



Title	Market orientation, competitive advantage, and performance: A demand-based perspective
Author(s)	Zhou, KZ; Brown, JR; Dev, CS
Citation	Journal Of Business Research, 2009, v. 62 n. 11, p. 1063-1070
Issued Date	2009
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**MARKET ORIENTATION, COMPETITIVE ADVANTAGE, AND PERFORMANCE:
A DEMAND-BASED PERSPECTIVE**

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August 2008

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ABSTRACT

This study assesses how customer value affects a firm's market orientation and consequently, competitive advantage and organizational performance in a service industry – the global hotel industry. The findings show that if a firm perceives its customers as valuing service, the firm is more likely to adopt both a customer and a competitor orientation; if the firm thinks its customers are price sensitive, the firm tends to develop a competitor orientation. Moreover, the greater a firm's customer orientation, the more the firm is able to develop a competitive advantage based on innovation and market differentiation. In contrast, a competitor orientation has a negative effect on a firm's market differentiation advantage. Finally, innovation and market differentiation advantages lead to greater market performance (e.g., perceived quality, customer satisfaction) and in turn, higher financial performance (e.g., profit, market share).

INTRODUCTION

How a firm achieves and maintains a competitive advantage has aroused great attention in the strategy literature, with the emergence of two dominant yet competing perspectives: competitive forces perspective (Porter, 1985) and the resource-based view (RBV) (Barney, 1991). The former suggests that industry structure and a firm's strategic positioning are primary drivers of competitive advantage, whereas the latter argues that competitive advantage stems from a firm's unique assets and inimitable capabilities. Although these two views differ sharply on how competitive advantage is achieved, they both "focus primarily on firm's supply-side interactions and largely neglect the demand environment in which these interactions take place" (Adner and Zemsky, 2006: 215).

A number of theoretical issues arise as a result of overlooking demand-side factors. On the one hand, the tautology critique of the RBV is precisely due to the *value* of resources being defined in terms of their ability to improve a firm's efficiency and effectiveness, but not from the understanding of the demand context in which a firm is operating (Barney, 2001: 52; Priem and Butler, 2001). On the other hand, although the competitive forces perspective recognizes demand heterogeneity, its research agenda focuses mostly on interfirm competition in terms of erecting entry barriers and excluding rivals from opportunities (Adner and Zemsky, 2006). Particularly under-researched is how demand diversity such as customer value heterogeneity and decreasing marginal utility affects firms' strategic orientations and subsequent competitive advantage (Adner and Zemsky, 2006; Desarbo, Jedidi, and Sinha, 2001).

To fill this research void, this study takes a demand-based perspective to study how customer value heterogeneity affects a firm's market orientation, competitive advantage, and firm performance. Although market orientation is viewed as a critical way to respond to market

demand and create superior value, the relationship between market orientation and firm performance is probably more complicated than expected (Zhou et al., 2008). In particular, researchers have suggested that customer and competitor orientations, two focal components of market orientation, have differential implications for firm performance. For example, Han, Kim and Srivastava (1998) indicate that customer orientation is perhaps most fundamental element of market orientation. Deshpande, Farley and Webster (1993) suggest that competitor orientation can be antithetical to customer orientation. Armstrong and Collopy (1996: 197) find competitor-orientation to be even "... detrimental to profitability." Lukas and Ferrell (2000) document that customer and competitor orientations have different implications for new product performance. Therefore, clarifying why customer and competitor orientations differ in their effects on performance is imperative to further understanding of how market orientation contributes to performance.

