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Benchmarking firm capabilities for sustained financial performance in the U.S. restaurant industry

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ABSTRACT

This study is designed to present an empirical assessment of important firm capabilities appropriate for benchmarking and on which firm capabilities restaurant firms should focus to achieve sustained financial performance. It also examines the key normative benchmarking theory premise that firm capabilities associated with sustained financial performance can be identified and that a firm's capability gaps, defined herein as the capability gaps between the firm and the selected benchmark firms (e.g., Camp, 1995), explain its financial performance. Lastly, this study shows how to use profile deviation to benchmark firm capabilities and extends this methodology by employing a model that incorporates interdependencies among firm capabilities. Findings offer pragmatic guidelines for restaurateurs to exercise benchmarking to pinpoint and enhance firm capabilities that would lead to sustained competitive advantage.

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1. Introduction

The restaurant industry, largest private employer in the U.S. with 12.9 million workers, is projected to have sales reaching $632 billion in 2012 and equal to almost 4% of the U.S. GDP (National Restaurant Association, 2012). However, the riskiness of the restaurant business has also been well recognized by both academics and industry practitioners (Parsa et al., 2005). A commercial that aired during one restaurant reality show stated that approximately 90 percent of restaurants fail before the end of their first year of operation (Burnett et al., 2003). Although such claim of the high failure percentage is disputable, it clearly reflects a wide-spread perception and thus reality about the difficulty of surviving in the restaurant industry. According to some restaurant literature, not only does the restaurant industry suffer from a roughly 30% bankrupt rate on average in the first operation year (Kim and Gu, 2006; Thompson and Kwortnik, 2008), but also a restaurant's high sensitivity to economic fluctuations tends to regularly heighten the business risks (Lee et al., 2011). Consequently, how to achieve sustained financial performance emerges as a critical empirical question even more for the restaurant industry than for other industries which are less sensitive to economic conditions.

Although a significant amount of attention has been paid to understanding restaurant performance or failure (e.g., Assaf et al., 2010; David et al., 2006; Geller and Heath, 1981; Hua et al., 2011; Madanoglu et al., 2008; Morey and Dittman, 2003; Parsa et al., 2005), prior studies have not yet addressed the issue of sustained restaurant financial performance, leaving a critical gap in the hospitality literature. Sustained financial performance may be defined as a financial performance pattern that exhibits value growth over a period of ten years (e.g., Roberts and Dowling, 2002) and three major theoretical perspectives have emerged in support of benchmarking firm capabilities to gain sustainable competitive advantages and better performance: (1) resource-based view (RBV) theory (e.g. Amit and Shoemaker, 1993; Barney, 1991); (2) market-based learning theory (e.g., Slater and Narver, 1995); and (3) organizational learning theory (e.g., Dickson, 1992; Teece et al., 1997).

This article, therefore, is designed to address the critical gap in the literature based on these three theories and provides valuable guidance for restaurateurs. First, this article examines the key normative benchmarking theory premise that a firm's capabilities associated with sustained financial performance can be identified and that a firm's capability gaps, defined herein as the capability gaps between the firm and the selected benchmark firms (e.g., Camp, 1995), explain its financial performance. Second, this article presents an empirical assessment of important firm capabilities appropriate for benchmarking and which firm capabilities restaurant firms should focus on to achieve sustained financial performance. Third, this study shows how to use profile deviation (further elaborated later) to benchmark firm capabilities and extends this methodology by employing a model that incorporates interdependencies among firm capabilities. Findings offer

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pragmatic guidelines for restaurateurs to exercise benchmarking to pinpoint and enhance firm capabilities that would lead to sustained competitive advantage.

2. Research framework

Benchmarking has been known as an effective market-based learning process that emphasizes best practice identification and replication from other entities to improve a firm's own performance (Camp, 1995; Mittelstaedt, 1992). The dynamic benchmarking process has evolved from mostly result-oriented to more capability-oriented: the primary focus has shifted from the deliverables of top-performing firms to the capabilities that generated them (e.g., Anderson, 1999; Ralston et al., 2001). Despite the widely used dichotomy of content and process in scholarly work, benchmarking firm capabilities touches both process and content issues in practice (e.g., Fawcett and Cooper, 2001; Zairi, 1998) and usually involves a three-stage learning process: first, managers seek firms with superior performance and identify the relevant capabilities that drive the performance (the search stage); second, managers assess capability distinctions between their own firm and the benchmark firms (the gap assessment stage); and lastly, managers create and execute plans to close capability gaps identified in the second step (the capability improvement stage) (e.g., Camp, 1995; Garvin, 1993).

Three key theories support that benchmarking firm capabilities can help firms to gain both sustainable competitive advantages and better performance. First, resource-based view (RBV) theory contends that the fundamental cause of inter-firm performance variations lies in the heterogeneity of the firm's resources and capabilities (Amit and Shoemaker, 1993; Barney, 1991). As long as benchmarking helps a firm to improve its capabilities, it should result in competitive advantage (Teece et al., 1997). Further, benchmarking itself can be valuable, inimitable, and nonsubstitutable to an extent that the resultant firm capability improvements can be maintained (Dickson, 1992).

