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Market orientation, competitive advantage, and performance: A demand-based perspective ☆

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ABSTRACT

This study assesses how customer value affects a firm's market orientation and consequently, competitive advantage and organizational performance in a service industry — the global hotel industry. The findings show that if a firm perceives its customers as valuing service, the firm is more likely to adopt both a customer and a competitor orientation; if the firm thinks its customers are price sensitive, the firm tends to develop a competitor orientation. Moreover, the greater a firm's customer orientation, the more the firm is able to develop a competitive advantage based on innovation and market differentiation. In contrast, a competitor orientation has a negative effect on a firm's market differentiation advantage. Finally, innovation and market differentiation advantages lead to greater market performance (e.g., perceived quality, customer satisfaction) and in turn, higher financial performance (e.g., profit, market share).

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1. Introduction

How a firm achieves and maintains a competitive advantage has aroused great attention in the strategy literature, with the emergence of two dominant yet competing perspectives: competitive forces perspective (Porter, 1985) and the resource-based view (RBV) (Barney, 1991). The former suggests that industry structure and a firm's strategic positioning are primary drivers of competitive advantage, whereas the latter argues that competitive advantage stems from a firm's unique assets and inimitable capabilities. Although these two views differ sharply on how competitive advantage is achieved, they both "focus primarily on firm's supply-side interactions and largely neglect the demand environment in which these interactions take place" (Adner and Zemsky, 2006: 215).

A number of theoretical issues arise as a result of overlooking demand-side factors. On the one hand, the tautology critique of the RBV is precisely due to the *value* of resources being defined in terms of their ability to improve a firm's efficiency and effectiveness, but not from the understanding of the demand context in which a firm is operating (Barney, 2001: 52; Priem and Butler, 2001). On the other hand, although the competitive forces perspective recognizes demand heterogeneity, its research agenda focuses mostly on interfirm competition in terms of erecting entry barriers and excluding rivals from opportunities (Adner and Zemsky, 2006). Particularly under-researched is how demand diversity such as customer value heterogeneity and decreasing marginal utility affects firms' strategic orientations and subsequent competitive advantage (Adner and Zemsky, 2006; Desarbo et al., 2001).

To fill this research avoid, this study takes a demand-based perspective to study how customer value heterogeneity affects a firm's market orientation, competitive advantage, and firm performance. Although market orientation is viewed as a critical way to respond to market demand and create superior value, the relationship between market orientation and firm performance is probably more complicated than expected (Zhou et al., 2008). In particular, researchers have suggested that customer and competitor orientations, two focal components of market orientation, have differential implications for firm performance. For example, Han, Kim, and Srivastava (1998) indicate that customer orientation is perhaps most fundamental element of market orientation. Deshpande, Farley, and Webster (1993) suggest that competitor orientation can be antithetical to customer orientation. Armstrong and Collopy (1996: 197) find competitor-orientation to be even "… detrimental to profitability." Lukas and Ferrell (2000) document that customer and competitor orientations have different implications for new product performance. Therefore, clarifying why customer and competitor orientations differ in their effects on performance is imperative to further understanding of how market orientation contributes to performance.

This study tests a model (see Fig. 1) that links customer value, market orientation, competitive advantage and firm performance. Building on a demand-based perspective (Adner and Zemsky, 2006),

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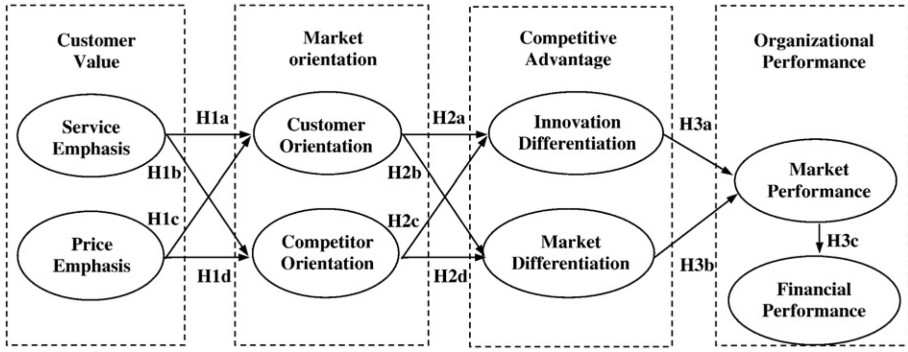

Fig. 1. The conceptual model.

this study examines how customer value heterogeneity affects a firm's emphasis on customers vs. competitors; how customer and competitor orientations influence innovation and market competitive advantage; and finally, how the two forms of competitive advantage impact the firm's market and financial performance. This research attempts to contribute to the literature in three ways. First, this research investigates how customer value drives market orientation, an important issue that has received little theoretical and empirical assessment. Second, this study provides some insight into the evolving debate on the merits of market orientation by modeling competitive advantage as mediating the link between market orientation and performance. Third, extant market orientation and competitive advantage literatures have mainly focused on the financial aspects of firm performance (e.g., Hult et al., 2005; Zhou et al., 2005b). This study extends this line of enquiry by considering both market and financial dimensions of performance.