This study tests a model (see Figure 1) that links customer value, market orientation, competitive advantage and firm performance. Building on a demand-based perspective (Adner and Zemsky, 2006), this study examines how customer value heterogeneity affects a firm's emphasis on customers vs. competitors; how customer and competitor orientations influence innovation and market competitive advantage; and finally, how the two forms of competitive advantage impact the firm's market and financial performance. This research attempts to contribute to the literature in three ways. First, this research investigates how customer value drives market orientation, an important issue that has received little theoretical and empirical assessment. Second, this study provides some insight into the evolving debate on the merits of market orientation by modeling competitive advantage as mediating the link between market orientation and performance. Third, extant market orientation and competitive advantage

literatures have mainly focused on the financial aspects of firm performance (e.g., Hult et al., 2005; Zhou, Yim and Tse, 2005b). This study extends this line of enquiry by considering both market and financial dimensions of performance.

Figure 1 here.

CONCEPTUAL DEVELOPMENT

A Demand-Based Perspective

Nearly fifty years ago, marketers began to recognize the importance of tailoring their market offerings to the shifting tastes, preferences, and desires of consumers (Keith, 1960). The basic tenet of such a demand-based perspective (i.e., the marketing concept) is that demand dynamics such as customer value heterogeneity will necessarily affect new technology development, customer choices, firm strategies, and therefore influence a firm's competitive advantage (Adner, 2002; Adner and Zemsky, 2006). For example, Adner (2002) proposes an analytical model examining how customer preference overlap and preference symmetry lead to the emergence of disruptive innovations. Adner and Zemsky (2006) model how customer heterogeneity and decreased marginal utility from performance improvement, two important elements of demand drivers, affect firm's sustainable competitive advantage. From this view, understanding what customers value within a given offering, creating value for them, and then managing the value are essential for businesses to devise their core strategies and achieve success.

This perspective is critical for value creation because without knowing what customers actually value, firms can not define and deliver a value proposition to satisfy them (DeSarbo et al., 2001). Therefore, this view adds to the competitive forces perspective by shifting the focus from interfirm competition and entry barriers to customer demand. This perspective also complements the RBV by clarifying what are *valuable* resources (i.e., those that are desired by

customers) and suggesting that strategic heterogeneity originates not only from firms' internal resource differences, but also from customer value heterogeneity in the external environments (Adner and Zemsky, 2006: 234).

The demand-based view is still in its infancy stage and needs more empirical examination. Adner and Zemsky (2006: 234) indicate particularly that a fruitful direction would be to explore how firms adjust their strategies in response to heterogeneous customer values and the implications of those adjustments for achieving competitive advantage. This view requires firms to learn extensively about their customers and then translate customer preferences to firm strategies and orientations that are in line with what customers value.

As the first empirical study to address this issue, this study examines how customer value heterogeneity affects a firm's decision to focus on customers versus competitors. In line with Adner and Zemsky (2006), the study views customer value heterogeneity as what customers emphasize and desire in their preferences. In essence, customer value involves a trade-off between customers' judgments of a product's overall excellence or superiority (e.g., quality) against the sacrifice (e.g., price) needed to obtain the product (Desarbo et al., 2001). And, customers vary widely according to their emphasis on the quality offered and the price required by the firm. Because the research context is the service industry, this study views quality as the services provided by the firm to the marketplace. Therefore, this study classifies customer value in terms of service (or quality) emphasis and price emphasis. In assessing a firm's offering, service-emphasis customers are primarily concerned with the benefits or utilities they hope to receive. In contrast, price-emphasis customers mainly value the market offering in terms of the price and other resources (e.g., time) they must sacrifice to obtain the product (Zeithaml, 1988).

As two of the components of market orientation, *customer orientation* focuses on “the sufficient understanding of one’s target buyers,” whereas *competitor orientation* emphasizes the understanding of “the short-term strengths and weaknesses and long-term capabilities and strategies of both the key current and potential competitors” (Narver and Slater, 1990: 21-22). *Interfunctional coordination*, a third dimension of market orientation, promotes the coordinated use of company resources and customer-related activities throughout the entire organization. Researchers seem to agree that interfunctional coordination is critical for responding to the market intelligence effectively (Kohli and Jaworski, 1990; Narver and Slater, 1990). However, controversy exists regarding the roles of customer and competitor orientations in affecting performance. Further, customer and competitive orientations are two primary means that firms employ to interact with environments (Day and Wensley, 1988). Therefore, this study focuses on the customer and competitor orientation facets of market orientation and treats interfunctional coordination as a control. Building on demand-based perspective, this paper examines how customer value emphasis affects a firm’s adoption of a customer versus a competitor orientation.