Second, financial researchers have investigated how a firm adjusts its firm characteristics according to market environment to improve financial performance (e.g., Choi, 2010; Kim and Gu, 2003). In addition, market orientation researchers have shown that benchmarking can help a firm's resource deployment and capability development appropriate for its market environment (Slater and Narver, 1995). Specifically, benchmarking offers a practical mechanism for managers and employees to contextualize their attention in a competitive environment (e.g., Hiebeler et al., 1998; Teece et al., 1997), to form a consensus of the capabilities that would produce the desired performance (e.g., Camp, 1995; Zairi, 1998), and to properly allocate investment in capability enhancement (e.g., Brockett et al., 2001; Camp, 1989). Consequently, market orientation researchers have argued for the notion that benchmarking is an effective learning tool that helps create firms that are driven by market (Day, 1994; Slater and Narver, 1995).

Third, organizational learning theory suggests that a firm must be more vigilant, timely, and accurate in understanding market dynamics than are its rivals for benchmarking to form sustainable competitive advantages (e.g., Dickson, 1992; Teece et al., 1997). Constraints that limit a firm to improve from market surveillance such as "perceptual bias" (e.g., Dickson, 1992), "core rigidity" (e.g., Leonard-Barton, 1995), and "satisficing problems" (e.g., Winter, 2000) can be alleviated by benchmarking (e.g., Levinthal and Myatt, 1994). March (1991) points out that imitation and experimentation may help realize organizational learning. Since benchmarking is widely considered as effective for imitative learning (Mittelstaedt, 1992; Voss et al., 1997), it also offers a great opportunity for experimental learning (Dickson, 1992; Haunschild and Miner, 1997) considering distinct organizational and capability contexts tend to create a unique combination of capabilities in the benchmark firm (Collis, 1994; Grant, 1996).

Identifying and monitoring firm capabilities can offer empirical support to assist managers in recognizing the need for capability enhancement (e.g., Day and Wensley, 1988). The first two stages of benchmarking are imperative to choose the proper benchmarks, to gauge potential values of alternative capability enhancements, and to initiate rigorous investigations of the benchmark firms to device and implement capability enhancements (Camp, 1995; Day, 1994). Consequently, the search and gap-assessment stages of benchmarking form a competitive advantage by themselves and are necessary for the capability improvement stage to succeed. Following through the benchmarking stages, this study begins with examining that distinct firm capabilities are identifiable and can be connected to sustained financial performance. It then defines and examines benchmark firms and addresses the following question: Which firm capabilities should restaurant firms focus on to achieve sustained financial performance?

3. Empirical assessment of firm capability benchmarking

3.1. Identifying firm capabilities for benchmarking

The search stage of benchmarking focuses on capability identification and isolation that contribute to sustainable performance for further study (Camp, 1989). Although the idea of benchmarking a restaurant firm's capabilities is not new, relevant firm capabilities have not yet been comprehensively cataloged. As a starting point, this study proposes ten firm capabilities, based on the literature, used to transform resources into valuable financial performance, and therefore, those are suitable for benchmarking purposes. Following the methodology by Greve (1998) and Lev and Thiagaraja (1993), this study uses the disproportionate change with regard to the relevant historical or social benchmarks to gauge firm capabilities. For example, the disproportionate change of cost of sales is defined against its historical benchmark: the relative change in cost of sales minus the relative change in sales; the disproportionate change of growth is defined against its social benchmark: the relative change in firm sales minus the relative change of industry sales (see detailed definitions for all capability variables of interest in Table 1).

(1). *Cost Control*. Commonly considered as a less noisy proxy than earnings for the relation between a firm's input and output prices, cost of sales is believed to be driven by underlying factors such as intensity of competition (e.g., Nickell, 1996) and operating leverage (e.g., Lev, 1974). Variations in cost of sales measured in disproportionate change are, therefore, reflecting a firm's capability to control cost and informative with regard to firm performance. For example, a negative disproportionate change of cost of sales indicates slower growth in cost of sales relative to that in sales on an annual basis, which would enhance current financial performance. (2). *Marketing*. Along the same line of reasoning, the disproportionate change of advertising can be considered as a proxy for a firm's marketing capabilities and bring positive influence on a firm's performance given advertising is used effectively (e.g., Bublitz and Ettredge, 1989; Hua et al., 2011). (3). *Rent Utilization*. Anecdotal evidence from the restaurant industry suggests possibilities to renegotiate rent and thus could significantly improve a firm's financial performance (e.g., Williams, 2006). Along this line of reasoning, if rent expenses have systematically gone down (up) in the restaurant industry over the sampled period, a positive (negative) impact on financial performance is expected. (4). *Sales Growth*. A firm's capability to increase sales is undoubtedly essential to business. Disproportionally faster sales growth, if systematic, would