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Full Length Article

Market orientation and innovation performance: The moderating roles of firm ownership structures

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ABSTRACT

The marketing literature documents inconsistent results on the link between Market Orientation (MO) and innovation performance. The agency theory suggests that agency problems exist in firms between the principal (owner) and the agent (managers). A proper firm ownership structure design may solve the principal-agent problem. In this study, we investigate an understudied research question: whether and how ownership structures may affect the relationship between MO and innovation performance? We posit that firms should align three different dimensions of ownership structures with MO in order to achieve a superior innovation performance. We assembled a unique data set, with 242 publicly-traded companies, by merging three different data sources in an emerging market — China to test our framework. The results support our proposed model, and confirm the moderating role of ownership structures in the relationship between market orientation and firm innovation performance in China. First, all things being equal, non-state-owned firms may achieve a higher level of innovation performance than their state-owned counterparts through their implementation of MO. Second, allowing top managers to have a certain fraction of the firm's ownership stake (called managerial ownership), that can switch risk preference and time preference of top manager's to those of shareholders, may foster the effect of MO on innovation performance. Third, a high ratio of major owners over minor owners (named as ownership concentration), that can empower and motivate shareholders to closely monitor a manager's behavior, may also strengthen the relationship between MO and innovation performance. The Chinese data from a transition economy sheds light on the ownership structure reforms in China, and provides novel new insights to the marketing theory and practice regarding the role of two new additional emerging dimensions of ownership structures — managerial ownership and ownership concentration in the relationship between MO and innovation performance. Theoretical and managerial implications are discussed, and several avenues for future research are proposed.

1. Introduction

> "…Any business enterprise has two – and only two – basic functions:marketing and innovation (Drucker, 1954, p. 37)."

Successful innovation not only helps a firm achieve a competitive advantage; it also makes a significant contribution to the firm's survival, and its growth as well as financial success (Gatignon & Xuereb, 1997; Grinstein, 2008). Marketing scholars suggest that market orientation enhances the consequences of innovation (e.g., Han, Kim, & Srivastava, 1998; Hurley & Hult, 1998; Im & Workman, 2004; Kirca, Jayachandran, & Bearden, 2005). In this study, *innovation performance* is defined as the extent to which a firm's new products may contribute to its overall product performance. *Market orientation* (MO) refers to a marketing strategy in which a firm places the customer's needs and wants at the center of its tenets and tactics, and focuses on learning about its customers, competitors, and environment through an interfunctional coordination (Jaworski & Kohli, 1993, 1996; Slater & Narver, 1994a, 1994b). Although MO plays a pivotal role in the new product innovation process, the empirical evidence about the positive effect of MO on innovation is not consistent in the literature. On the one hand, some studies find a positive relationship between MO and new product innovation (e.g., Agarwal, Erramilli, & Dev, 2003; Atuahene-Gima, 1995; Han et al., 1998; Slater & Narver, 1994a, 1994b; Wei & Morgan, 2004). On the other hand, a number of studies show no direct impact of MO on the success of new products (e.g., Appiah-Adu & Ranchhod, 1998; Atuahene-Gima, 1996; Greenley, 1995; Im & Workman, 2004; Langerak, Hultink, & Robben, 2004).

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This inconclusiveness motivates further research to investigate the potential moderating variables in order to explain the unstable relationship between MO and innovation (e.g., Dibrell, Craig, & Hansen, 2011; Grinstein, 2008; Wei & Atuahene-Gima, 2009, etc.). For example, Grinstein (2008) found that highly competitive environments strengthen the effect of MO on innovation, but high technology turbulence weakens it. In addition, Wei and Atuahene-Gima (2009) found that the effect of MO on new product performance may depend on a proper reward system design. Furthermore, the effect of MO on firm innovativeness is also found to be affected by managerial attitudes towards the natural environment (Dibrell et al., 2011).

Despite the progress in this area, one important moderator is still missing in the literature. Internal organizational structure is regarded as one of the most important complementary resources for an organizational strategy's success (Chandler, 1962; Miller, 1988; Olson, Slater, & Hult, 2005). For example, firms may achieve its mission and goals only when its ownership structure supports a corporate strategy (e.g., Kor & Mahoney, 2005; Thomsen & Pedersen, 2000). *Ownership structure* represents “a formal institution, deals with the matter of how – and by whom – public company shares are owned” (Crossland & Hambrick, 2007, p. 771). Gedajlovic (1993) argues that ownership structure can serve as a moderating variable by changing the strategy–performance relationship, because it determines a firm's goals and modifies the behavior of senior managers through shaping incentive (Porter, 1990). For example, Li, Chau, and Lai (2010) found that the identity of the dominant shareholder (state-owned vs. non-state owned) significantly moderates the relationship between MO and organizational e-business assimilation.