Customer Value and Market Orientation

When a firm’s customers are service-sensitive, their primary concern in assessing the market offering’s value is the benefits they receive. Because customers differ widely in their perceptions of benefits, their demands or needs are highly specific and heterogeneous (Monroe, 1990). Over time, customers become more sophisticated and demand services with superior performance and reliability that are previously unheard of. Increasing sophistication means that customers are more sensitive to nuances and differences in the products and are attracted to those that are uniquely tailored to their particular problems and needs (Zhou, Gao, Yang, and Zhou, 2005a)

In such a market, a firm must develop a sufficient understanding of its target customers in order to deliver superior value to those customers (DeSarbo et al., 2001). To compete on the delivery of superior customer value, a firm should be able to answer four basic questions: “(1) what exactly do customers value? (2) Of all the things customers value, on which ones should we focus to achieve advantage? (3) How well do customers think we deliver that value? (4) How will what customers value change in the future?” (Woodruff, 1997: 140). To answer these questions a firm must closely monitor its customers. Because customers’ perceptions of a product’s benefits change over time, a firm’s offerings that match customers’ needs today will very likely not match their needs tomorrow (Zhou et al., 2005b). Therefore, a firm must ascertain the changing preferences of customers continuously and adjust its offerings accordingly. In other words, a tilt toward a customer focus is necessary to reach and satisfy service-conscious customers.

Customers’ service emphasis may also lead to a greater level of competitor orientation. First, a firm can better recognize its competitive position if the firm has a clear understanding of the strengths and weaknesses of its key current and potential competitors. Such an understanding enables the firm to develop a product and services mix in order to position itself effectively against the competition (Li and Calantone, 1998). Second, because customers’ needs are dynamic, a firm can attempt to anticipate changing customer preferences by monitoring the successes and failures of its competitors (Porter, 1985). Thus, firms can develop future products and services that are more effectively positioned in the marketplace as a result of tracking their competitors. In short, a customer value emphasis on service drives firms to gather, interpret, disseminate, and act upon competitive information so that they can meet and beat the competition. Hence,

H_{1a}: The more the firm's customers emphasize service, the more customer-oriented the firm.

H_{1b}: The more the firm's customers emphasize service, the more competitor-oriented the firm.

Price-conscious customers weigh their sacrifice (what they must pay) most heavily in assessing the value of a firm's market offering. The needs of such customers are relatively predictable (i.e., they generally focus on price) and, therefore, the strategic focus should be on price. To achieve a competitive advantage in price-conscious markets, a firm must continually monitor its own operations in search of cost advantages. The firm should also keep tabs on its competitors to determine their sources of cost advantage (Day and Wensley, 1988). Only after the firm gets a clear idea of its cost position in a competitive market, can it make correct pricing decisions (Porter, 1985). Therefore, when its customers strongly emphasize price, the firm's strategic orientation falls necessarily on competitors. In contrast, when customer needs are quite predictable, as with price-conscious customers, firms can forego frequent and extensive monitoring of their customers because such activities are expensive (Day and Wensley, 1988). This discussion suggests that, for price-conscious markets, firms should pay closer attention to their competitors. Therefore,

H_{1c}: Customers' price emphasis has no significant bearing on the degree of a firm's customer orientation.

H_{1d}: The more the firm's customers emphasize price, the more competitor-oriented the firm.

