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# Investigating the relationship between operating costs and firm profitability using longitudinal data from Indian Hotels

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**Introduction:**

Tourism in India plays an economic importance and is growing rapidly. Tourism gained peak growth in the year of 2017, compared to 2010(UNWTO, 2018). The growth rate of international tourist arrivals in the year 2017 is 7%(UNWTO, 2018). Ministry of Tourism, Government of India, expecting 20million foreign tourists by the year 2020(MINISTRY OF TOURISM, 2018). The growth rate of foreign tourists arrivals are 15.6% in the year of 2017 compared to 2016(MINISTRY OF TOURISM, 2018). Tourism generating 10 % of world GDP(Gross Domestic Power)(UNWTO, 2018), The service industry contribution is massive for tourism industry, "30% of the services exports" are happening in the world to support tourism industry(UNWTO, 2018). During 2017, the growth of tourism industry in India is tremendous and the performance of India Tourism industry increased the overall revenue of South Asia(UNWTO, 2018). With the 7% share of foreign tourist arrivals in India in the year of 2017, India stood top in South Asia(UNWTO, 2018).

Despite the growth of tourism industry, the hospitality industry unable to make significant profits due to taxation policies(Saxena, 2018), lack of skilled workforce and due to high operational costs involved(Mun & Jang, 2018). With the ease of technology, customers can make buying decisions by reading the information available in third-party websites; it's created the massive pressure on top-level managers to maintain the quality and to reach the expectations of the customers. In the digital era, marketing managers need to change their strategies to increase revenues and gain profits. Traditionally marketing managers focused only on marketing activities, but to understand the viability of the marketing activities and allocation of resources in the hospitality industry, Bierman Jr and Smidt (2012) suggested 5 functional areas, such as "cost control, revenue analysis, profitability analysis, investment-decision analysis and analysis of financial sources for hospitality industries". There is a high correlation between marketing activities on financial performance by increasing sales, brand value and brand image(Lovett & MacDonald, 2005).

In the current era, the challenges for firms are customer retention and customer acquisition. With the evolution of technology, customers changed the way of doing business from a traditional approach to e-commerce to m-commerce. With one finger touch business transactions are happening. These are the opportunities and challenges for the firms.

From the past two decades, scholars did immense work on in the marketing, HR settings(Y. Van Vaerenbergh & Orsingher, 2016). Very few studies has been done in operations and multidisciplinary settings(Y. Van Vaerenbergh & Orsingher, 2016). This study aims to link the firm performance with the operations cost variables in hotel settings. In India, many hotels are running by small, medium enterprises. They have limited knowledge on cost management. This study explored the uses of operating cost management in hotel sector.

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**Literature Review:**

**Advertisement Cost and Firm Performance:**

| Author | Variable(s) used in the study | Results |
|---|---|---|
| (Assaf, Josiassen, Ahn, & Mattila, 2017) | Advertising spending, firm performance:Sales, Firm Value and CSR | There is a significant role of advertisement on firm performance, depends on the firm size and firm volume advertisement impact sales and profits, firms who spends more on CSR activities will gain more returns. |
| (Qi, Hudson, David A. Cárdenas, & Mou, 2018) | Advertising expenses, other expenses, sales, firm value,and Book Value | Advertising expenses not only contribute to firm value, it also helps as a strategic investment. Advertisement increases the brand value and it contribute to sales and increases the profits. Compared with other expenses advertisement expenses contributing more to the firm value and advertisement expenses has significant contribution to "firm market value" rather than "book value"(Qi et al., 2018). |
| (Joshi & Hanssens, 2010) | Advertising spending's, Firm Value (Sales and profits) | The author not only studied the role of advertisement spending's on firm value, by using 15 years financial data the author conclude that advertisement spending's has significant contribution on sales and profit on long-term duration and less impact on short-term duration. The author identified the important relationship between customers satisfaction; advertisement spending's and firm value. He cautioned that too much advertisement spending's may impact the stock prices. |
| (Currim, Jooseop Lim, & Joung W. Kim, 2012) | Shareholder value, social media, year, word of mouth, frequency | The author stated that firm initiative customer engagement practices will increase the customer engagement but share value may decrease because of shareholders may think that these are the risks taking by firms. |
| (Chen & Lin, 2013) | Room revenue<br>Advertising expenditure (divided by 1,000,000), Type of location (1 = Resort; 0= otherwise), Type of operation (1 = Chain; 0= independent), Distance to the nearest international airport, Average daily room rate, Measurement of market concentration, The number of guest rooms,<br>Room occupancy rate. | The researcher did the in-depth study on how advertisement contributing to firm performance. The researcher conclude that advertisement influence the Average Room Rate(ARR) rather than increasing the room occupancy. |
| (Luo & Jong, 2010) | Earnings Forecast Changes ,Firm Return, Research and Development cost , Total Assests, Advertising Expense ,Firm Risk, Return on Assests(ROA), Analyst | The researcher did comprehensive study by taking 20years financial data to check the impact of advertisement on firm value through analyst advice. Analyst plays major role to improve firm value by analyzing the future sales, risks and profits. |

