financial performance. Meanwhile, Hu, Horng and Sun (2009) found that knowledge sharing and team culture can enhance service innovation performance in the hotel industry. Hotels owners need to develop knowledge sharing behaviors plus a team culture. Furthermore, Chiang and Hsieh (2012) believed that hotels must inspire their employees to perform their best and encourage employees to fulfill their responsibilities as citizens. They found that perceived organizational support and psychological empowerment positively influence employees' organizational citizenship behavior in the hotel industry. Marco-Lajara, del Carmen Zaragoza-Saez, Claver-Cortés and Úbeda-García (2016) found that the knowledge coming from a hotel's employees positively affects service quality and hotel performance.

Boutique hotels are small size hotels applying differentiation strategies. According to the literature on the agglomeration effect in the hotel industry, boutique hotels are more likely to gain from spillover from competitors and enjoy the benefits of agglomeration. Therefore, I propose:

Proposition 1: *Boutique hotels will have better performance than non-boutique hotels in a hotel cluster.*

Strategic Human Resource Management

Given the importance of employees in hotels and especially in boutique hotels, hotel managers need to explore how to enhance employee work motivation and engagement to gain the differentiation advantage that boutique hotels seek. Strategic human resource management has been considered as a bridge to connect macro firm strategy and micro employee stakes (McClean & Collins, 2011; Rogg, Schmidt, Shull & Schmitt, 2001). Hoque (1999) examined the relationship between human resource management and performance in the UK hotel industry. The results demonstrate that a high degree of alignment between human resource management and hotel strategy leads to enhanced hotel business performance.

In general, firms include three types of resources: physical capital resources, human capital resources, and organizational capital resources (Barney, 1991). Human resource management practices can enhance the service quality of hotels. Erkutlu and Chafra (2006) explored different types of leadership and their influence on employee stress in boutique hotels. Choochote and Chochiang (2015) explored the influence of electronic human resource management (E-HRM) practices and found that E-HRM has been widely used in job recruitment, employee engagement, idea and creativity exchanges, and organizational structure. However, the use of E-HRM is low regarding compensation, career development, and training programs. Batt (2002) examined the relationship between human resource practices, employee quit rates, and organizational performance in the service sector and found that employee quit rates are low and organizational performance is high when the human resource practices focus on developing employee skills, forming employees into teams, encouraging employee participation in decision making, and providing relatively high compensation and employment security. Taylor and Davies (2004) explored the extent and role of training and demonstrated its contribution to strategic goal achievement and boutique hotel performance. Nankervis (2000) proposed that human resource management practices provide key future competitiveness in the hotel industry. Sun, Aryee and Law (2007) found that human resource management practices can enhance service-oriented citizenship behaviors by hotel employees, reduce their turnover, and enhance their productivity.

The strategic human resource management system refers to a configuration of coherent practices designed to enhance employees' skills, motivation, and participation in order to improve the value of their collective contributions (Han, Kang, Oh, Kehoe & Lepak, In Press). A strategic human resource management system can be discussed from a strategic view, a contingent view and a social exchange view. In the strategic view, researchers tend to emphasize the particular fit between the strategic human resource management system and organization strategies. In the contingent view, researchers believe that a high performance work system can enhance firm performance when HR practices are compatible with each other in the system (Saridakis, Lai & Cooper, 2017). A strategic human resource management system can also be considered as a coordination mechanism which enables employees to act in concert toward the achievement of organizational goals (Ostroff & Bowen, 2016). In the social exchange view, researchers suggest that HR practices can enhance firm performance by developing a social exchange relationship between an organization and its employees (Settoon, Bennett & Liden, 1996; Konovsky & Pugh, 1994).

In this paper, the role of a strategic human resource management system is studied from a social exchange perspective. According to Cropanzano & Mitchell (2005), social exchange refers to interdependent interactions that generate obligations. A social exchange can exist between individuals (such as friendship) or between employees or organizations (such as affective commitment). From the social exchange perspective, organizations invest in strategic human resource management systems to develop employees' capabilities, motivation, and opportunities to archive their personal values (Zhou, Hong, & Liu, 2013). At the same time, organizations depend on employees to contribute to the firm's performance and long-term success. The exchange between the organization and its employees needs to be a high-quality social exchange rather than a market transaction, especially for service-based organizations pursuing innovation and performance. In the hotel industry, employees have a high degree of involvement in the direct activity of the business. If a high-quality social exchange exists, employees may be willing to participate in organizational activities, even extra-role organizational activities, regardless of the organizational hierarchy (Slack, Corlett & Morris, 2015). Also, if a high quality social exchange exists, employees might be more involved in their jobs, have a strong sense of belongingness (Meacham, Cavanagh, Shaw & Bartram, 2017), and work beyond their job descriptions (Huang, Lee, McFadden, Murphy, Robertson, Cheung & Zohar, 2016).