Market Orientation and Competitive Advantage

Competitive advantage refers to the comparative positional superiority in the marketplace that leads a firm to outperform its rivals (Porter, 1985). For example, a firm can achieve a cost advantage when the firm operates at a lower cost than its competitors but offers a comparable product. Also, a firm can achieve a differentiation advantage when customers consistently perceive its offerings as superior to those of its competitors (Porter, 1985). Miller (1987, 1988) further distinguishes between two types of differentiation advantages: innovation and market. In particular, a *market differentiation advantage* occurs when a firm creates a unique image in the marketplace and achieves customer loyalty through meeting customers' particular needs (Miller, 1987), and an *innovation differentiation advantage* arises when a firm creates "the most up-to-date and attractive products by leading competitors in quality, efficiency, design innovations, and style" (Miller, 1988: 283).

Innovation and market differentiation advantages are related yet distinct. Innovation advantage occurs when a firm leads its competitors in the development and successful commercialization of new goods and/or services. An innovating firm emphasizes R&D and the latest technologies in its new product development and aims at being the first to market with new products (Li, 2005; Miller, 1988). In contrast, a market differentiation advantage requires a firm to use attractive packaging, good service, convenient locations, reliable products, and careful pricing to create a unique image, which does not imply a highest quality or most up-to-date product (Miller, 1987). For example, some hotel brands (e.g., W, Radisson and Meridien Hotels) use advanced technologies to top their competitors in terms of cutting-edge design, rapid guest check-in, and in-room amenities. Clearly, these firms differentiate themselves on the basis of innovation. Other brands, such as Four Seasons and Ritz-Carlton, achieve a market

differentiation advantage through providing a unique atmosphere, service consistency, and a full range of services. While these latter brands continually introduce new services, they do not compete head-to-head with other hotel brands in terms of technological innovation.

The direct relationship between market orientation and firm performance is well-established (see Kirca, Jayachandran, and Bearden, 2005 for a review). Under-studied is the processes through which market orientation affects performance (Hult et al., 2005). To explain why customer and competitor orientations may differ in their performance impacts, this study compares how customer and competitor orientations differentially affect a firm's ability to achieve market and innovation advantages, which consequently affect firm performance. Because previous research appears to have reached a consensus that competitor orientation likely leads to a cost advantage (e.g., Day and Wensley, 1988; Han et al., 1998), this study focuses on market and innovation facets of differentiation advantages as reasons why customer and competitor orientations differ in their performance implications.

Customer orientation emphasizes understanding one's target customers sufficiently so as to continuously create superior value for them. Because customers' needs change rapidly, a customer orientation requires a clear understanding of the cost and revenue dynamics of target customers in both the present and the future. Due to its external focus on collecting, analyzing, and disseminating information about customers, a customer-oriented firm can anticipate its customers' changing needs and respond to them through continuous innovation (Han et al., 1998). Moreover, when a firm clearly recognizes a gap between its customers' needs and its market offerings, the firm can direct resources toward filling that gap through successful innovations (Slater and Narver, 1998). Recent empirical research has also found customer

orientation to be an important determinant of an organization's innovativeness and new product advantage (Zhou et al., 2005b).

A customer orientation can also enable a firm to develop a competitive advantage based on market differentiation. With the knowledge of what customers desire, a customer-oriented firm can then make its market offerings more appealing by adjusting its marketing mix (Porter, 1985; Miller, 1988). Further, because the major objective of a customer-orientation is to achieve long-term customer satisfaction, a customer-oriented firm is highly motivated to provide offerings that uniquely meet the particular needs of its target market (Slater and Narver, 1998). Thus, a customer-oriented firm appeals to its customers by developing a unique image through the effective tailoring of its marketing mix.

H_{2a}: The greater the firm's customer orientation, the greater its innovation differentiation advantage.

H_{2b}: The greater the firm's customer orientation, the greater its market differentiation advantage.

