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Performance implications of the direct and moderating effects of centralization and formalization on customer orientation

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Abstract

Drawing on the control literature in marketing and management, this paper addresses the direct and moderating effects of control mechanisms on the formation and implementation of customer orientation. The key focus of this paper is to examine how two of the most widely studied control mechanisms — centralization and formalization — affect customer orientation formation and implementation differently. We hypothesize that centralization will reduce the effect of the formation and implementation of customer orientation. In contrast, we expect formalization to negatively influence the formation of customer orientation but bolster the impact of customer orientation on firm performance. Furthermore, we hypothesize a three-way interaction among customer orientation, centralization, and formalization on firm performance. Using top management team (e.g. CEO) data from leading firms in the industrial production sector, our results support the universal negative role of centralization on customer orientation formation and implementation. For formalization, our results did not support a negative effect on the development of customer orientation, but supported a positive effect on the implementation of customer orientation. Finally, customer orientation was found to have a positive effect on firm performance when a decentralized organization was coupled with formalization.

Keywords: Customer orientation; Centralization; Formalization; Control theory

Getting to the point where you can reap the rewards of a customer orientation is by no means a simple task nor is building one. Managers are keen to know the best way to obtain results from not only implementing a customer orientation but also constructing a healthy customer-oriented organization. The goal of our paper is to deliver some insights into this enquiry by suggesting that the answer may reside in the type of internal controls that support or hinder customer orientation efforts. More recently, marketing scholars have expressed interest in identifying the ways in which firms can move towards a customer-focused organizational structure (Homburg, Workman, & Jensen, 2000). Menon, Bharadwaj, Adidam and Edison (1999) have suggested the importance of including both strategy implementation and strategy formation simultaneously in one model. To this end, our research provides empirical support that is consistent with the movement towards building and reaping benefits from the formation and implementation of customer orientation. In accordance with Jaworski (1988), we use the terms "control" and "organizational structure" interchangeably. In fact, Jaworski (1988, p. 27) asserted that "if formal controls influence individuals or groups, organizational structure is, by definition, a control mechanism."

We use the term "customer orientation formation" to describe the direct effect of control mechanisms on customer orientation. Hence, the focus in this paper is on how control mechanisms work as antecedents to the development of customer orientation. Noble and Mokwa (1999, p. 57) describe implementation as "a critical link between the formulation of marketing strategy and the achievement of superior organizational performance." Similarly, White, Conant, and Echambadi (2003, p. 115) define implementation as "the organization's competence in executing, controlling, and evaluating its marketing strategy." Thus, in light of the definitions offered in the literature, we employ the term "customer orientation implementation" to capture the customer orientation–firm performance relationship.

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Our research considers formalization and centralization as two key formal controls that are expected to function not only as antecedents to customer orientation, but also as moderators to the customer orientation–firm performance relationship. The rationale for focusing only on formal controls rests on well-accepted theoretical grounds in the literature (Jaworski, 1988; Ouchi, 1978). Jaworski and Kohli (1993) and Kirca, Jayachandran, and Bearden (2005) assert that formalization and centralization are organizational systems (structures) that influence market orientation. In management, Lin and Germain (2003) studied how formalization and centralization affect customer orientation in a social market such as China.

Most, if not all, firms in today's globalized business world realize the importance of being customer-oriented. Despite the significance customer orientation attracts in marketing literature, little is known about what controls are best- or least-suited to effectively build and maximize the effect of a customer orientation on firm performance, especially for industrial production firms. Some research has been conducted in the service domain (Hartline, Maxham, & McKee, 2000; Kelly, 1992). An important difference, however, exists between research in the industrial service domain and the proposed study here. The service-versus-production distinction may influence the same control mechanism differently. For example, in an industrial service setting, greater formalization may breed less empowerment, which, in turn, can limit the range of actions available to employees to serve customers better. This situation, however, is less certain in an industrial production context where reliability and the minimization of defects (i.e. zero defection) are critical factors. In such settings, formalization may actually enhance the positive effect of customer orientation on firm performance (e.g. Michaels, Cron, Dubinsky, & Joachimsthaler 1988).

Using salesforce data collected from a manufacturer of industrial building materials, Michaels et al. (1988) showed that formalization actually increased organizational commitment by reducing role ambiguity and role conflict. Oliver and Anderson (1994) obtained similar results, finding that behavioral control, as opposed to outcome control, contributed to greater organizational commitment from salespeople. In the computer manufacturing industry, results have shown that role formalization is positively associated with R and D and marketing integration (Ayers, Dahlstrom, & Skinner 1997). Therefore, although formalization may be detrimental to implementing a customer orientation in a service context, the implication is less clear in a production context. Our study attempts to fill this void in the literature.

Further, in a meta-analysis on innovation, Damanpour (1991) asserted that different organizational features influence the initiation and implementation of innovation (Zaltman, Duncan, & Holbek 1973). According to the "ambidextrous model of innovation," both low formalization and low centralization foster the initiation of innovation while high formalization and high centralization facilitate the implementation of innovation (Duncan, 1976). Based on these findings, we tested formalization and centralization as antecedents to customer orientation, and also as moderators of the customer orientation–firm performance relationship, in order to examine whether identical controls can affect the formation and implementation of customer orientation differently.

Marketers have long been interested in both the construction and consequences of customer orientation. Much has been written about the economic benefits of a customer orientation, such as increased customer satisfaction, loyalty, and improved financial performance (e.g. Brady & Cronin, 2001; Jaworski & Kohli, 1993; Kohli & Jaworski, 1990). However, little is known about which organizational controls are necessary to develop and further strengthen the performance effect of customer orientation.

Furthermore, despite the significance of customer orientation in both marketing theory and practice, a clear and consistent link has not been made between customer orientation and organizational performance (e.g. Noble, Sinha, & Kumar, 2002). This is quite disappointing and startling given the status that customer orientation occupies in marketing. Although the direct link between market orientation and organizational performance has received empirical support, the disaggregate approach between customer orientation and organizational performance has much less support. Noble et al. (2002, p. 28) provide the following rationale for this disparity, which we accept as a key rationale in examining customer orientation:

> "The disaggregation of the market orientation construct can be supported both methodologically and theoretically. In terms of research design and implementation of findings, a disaggregation of the market orientation construct allows for better control of error or 'noise' that may influence more holistic measurement attempts. Narver and Slater's (1990) framework has yet to be completely and effectively studied in a disaggregate manner."

For managers, the importance of customer orientation has been readily accepted. The next research question in this key area that deserves attention is: "How do we design an organization by deploying the appropriate controls that are best suitable to nurturing a customer orientation and realizing the performance effect of customer orientation?" Given the lack of research, it is timely that this study seeks to delineate the necessary controls to further enhance the benefits of customer orientation on firm performance. In particular, we examine formalization and centralization as two key control mechanisms. Consequently, this study will advance our knowledge regarding the effects of these two controls when developing a customer orientation and obtaining the performance effect of customer orientation.

Our study has three objectives. The first is to develop an integrated model that tests both the direct and moderating effects of centralization and formalization on the formation and implementation of customer orientation. Second, based on our integrated model, we examine whether centralization and formalization affect customer orientation formation and implementation differently. Finally, we address how centralization and formalization jointly influence the impact of customer orientation on firm performance (i.e. interaction of multiple controls). For instance, formalization in industrial production firms may be seen as a positive, but when coupled with centralization, it can be less effective.