Intern. J. of Research in Marketing 26 (2009) 284–293

Contents lists available at ScienceDirect

Intern. J. of Research in Marketing

journal homepage: www.elsevier.com/locate/ijresmar

Linking marketing capabilities with profit growth

Neil A. Morgan [a,*], Rebecca J. Slotegraaf [a], Douglas W. Vorhies [b]

[a] Kelly School of Business, Indiana University, Bloomington, IN 47405, United States
[b] School of Business, University of Mississippi, United States

ARTICLE INFO

Article history:
First received in 19 February 2009
and was under review for 1 month

Area editor: Aric Rindfleisch

Keywords:
Marketing strategy
Branding
CRM

ABSTRACT

Profit growth is one of the primary drivers of a firm's stock price and therefore is a clear priority for managers. Yet little is known about how a firm's marketing capabilities may be linked with its profit growth. In this study, we use data from a cross-industry sample of 114 firms to investigate how market sensing, brand management, and customer relationship management (CRM) capabilities determine firms' revenue growth and margin growth—the two components of profit growth. Our results reveal that these marketing capabilities have direct and complementary effects on both revenue and margin growth rates. Critically, we find that brand management and CRM capabilities have opposing effects on revenue and margin growth rates, such that a failure to examine these two underlying components would mask the relationships between these marketing capabilities and ultimate profit growth rates.

1. Introduction

Linking marketing activities and resource deployment with financial performance and firm value has become a clear priority among marketing scholars (Rust, Ambler, Carpenter, Kumar, & Srivastava, 2004). Firms expend significant resources on building, maintaining, and leveraging marketing capabilities, and recent research has greatly enhanced knowledge concerning the link between marketing capabilities and firm performance (e.g., Krasnikov & Jayachandran, 2008; Slotegraaf & Dickson, 2004; Vorhies & Morgan, 2005). While researchers agree that firm performance is a complex multi-dimensional phenomenon, growth is clearly a top priority for managers (Day, Reibstein, & Shankar, 2009). Profit growth in particular is widely viewed as being of fundamental importance to investors and managers alike (e.g., Brealey, Myers, & Allen, 2008; Day & Fahey, 1988), not least because investors value firms on the basis of their expected future cash flows (Rappaport, 1997; Srivastava, Shervani, & Fahey, 1998). Despite this, profit growth is an infrequently used measure of firm performance in marketing, and we have limited knowledge concerning the link between marketing capabilities and a firm's profit growth.

In this research, we address this knowledge gap by examining how specific marketing capabilities can influence a firm's profit growth. Our study makes two contributions to the advancement of knowledge in this important domain. First, building on endogenous growth theory from economics as well as resource-based (RBV) and dynamic capabilities (DC) theories from strategic management, we develop a theoretical framework linking a firm's market sensing, brand management, and CRM capabilities with the two primary components of profit growth—revenue growth and margin growth. Using a data set comprised of both primary and secondary data, we show that a firm's CRM and brand management capabilities have significant but directionally different direct effects on its revenue and margin growth rates. Examining the interaction effects of these three marketing capabilities, we also find that market sensing is primarily important as a complementary capability in determining a firm's growth rate.

Second, we provide new insights into the nature and the marketing capability drivers of firm profit growth. Importantly, we show that the two primary components of profit growth rates—revenue and margin growth rates—tend to move in opposite directions. This suggests that in most circumstances, managers pursuing profit growth are forced to make trade-off decisions. This has important implications for managers seeking to grow their firms' profits in order to maximize their stock value. It also has critical implications for researchers seeking to examine relationships between marketing resources, capabilities, activities, and profit growth. In particular, we reveal that directionally different effects on revenue and margin growth rates mask the effects of a firm's CRM and brand management capabilities on its rate of profit growth.

2. Theoretical framework

Much of the research seeking to understand the financial impact of marketing is theoretically anchored in the RBV. This resource-based theory views heterogeneity in resources among firms as fundamental in explaining firm performance, with valuable, rare, inimitable, and non-substitutable resources considered most beneficial (Barney, 1991; Wernerfelt, 1984). However, while the RBV has been an influential theoretical framework in contributing to our understanding of firm

* Corresponding author. Tel.: +1 812 855 1114; fax: +1 812 855 6440.
E-mail address: namorgan@indiana.edu (N.A. Morgan).

0167-8116/$ – see front matter © 2009 Elsevier B.V. All rights reserved.
doi:10.1016/j.ijresmar.2009.06.005

performance (Peteraf, 1993), it has also been criticized for its inability to explain how firm resources are developed and deployed to achieve competitive advantage (e.g., Lengnick-Hall & Wolff, 1999; Priem & Butler, 2001). To address such limitations, theorists have achieved a number of developments that are collectively labeled dynamic capabilities (DC) theory. DC theory posits that the most significant and enduring source of competitive advantage, rather than being located in the simple possession of idiosyncratic resources, is constituted by the capability of firms to acquire, integrate, and deploy resources in ways that match each firm's market environment (Eisenhardt & Martin, 2000; Morgan, Vorhies, & Mason, 2009; Teece, Pisano, & Shuen, 1997).

From this perspective, a firm's capabilities involve complex, coordinated patterns of skills and knowledge that become embedded as routines over time (Grant, 1996) and are distinguished from other organizational processes as they are performed better than those of their rivals (Bingham, Eisenhardt, & Furr, 2007; Ethiraj, Kale, Krishnan, & Singh, 2005). To the extent that such capabilities are valuable, they may be sources of advantage that are particularly difficult for rivals to compete away, since they are difficult to observe and embedded within the firm (Day, 1994; Grewal & Slotegraaf, 2007). The literature suggests that marketing capabilities in particular may be immobile (Capron & Hulland, 1999), inimitable (e.g., Bharadwaj, Varadarajan, & Fahy, 1993), and largely non-substitutable value-creation mechanisms (e.g., Moorman & Rust, 1999).