| | | |
|---|---|---|
| | Coverage, Liquidity, Total Dividend<br>Return on Assests | |
| (Sridhar, Germann, Charles Kang, & Rajdeep Grewal, 2016) | Firm performance: Tobin's Q**, Advertisement Budget Spending's (National Media, Regional Media andonline Media)* and Industry competitive intensity*** | Advertisement plays important role in firm-performance, but the hidden question is there are many mediums of the advertisement are there. Which is the best form and what's the purpose of those are investigated by researcher. There are broadly three types of advertisement medias are there, national media, regional media and online media. Each media individually contributing to firm performance and but the interaction effect shows the negative effect on firm performance. The national media is good to distribute the emotional messages and to build the brand reputation. While Online media and regional media can be used to promote the products or services. |
| (Assaf, Josiassen, Mattila, & Kneˇ, 2015) | Advertising spending*, Sales performance**, hotel size and star ratings#, type of ownership***,degree of customer satisfaction*** | Many firms think that advertisement as a cost rather than investment. Advertisement increases the firm performance through increasing sales and increasing customer satisfaction. For large firms advertisement plays major role to increase the hotel sales. Star ratings impact the hotel sales. |
| (Feng, Morgan, & Rego, 2015) | Marketing department power* Firm Performance**, Resource attraction#, TMT(Top Management team) attention # | |

***=Control Variable, #=Mediators and Moderators *=Independent Variables **=Dependent Variables

Advertisement plays an important role to gain the customers loyalty, satisfaction for any firms. Firms spend million amount of money to not only improve sales and profits but also to gain the brand image by engage customers(Pansari& Kumar, 2017; Sridhar et al., 2016). Sometimes, one decision may change the fate of the firm. For example, WestJet airlines Christmas promotion initiatives attracted 480 million viewers but the actual target was 2 million users("WestJet Christmas Miracle: Real-time Giving - YouTube," 2013).(Bender, 2013)rightly stated that advertisement can gain the people emotions, in turn, it improves the brand reputation. Happier customers will increase the brand image by sharing to friends, writing in blogs, writing online reviews and spread the information in the form of word of mouth(Pansari& Kumar, 2017).

Hotels do not do the mass advertisement, many hotels focus on relationshipbuilding. The advertisement strategies of the Hotels differ from Products. Hospitality industry can't offer complimentary room service, food and beverage services to potential customers due to the cost involved is higher. Yes, hospitality industry provides complimentary services to the decision makers like travel agents, tour operators and to their clients. So the advertisement strategy of the hotels is unique and concentrated. Hospitality industry would like to build the relationship with the customers rather than transactional business.