2. Conceptual development

2.1. A demand-based perspective

Nearly fifty years ago, marketers began to recognize the importance of tailoring their market offerings to the shifting tastes, preferences, and desires of consumers (Keith, 1960). The basic tenet of such a demand-based perspective (i.e., the marketing concept) is that demand dynamics such as customer value heterogeneity will necessarily affect new technology development, customer choices, firm strategies, and therefore influence a firm's competitive advantage (Adner, 2002; Adner and Zemsky, 2006). For example, Adner (2002) proposes an analytical model examining how customer preference overlap and preference symmetry lead to the emergence of disruptive innovations. Adner and Zemsky (2006) model how customer heterogeneity and decreased marginal utility from performance improvement, two important elements of demand drivers, affect firm's sustainable competitive advantage. From this view, understanding what customers value within a given offering, creating value for them, and then managing the value are essential for businesses to devise their core strategies and achieve success.

This perspective is critical for value creation because without knowing what customers actually value, firms can not define and deliver a value proposition to satisfy them (Desarbo et al., 2001). Therefore, this view adds to the competitive forces perspective by shifting the focus from interfirm competition and entry barriers to customer demand. This perspective also complements the RBV by clarifying what are *valuable* resources (i.e., those that are desired by customers) and suggesting that strategic heterogeneity originates not only from firms' internal resource differences, but also from customer value heterogeneity in the external environments (Adner and Zemsky, 2006: 234).

The demand-based view is still in its infancy stage and needs more empirical examination. Adner and Zemsky (2006: 234) indicate particularly that a fruitful direction would be to explore how firms adjust their strategies in response to heterogeneous customer values and the implications of those adjustments for achieving competitive advantage. This view requires firms to learn extensively about their customers and then translate customer preferences to firm strategies and orientations that are in line with what customers value.

As the first empirical study to address this issue, this study examines how customer value heterogeneity affects a firm's decision to focus on customers versus competitors. In line with Adner and Zemsky (2006), the study views customer value heterogeneity as what customers emphasize and desire in their preferences. In essence, customer value involves a trade-off between customers' judgments of a product's overall excellence or superiority (e.g., quality) against the sacrifice (e.g., price) needed to obtain the product (Desarbo et al., 2001). And, customers vary widely according to their emphasis on the quality offered and the price required by the firm. Because the research context is the service industry, this study views quality as the services provided by the firm to the marketplace. Therefore, this study classifies customer value in terms of service (or quality) emphasis and price emphasis. In assessing a firm's offering, service-emphasis customers are primarily concerned with the benefits or utilities they hope to receive. In contrast, price-emphasis customers mainly value the market offering in terms of the price and other resources (e.g., time) they must sacrifice to obtain the product (Zeithaml, 1988).

As two of the components of market orientation, *customer orientation* focuses on "the sufficient understanding of one's target buyers," whereas *competitor orientation* emphasizes the understanding of "the short-term strengths and weaknesses and long-term capabilities and strategies of both the key current and potential competitors" (Narver and Slater, 1990: 21–22). *Interfunctional coordination*, a third dimension of market orientation, promotes the coordinated use of company resources and customer-related activities throughout the entire organization. Researchers seem to agree that interfunctional coordination is critical for responding to the market intelligence effectively (Kohli and Jaworski, 1990; Narver and Slater, 1990). However, controversy exists regarding the roles of customer and competitor orientations in affecting performance. Further, customer and competitive orientations are two primary means that firms employ to interact with environments (Day and Wensley, 1988). Therefore, this study focuses on the customer and competitor orientation facets of market orientation and treats interfunctional coordination as a control. Building on demand-based perspective, this paper examines how customer value emphasis affects a firm's adoption of a customer versus a competitor orientation.

2.2. Customer value and market orientation

When a firm's customers are service-sensitive, their primary concern in assessing the market offering's value is the benefits

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