As firms strive to improve their financial position and stock value, profit growth becomes a key objective (Brealey et al., 2008). To achieve profit growth, firms can increase sales revenue, margins, or both. When operating within a munificent environment, demand may often exceed supply, creating the potential for simultaneous growth in sales revenue and margins (Dickson, 1992; Keats & Hitt, 1988). However, absent strong market-level growth, a firm can grow its sales revenue and/or margins in only two ways: i) by growing its market share through some combination of increasing unit sales to current customers and acquiring new customers and ii) by raising margins through some combination of raising prices realized for each unit of output sold and/or lowering costs. However, there are often trade-offs between sales revenue and margins, such that these two components of profit growth rarely increase simultaneously (e.g., Markman & Gartner, 2002; Steffens, Davidsson, & Fitzsimmons, 2009). For this reason, we focus on the extent to which marketing capabilities influence revenue and margin growth separately, while accounting for any potential synergies.

Our underlying theoretical logic for expecting a link between marketing capabilities and profit growth is based on endogenous growth theory from economics. Specifically, endogenous growth theory posits that market- and economy-level growth can be affected by firm and government actions that create and disperse “useful knowledge” (e.g., Lucas, 1988; Romer, 1986). Marketing scholars have recently begun to build on endogenous growth theory to link market-based assets and the capabilities by which they are created and deployed with economy-level (Fornell, Rust, & Dekimpe, in press) and market-level (Bharadwaj, Clark, & Kulviwat, 2005) growth. At the firm level, to the extent to which marketing capabilities can be used to create and disseminate useful knowledge (Bharadwaj, et al., 2005), and have the characteristics of value, inimitability, immobility, and non-substitutability (e.g., Vorhies & Morgan, 2005), firms with stronger marketing capabilities should be better positioned to create demand growth and appropriate the accompanying growth in economic rents.

The marketing literature identifies a number of conceptualizations of different marketing capabilities. Here we focus on capabilities that are consistent with both Day's (1994) marketing capability model and Srivastava et al.'s (1998) framework linking market-based assets with cash-flow growth. Day's (1994) focus is on market sensing and the firm's ability to link with end-user and channel customers. Srivastava et al. (1998) also emphasize the importance of developing market knowledge but distinguish between the creation and leveraging of brand- and customer-based assets. As a result, we focus here on three capabilities[1]. First, *market-sensing capability* reflects a firm's systematic, thoughtful, and anticipatory ability to “learn about customers, competitors, and channel members in order to continuously sense and act on events and trends in present and prospective markets” (Day, 1994: 43). This capability generates superior market knowledge, which is posited to be critical for any dynamic capability (Eisenhardt & Martin, 2000; Grant, 1996). Second, *CRM capabilities* underlie a firm's ability to create and manage close and strong customer relationships (Rust et al., 2004), which have been posited as a key market-based resource that should be linked with cash-flow growth (Srivastava et al., 1998). Third, *brand management capabilities* concern the processes and activities that enable a firm to develop, support, and maintain strong brands (Aaker, 1994; Hulland, Wade, & Antia, 2007), which in turn have been identified as another key resource linked with firms' ability to grow cash-flows (Srivastava et al., 1998).

We investigate the extent to which these three marketing capabilities are directly linked to a firm's profit growth, and also whether there are complementary effects among these capabilities that help to explain profit growth. In examining profit growth, we follow the conventional economic and financial approach and focus on growth rates. As outlined above, while profit growth is desirable, it is difficult to achieve because its primary components—revenue growth and margin growth—often move in opposite directions. We therefore focus our predictions on the direct and complementary linkages between marketing capabilities and rates of growth for the two components of profit growth.

2.1. Hypotheses

2.1.1. Market-sensing capability

Market-sensing capability concerns a firm's ability to learn about customers, competitors, channel members and the broader market environment in which it operates (Day, 1994). The literature suggests numerous reasons to expect that market-sensing capabilities may be linked with firms' revenue and margin growth rates. From a revenue growth perspective, superior market-sensing capabilities allow a firm to identify underserved segments and those where its rivals' offerings may not be fulfilling customer and channel requirements (Slater & Narver, 2000). These underserved and/or unsatisfied segments provide good targets for the firm's efforts to grow revenue by attracting new customers. The customer intelligence aspects of market sensing should also provide insights for managers concerning opportunities within the existing customer base to expand the share of customer requirements that the firm can exploit (Morgan, Anderson, & Mittal, 2005).

From a margin growth rate perspective, superior market-sensing capabilities provide market insights that enable firms to lower their average costs through more productive resource use by better matching the firm's resource acquisitions and deployments with customer and prospect opportunities (e.g., Hult, 1998; Morgan et al., 2009). Firms that do so are also better able to accurately forecast the value of different resources, which enables them to avoid overpaying for resource acquisitions (Makadok, 2001). Firms with strong market-sensing capabilities are also better able to identify the least price-sensitive customers and prospects, which enables them to charge higher prices. These capabilities should also provide new insights into how a firm's product and service offerings may provide the greatest non-price value to customers and channel members (Slater and Narver, 2000). Finally, superior market sensing allows a firm to learn more and learn faster about customer and competitor reactions to its

[1] Since channel bonding capabilities apply only to firms that sell indirectly to end-user customers, we do not consider this capability here.