**Training Cost and Firm Performance:**

| Author | Variable(s) used in the study | Results |
|---|---|---|
| (García & María, 2015) | Training per employee*,Turn over rate*, No of employees*, Customer Satisfaction#, Gross | Human Capital play a significant role in firm performance. Firms who invest higher amount on training are gaining higher profits compared to firms who are neglected training |

| | | |
|---|---|---|
| | Operating Profit(GOP)**,Occupancy Rate**, Hotel category***, size***,Chain***,location*** | cost are else who treated training cost as a cost rather than investment. In Hospitality industry better-trained manpower can serve better to their customers it leads to higher occupancy rates. |
| (Molina & Ortega, 2003) | Tobin's Q**, Total returns to shareholders (TRS)**, recruiting excellence*, collegial and flexible workplace*, communica- tions integrity,* and clear rewards and accountability* | Training plays a significant role in firm performance. Training leads to employee satisfaction, satisfied employees can deliver services bitterly and improve the market value and shareholders values which lead to better firm performance. |
| (Dhar, 2015) | Perceived accessibility*, perceived support*, perceive benefits from training*, Organizational Commitment# and service quality** | Training plays significant role in improving service quality through organizational commitment. Small and medium(SME) sized hotels are growing in India and generating employment, so training to SME employees will improve service quality which improve sales and revenue of SME hotels. Mixed samples were used to measure the effects of employee training on service quality gained by customers. |
| (Sung & Choi, 2018) | Firm Investment in T&D*,Employee Positive Perceptions of T&D*,Employee Competence#, Employee Commitment Firm#, Voluntary Participation#, Firm performance(Innovative Performance)**, Industry Type***, Market demand***, Technology change*** | Training and Development improves the firm performance by introducing innovative products.T&D improves the employees skill set which improves confident and competence power among employees. When employee got sufficient training they motivate and leads to commitment towards organization which improves the productivity of the firms. |
| (Kim & Ployhart, 2014) | Staffing*,Training*, firm performance**, Internal productivity, firm size*** | Investment on employee training will improve the firm performance. Training improves the internal productivity, which leads to profits. Effective staffing strengthens the firm after recession and training improves fir performance before recession. Training and staffing improves firm performance by increasing firm productivity. The firm size controls the training to firm performance, larger organizations who invest more on training are getting more profits compared to small organization. Firms takes the investment decision on staffing and training depends on market economic conditions. When economic conditions are great, so investment on training improves the profits but when economic conditions are not good staffing strengthens the organizations will help to stabilize in the market. |

*=Independent Variables **=Dependent Variables ***=Control Variable, #=Mediators and Moderators

From the past two decades massive research has been done on consequences and antecedents of training and staffing(Bell, Tannenbaum, Kevin Ford, Noe, & Kraiger, 2017).From the past two decades scholars started using "multilevel analyses"(Bell et al., 2017) to check the effects of training and staffing on employee performance, motivation, satisfaction as an employee outcomes and firm performance, profits and shareholder values as a firm outcomes(Bell et al., 2017; Van Iddekinge et al., 2009). In service industry, human plays important role to deliver services to customers(Chang & Chang, 2008). Due to the inseparability nature of services human interactions plays important role in service industry(Lee & Ok, 2015). For example, booking of the hotel, check-in, and billing may go automation, but receiving guest, handling luggage and providing room services, food and beverage services will happen only with human interaction. Moreover, hospitality industry delivers experiences to customers. The guest check out a hotel room with some experience (either satisfaction or dissatisfaction). Satisfied customers are spreads positive word of mouth and appreciate staff. In customer satisfaction index staff behavior plays competitive role. So, training to existing employees and to new employees can deliver services betterly. Studies revealed different results on the role of training in organizations, some studies stated that training improves the firm performance(García& María, 2015; Glaister, Karacay, Demirbag, & Tatoglu, 2018; Oh & Kim, 2017a) but some studies stated that the training unmotivated the employees which leads to low productivity(Glaveli& Karassavidou, 2011).

**Conceptual Model:**

Training Cost
Advertisement Cost
Repairs and maintenance cost
A

Sales performance

**Hypothesis Proposed:**

H1: Advertisement cost has significant relationship with firm performance
H2: Training cost has significant relationship with firm performance
H3: Repairs and maintenance cost has significant relationship with firm performance

**Research Methodology:** This study is quantitativein nature. The study is multidisciplinary; this study is the combination of marketing, finance and operations discipline. Secondary data will be used.