Given the critical role of ownership structure in the corporate strategy–performance link, the main objective of this research is to investigate whether and how different ownership structure designs can change the effect of MO on innovation performance. Based on agency theory, we propose that different ownership structure designs can change the effect of MO on innovation performance. We collected data from more than 200 publicly-traded firms in emerging markets. We found that three different ownership structure designs (i.e., identity of the dominant shareholder, managerial ownership, and ownership concentration) significantly change the relationship between MO and innovation performance.

Our research attempts to contribute to the marketing and innovation literature in three ways. First, we suggest that ownership structure may affect the MO-innovation performance link. This has not been considered in previous studies. In this study, we use agency theory to examine the influence of ownership structure on the MO-innovation performance link. Investigation of the unknown impact of ownership structure may make key contributions to the literature by providing important new insights and new implications for business practice.

Second, the literature argues that studies of the MO-innovation performance link are heavily biased, and that more than 80% of the samples are from developed countries (Grinstein, 2008). An increasing number of scholars have realized that atomistic firms may generally reflect the reality of North American and other western economies, where most firms are privately owned. However, this may not be the case in emerging and transitional economies characterized by a variety of ownership structures (Peng, Tan, & Tong, 2004). As a consequence, it is questionable whether existing findings from developed countries can be generalized for firms in less-developed economies. For this reason, scholars argue that future research will benefit from investigations based on developing countries (Grinstein, 2008), and “mixed economies with heterogeneous ownership groups” (Gedajlovic, 1993, p. 748). To fill in this research gap, we select China, the largest emerging market in the world, as the research context to explore the role of ownership structures in the MO-innovation link. The emerging-market context of this investigation may extend current knowledge regarding the role of ownership structure in developing markets, and enrich the literature by adding new findings from a non-western context.

Third, the ownership structure reforms experienced in an emerging market such as China calls for new research on this topic. Although restructuring the ownership structure has been considered as the key to the success of China's economic reform in the past two decades, marketing scholars still have limited knowledge, and understanding of the impact of new ownership structures on MO and innovation. Salient ownership structural changes have been made in corporate governance in this economic transition process. For example, firms formerly owned solely by the state/government in centrally-planned economies have been allowed to include a variety of owners, such as individual shareholders, institutional shareholders, management shareholders, foreign investors, and employee shareholders (Dharwadkar, George, & Brandes, 2000).

However, most of the previous studies of emerging markets tend to investigate only simple ownership structures, such as state-owned versus non-state-owned (Li et al., 2010). In order to gain a better understanding of the changes in the firm ownership structure in China, this research examines two additional new ownership structures: managerial ownership, and ownership concentration beyond the dichotomy of state vs. non-state ownership. Ignoring these new ownership structures may prevent us from seeing the full and true picture of corporate governance and its effect on emerging markets. Unlike developed economies, managerial ownership is still minimal in China. Investigating the potential effect of newly-added ownership structures may further develop the understanding for both scholars and managers towards the ownership structure reforms in China. Simultaneously studying both old and new ownership structures may capture the complexities of ownership structures influencing the MO-innovation performance link, and contribute new insights to both the marketing literature and its practice.

The rest of this study is structured as follows: (1) the theoretical background is presented and the hypotheses are developed; (2) the research methodology issues are addressed; (3) the empirical results are reported, and the findings of the study are discussed from both academic and managerial perspectives; and (4) the limitations of the study are discussed and suggestions for future research are provided.

2. Theoretical framework and hypothesis development

2.1. Agency theory and principal-agent problems

Agency theory has been characterized as “a theory of the ownership structure of the firm” (Jensen & Meckling, 1976, p. 309). It informs a structured approach to analyze the economic incentives of a firm's management and its owners (Eisenhardt, 1989). The fundamental assumption underlying agency theory is that agency problems arise from conflicting goals and interests, and/or different risk or effort preferences, between the principal (owner) and the agent (managers). For example, shareholders are generally interested in promoting the long-term profitability of a firm and thus maximizing the value of their investments, while managers may be more short-term oriented with a greater emphasis on personal wealth, employment security, and prestige (Berle & Means, 1932; Jensen & Meckling, 1976). Moreover, shareholders might be risk-neutral because they can diversify their portfolios over multiple firms, whereas managers tend to be risk-averse in that their employment security and their income are often tied to a single firm,; and they are unable to diversify their employment risk in the case of failure (Eisenhardt, 1989). This divergence of managers' and shareholders' objectives shapes their conflicting interests in selecting and promoting a dominant strategic orientation of the firm (Baysinger, Kosnik, & Turk, 1991), and thus exerts different influences on the firm's innovation performance as well (Hoskisson, Eden, Lau, & Wright, 2000; Kochhar & David, 1996). In such a case, shareholders (principals) need to worry about their agents (managers) who may pursue their own interests at the expense of those of the principals, which is called the principal-agent problem (Jensen & Meckling, 1976).