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# The impact of marketing capability, operations capability and diversification strategy on performance: A resource-based view

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ABSTRACT

Using resource-based view (RBV) of the firm as a theoretical backdrop; we aim to find out the relative impact of a firm's functional capabilities (namely, marketing and operations) and diversification strategies (product/service and international diversification) on financial performance. We hypothesize that this linkage depends on the firm's relative efficiency to integrate its resource–capabilities–performance triad. Using archival data of 102 UK based logistics companies, we find marketing capability is the key determinant for superior financial performance. This study highlights that a market-driven firm is likely to have better business performance than a firm focusing solely on operational capabilities. Also, firms are better off when they focus on a narrow portfolio of products/services for the clients and concentrate on a diverse geographical market. Our findings provide a new perspective to model a firm's functional capabilities and diversification strategy on its financial performance and offer a benchmarking tool to improve resource allocation decisions.


## 1. Introduction

Traditionally, marketing and operations functions have been studied separately in management literature (Karmakar, 1996). Marketing focused on creation of customer demand and how to offer customers a unique value proposition. On the other hand, operations focused on management of supply to fulfill customer demand. Porter (1985) argued that all functional areas of business contribute towards delivery of goods and services but marketing and operations are the two key functional areas that add and create value to customers. There is a growing body of management science literature which stresses the integration of marketing and operations functions as key to organizational performance (Balasubramanian & Bhardwaj, 2004; Ho & Zheng, 2004; Malhotra & Sharma, 2002; Sawhney & Piper, 2002). Mismatch between these two functions lead to production inefficiency and customer dissatisfaction, whereas a proper fit lead to superior competitive advantage and sustainable profits (Ho & Tang, 2004). It is widely accepted even among business leaders that ability to integrate such cross-functional expertise is essential for continued growth and profitability (Wind, 2005).

Diversification strategy, in terms of entering into a related or unrelated business and/or entering into a new geographic market is considered to be of crucial importance to an organization's long term leadership position in its own industry (Hoopes, 1999; Goerzen & Beamish, 2003; Nachum, 2004; Narasimhan & Kim, 2002). Strategic management literature has studied extensively the costs and the benefits of diversification strategy and its effect on competitive advantage for an organization (Chakrabarti, Singh, & Mahmood, 2007; Palich, Cradinal, & Miller, 2000; Ramanujam & Varadarajan, 1989). Researchers have particularly focused on the effect of product/service diversification which is defined as the synergy in different lines of business (Berger & Ofek, 1995; Bettis & Mahajan, 1985) and, international diversification or geographical diversification in a different market (Fang, Wade, Delios, & Beamish, 2007; Ghoshal, 1987; Kim, Hwang, & Burgers, 1993) on firm performance. Hitt, Hoskisson, and Kim (1997) argued that the ability of an organization to manage such diversification depends on their cross-functional capabilities and coordination activities. It is widely accepted that efficient linkage of various internal functions within an organization and interactions among them is crucial to manage the 'curvilinear effects' of diversification on performance (Narasimhan & Kim, 2002; Palich et al., 2000).

From the above discussions, it is clear that functional capabilities (marketing and operations) and diversification strategies (product/service and international diversification) have significant impact on a firm's financial performance. But to our knowledge, there has been no research to integrate all these constructs and find out the relative impact of each of them on firm performance. Thus, our first research objective is to understand the nature of relationship between marketing capability, operations capability, and diversification strategy (product/service and international) on organization's financial

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performance. Capabilities are broadly defined as “complex bundle of skills and accumulated knowledge that enable firms (or strategic business units — SBU) to coordinate activities and make use of their assets” (Day, 1990, p. 38). As a theoretical background of our study, we use the resource-based view (RBV) framework to assess how individual organization's resources and capabilities affect its financial performance (Wernerfelt, 1984). RBV theory suggests that each organization has a distinctive set of resources and capabilities, and some capabilities will have superior impact on financial performance than the others (Song, Benedetto, & Nason, 2007). Such difference in impact is attributed to the efficiency with which a firm is able to convert its resources into “valuable” “difficult to imitate” capabilities and into financial performance (Liebermann & Dhawan, 2005). Efficiency is defined as the ratio of a firm's output to that of its input and is measured in terms of the maximum feasible output which can be obtained with a given set of inputs (Liebermann & Dhawan, 2005). In this study, we specifically study the relationship in two contexts: high vs. low efficient firms in making this transformation. Thus, our second research objective is to understand how efficiency of a firm to convert its resources into financial outputs moderates the relationship between the functional capabilities and diversification strategy on overall business performance.

We accomplish our research objectives in three stages. First, following RBV rationale, we model the functional capabilities (marketing and operations) of a firm in the form of input–output transformation. This enables us to understand how a firm is able to optimally use its function specific resources to achieve function specific objectives. Such identification of sub-optimal resource usage provides insights to better resource allocation decisions. We use similar approach to classify firms into high and low efficient groups as per their overall business performance. Second, we propose and empirically test how diversification strategy affects firm performance. Third, we examine how business performance measured using multi-factor construct in stage 1 affects the relationship between functional capabilities and diversification strategy on firm's financial profitability.