**Sample of the Study:**

India is one of the fastest developing countries in terms of technology adaption. To test our model, we have taken 378hotelsfinancial data which are listed in Bombay stock exchange. Financial data of past 6 years has been collected from Prowess Database. For advertisement cost, training cost and firm performance Prowess data will be used

**Methodology:** Regression, econometrics methods will be used to check the relationship between advertisements cost, training cost to firm performance. Descriptive statistics and Pearson correlation used to find out the relationship between variables. To check the model, first, we calculate LM test to find, whether Random test or pooled test to use, our results suggested to use panel data regression. Hausman test conducted to use random or fixed effect. Hausman test suggested to go for fixed effect model.

**Table:1**

**Descriptive Statistics**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| logta | 1237 | 1.48 | 12.57 | 6.7716 | 1.85836 |
| ros | 1237 | -171.00 | 1.10 | -.5304 | 5.63994 |
| comp.s | 1237 | .01 | 6.10 | .2893 | .32787 |
| rm.s | 1237 | .00 | 1.80 | .0547 | .07756 |
| sde.s | 1237 | .00 | 6.80 | .0513 | .22601 |
| Valid N (listwise) | 1237 | | | | |

Where logta: Log of total assets, ros: Return on sales= Profit/Sales, comp.s= Compensation/Sales
Rm.s=Repairs cost/total sales, sde.s= selling and distribution costs/sales

Table2: Pearson Bivariate Correlation

| logta | ros | comp.s | rm.s | sde.s | |
|---|---|---|---|---|---|
| logta | 1 | | | | |
| ros | | 1 | | | |
| comp.s | -.063* | -.309** | 1 | | |
| rm.s | -.015 | -.170** | .517** | 1 | |
| sde.s | .071* | -.156** | .586** | .590** | 1 |
| | N | 1237 | | | |

Correlation is significant at the 0.05 level (2-tailed).*
Correlation is significant at the 0.01 level (2-tailed).**

Table 2 reports the correlation coefficients among the independent variables used in the regression over a period of six years from 2012 to 2017 with a total sample of 1237 firm year observations

**Table: 3**

**Model Parameters**

| Independent variable | Dependent variable<br>ROS= Netincome ÷ Sales |
|---|---|
| Compensation | -6.59***<br>(-5.59) |
| Repairs and maintenance | 0.35<br>(0.08) |
| Selling and distribution | 1.72<br>(1.07) |
| Total Assets | -0.005<br>(-0.73) |
| LM test(Random vs Pooled) | Random |
| LM test(Fixed vs Pooled) | Fixed |
| Hausmantest(Fixed vs Random) | Fixed |

Table 3 reports our main regression results.Fixed effect regressions model was used to estimate the regression equation (1) over a period of six years from 2012 to 2017 with a total sample of 1237 firm year observations.The results state that compensation of employees is having a significant influence on the firm performance. It depicts that the success of a hotel depends upon the salaries paid to its employees as it reiterates the notion that employees are pillars of an organization. Though the negative coefficient(-6.59, t= -5.59) of compensation says that hotels are spending heavily on the compensation in order to increase their sales. As per service profit theory employee satisfaction further improves the customer satisfaction by providing them superior customer services which makes them to make repeated purchases. Surprisingly our data reveals that expenditure on advertising is not significant even the coefficients are negative.

**Conclusion:** Hospitality industry need to manage the operating cost efficiently in order to gain profits. Data revealed that compensation plays negative and significant influence on return on sales. Surprisingly, our data showed insignificant relationship between selling and distribution, repairs and maintenance on return on sales. Further studies can test the relationship between operating cost and profits using longitudinal data. Due to the missing values, we used unbalanced panel data, further research can use balanced data and can find out the forecast of the profits and can identify the pattern between operation costs and profits.

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