A recent taxonomy paper listed nine types of human resource practices: compensation and benefits, job and work design, training and development, recruiting and selection, employee relations, communication, performance management and appraisal, promotion, and turnover, retention and exist management (Posthuma, Campion, Masimova & Campion, 2013). Boutique hotels enhance their differentiation advantage through HR practices that result in service quality. Boutique hotels can enhance their performance through human resource management in the following way: Hire candidates who have strong innovation-orientation and work enthusiasm; provide training to enhance employees' working capabilities and service-oriented organizational citizenship behaviors; communicate with employees about the hotel's mission and strategy and management's expectation of employee engagement; encourage employees to participate in decision-making regarding the guest experience; provide autonomy and feedback about employees' in-situ decisions which aim to improve hotel service quality; evaluate employee contributions to service exploration and development; and finally, compensate those contributions in a timely manner. These relationship-based strategic human resource management practices are also likely to reduce employee turnover, which leads to a threat of knowledge spillover. Overall, I propose that strategic human resource management practices will enhance a boutique hotel's differentiation, and therefore its performance:

Proposition 2: *Strategic human resource management practices positively enhance the relationship between being boutique and hotel performance.*

The Threat of Airbnb

Airbnb is an online marketplace for arranging or offering lodging, primarily homestays, or tourism experiences. The company does not own any of the real estate listings, nor does it host events; it acts as a broker, receiving commissions from each booking (Airbnb, n.d.). As of April 2019, there were a total of more than 150 million users on Airbnb. Since its launch, Airbnb has hosted over 500 million guests (Lewis, 2019). Researchers believe that Airbnb is a disruptive innovation, which lacks traditionally favored attributes but offers alternative benefits; in the long run, it transforms a market and captures mainstream consumers (Guttentag, 2015; Koh, & King, 2017). With millions of reservations booked through Airbnb, researchers pay more and more attention to its impact on the hotel industry. Unlike traditional two-sided markets, markets in the sharing economy include both professional decision-makers and nonprofessional decision-makers on the supply side (Li, Moreno & Zhang, 2015).

According to an online survey, nearly two-thirds of respondents used Airbnb as a hotel substitute. Empirical evidence found that Airbnb outperforms budget hotels/motels, underperforms upscale hotels, and has mixed outcomes versus mid-range hotels (Guttentag & Smith, 2017). Another empirical study found that, on average, Airbnb affects 8-10% of the revenue of nearby hotels. However, this impact is not uniform. Low-priced hotels and hotels that do not cater to business travelers are influenced the most (Zervas, Proserpio & Byers, 2017). Mody, Suess and Lehto (2017) identified that accommodation providers in the sharing economy are increasingly competing with the hotel industry vis-à-vis the guest experience. After conducting interviews, Mody et al. (2017) found that the following dimensions that are important for customers' accommodation: serendipity, localness, communication and personalization. In general, Airbnb appears to outperform hotel providers in the provision of all experience dimensions.

The outstanding performance of Airbnb is partially attributed to the less aggressive room pricing of non-professional hosts. This pricing inefficiency benefits all consumers, not just participants in the sharing economy (Zervas et al., 2017). Another reason can be that Airbnb constantly offers user-friendly features and can be a personalized and experiential. Meanwhile, Airbnb offers potentially rich connections between caring hosts and tourists (Lehr, 2015). These features of Airbnb present a big threat to boutique hotels, because boutique hotels aim to compete on differentiation by offering customers friendly and personalized services (Răbonţu & Niculescu, 2009) and providing intimate and individualistic atmospheres and styles (Mun & Endean, 2009). Customers who are simply looking for different room designs and styles can easily switch to Airbnb rather than stay in a boutique hotel.

With the challenges of Airbnb, boutique hotels should place emphasis on strategic human resource management practices to enhance the quality of employee-customer interactions. The in-person interaction is much more frequent in a boutique hotel than in an Airbnb accommodation. Boutique hotel managers should enhance employees' skills and capabilities to leverage customer satisfaction and loyalty. Therefore, I propose that Airbnb intensity will enhance a boutique hotel's dependence on strategic human resource management practices:

Proposition 3: *The degree of Airbnb intensity will enhance the positive moderation effect of strategic human resource management practices on the relationship between being boutique and hotel performance.*

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