We test our conceptual framework using archival financial data for UK road based logistics service providers. A logistics firm, operating in business to business context, has to excel in both operations capabilities through superior process knowledge and marketing capability through continuous creation of customer value. Firms in logistics industry are extremely dependent on the overall economic growth of the country; and the performance of freight intensive industries such as manufacturing, agriculture, and retail. However, with increase in focus on services dominant industries, stagnant economic growth, increase in fuel cost, and congestion on the roads, the logistics industry in UK is experiencing stagnation. The growth in freight transport in UK has been less than the GDP growth of the country (Office of National Statistics, 2006). In UK, the numbers of road freight operators have steadily fallen by 15% in the last decade. Rail and water based transport has steadily replaced road transport. The cost of moving freight by rail and sea has decreased over the years whereas, the cost of road transport has increased by a third during the last decade making it more challenging for the road transport operators to compete and sustain (Department of Transport, 2004). Thus, recession in economy, spiraling cost of operation, and tighter profit margin has made it imperative for the logistics companies to re-think about their value propositions to their customers, diversify through expansion of services offered and geographical coverage. Many logistics companies are thus going towards consolidation of their business portfolio to achieve greater efficiency. Despite the gloomy industry forecasts, there is a significant variation in performance of the logistics firms. The small and medium logistics firms experience a negative growth in business and very large firms have significantly higher profit than the firms in the other end of the spectrum (Office of National Statistics, 2006). Thus, it becomes critical to understand how functional capabilities and long term diversification strategies of logistics firms affect their business profitability and how efficiency of firms moderates this inter-relationship.

The rest of the paper is structured as follows. The next section discusses our theoretical underpinning of using RBV framework and the conceptualization of functional capabilities and diversification for logistics firms. Section 3 discusses the data and the methodology for measuring resources, capabilities and efficiency. Section 4 presents the empirical findings and Section 5 highlights the implications of our result, limitations of our study and provides direction for future research.

## 2. Conceptual framework

This section narrates our conceptual framework developed on the basis of resource-based view (RBV) theory. It is organized as follows. In subsection 2.1, we give a synopsis of RBV theory explaining the key concepts of resources, capabilities and their linkage to firm performance. In subsection 2.2, we describe the principal functional capabilities namely marketing and operations. We also explain the role of diversification and its impact on long term competitive advantage along with the arguments for hypotheses formulation. We hypothesize that such relationships between capabilities, diversification and performance is moderated by a firm's efficiency in transforming its financial resources into profitability outputs.

### *2.1. Resource-based view (RBV) — a synopsis*

RBV views a firm as a bundle of resources and capabilities (Wernerfelt, 1984). Amit and Schoemaker (1993) define resource as “stocks of available factors that are owned or controlled by the firm”. Resource consist of tangible components like financial and physical assets like property, plant and equipment, and intangible components like human capital, patent, technology knowhow (Grant, 1991; Amit & Schoemaker, 1993). Capability is defined as the ability of the firm to use its resource “to effect a desired end” (Amit & Schoemaker, 1993). It is like “intermediate goods” generated by the firm using organizational processes to provide “enhanced productivity to its resources” (Amit & Schoemaker, 1993). Capabilities are “invisible assets”, tangible or intangible organizational processes developed by a firm over a period of time that “cannot be easily bought; they must be built” (Teece, Pisano, & Shuen, 1997). RBV argues that firms will have different nature of resources and varying levels of capabilities. Firms' survival depends on its ability to create new resources, build on its capabilities platform, and make the capabilities more inimitable to achieve competitive advantage (Day & Wensley, 1988; Peteraf, 1993; Prahalad & Hamel, 1990). Thus, mere possession of superior resources cannot achieve competitive advantage for the firm, but how a firm deploys its scarce resources, put its capabilities to best use, invest and complement its existing capabilities infrastructure can bring “immobility and inimitability” to its resource-capability framework (Peteraf, 1993; Song et al., 2007). In marketing literature, there has been extensive use of RBV framework to analyze firm performance (Dutta, Narasimhan, & Surendra, 1999; Liebermann & Dhawan, 2005), to understand the interaction between marketing and other functional capabilities and their effect on performance (Song et al., 2007; Song, Droge, Hanvanich, & Calantone, 2005; Song, Nason, & Benedetto, 2008), and particularly to understand inter-organizational relationship performance (Palmatier, Dant, & Grewal, 2007). The results suggest that there is a significant relationship between capabilities and performance. Strategic management researchers have used RBV to understand the inter-firm difference in performance (Barney, 1986; Peteraf, 1993; Makadok, 2001). In addition, RBV theory suggests that heterogeneity in firm performance is due to ownership of resources that have differential productivity (Makadok, 2001). Since, a firm's capability is defined “as its ability to deploy resources (inputs)