Competitor orientation essentially focuses on identifying (1) current and potential competitors, (2) the technologies they utilize, and (3) whether they represent an attractive alternative from the perspective of the target customers (Narver and Slater, 1990). Competitor-oriented businesses watch competitors closely, match the marketing initiatives of competitors quickly, and attempt to understand both the short-term strengths and weaknesses and long-term capabilities and strategies of current and potential competitors. Then, using their rivals as a frame of reference, competitor-oriented firms can identify their own advantages and disadvantages. With a clear understanding of its own strengths and weaknesses as well as those of its competitors, a competitor-oriented firm could utilize information "... internalizing a

competitor's strengths by *imitation*, or nullifying a competitor's strength by product *innovation*" (Li and Calantone, 1998: 17, italics added).

Therefore, competitor orientation appears to have double-edged effects on innovation. On the one hand, with a better understanding of its relative standing in the marketplace, a competitor-oriented business can create a competitive advantage through continuous product innovation. On the other hand, a competitor-oriented firm may simply choose to imitate its competitors rather than develop innovative goods and services to decrease the high cost of product innovation. Empirical research by Lukas and Ferrell (2000) indicates that competitor-oriented firms tend to present the market with "me-too" products and eschew "new-to-the-world" innovations. On balance, then, these conflicting effects of competitor orientation on innovation may cancel each other, resulting in a non-significant relationship between competitor orientation and innovation differentiation advantage.

Because the emphasis of competitor orientation is to "meet and beat the competition," a competitor-oriented firm matches closely its capacities and offerings with those of its competitors (Day and Wensley, 1988). By focusing on its competitors, a firm may be unaware of its real interest, which may lead to inconsistent strategies and behaviors and, consequently, unstable product offerings (Armstrong and Collopy, 1996). Furthermore, a competitor-oriented firm tends to assume that what the competitors have done is correct, and thus may risk overlooking the products or services that are uniquely fitted to a particular market segment (Hamel and Prahalad, 1994). Therefore, competitor-oriented firms may have difficulty in developing a market differentiation advantage.

H_{2c}: The extent of a firm's competitor orientation has no significant bearing on the degree of its innovation differentiation advantage.

H_{2d}: The greater the firm's competitor orientation, the less its market differentiation advantage.

Competitive Advantage and Firm Performance

Existing literature has well-documented the positive effect of competitive advantage on performance, as competitive advantage provides a firm with the wherewithal to outperform its rivals. This study adds to the literature by suggesting that in service industries, competitive advantage enhances firm financial performance indirectly through improving market performance. *Market performance* refers to the firm's "ability to satisfy and retain customers by offering quality products and services ..." and *financial performance* reflects the firm's profitability and market impact (Moorman and Rust, 1999: 187). Frequently used indicators of market performance include customer satisfaction, product/service quality, customer retention, and customer loyalty, while costs, sales revenue, profitability, and market share are typical indicators of financial performance (Moorman and Rust, 1999).

An innovation advantage implies that firms provide their customers with the most up-to-date and innovative product offerings of superior value (Li, 2005). The more value the market offering provides, the more satisfied and loyal the firm's customers; and the higher the value, the more likely the firm's customers will perceive the market offering as being of higher quality (Zeithaml, 1988). Similarly, firms with a market differentiation advantage have successfully created unique images for their market offerings by specifically tailoring their marketing mixes to their target customers and, thus, can reap the benefits of high levels of customer loyalty and satisfaction (Miller, 1988).

A firm's market performance will positively affect its financial performance. Higher levels of service quality and customer satisfaction generate increased customer loyalty; and, because loyal customers are less sensitive to price changes, firms can command premium prices or sell more of their products at a given price, leading to a higher profit or market share (Porter, 1985). In addition to lower costs of servicing existing customers, the positive reputation that results from

higher levels of market performance enables the firm to attract new customers, introduce new products, and weather short-term environmental fluctuations more easily. In service industries (e.g., hotel), business success depends critically on the interactions between employees and customers (Anderson, Fornell and Rust, 1997), making service quality and customer satisfaction a key link between competitive advantage and financial performance. That is, differentiation advantage enhances financial performance indirectly through fostering market performance.

H_{3a}: The greater the firm's innovation differentiation advantage, the greater its market performance.

H_{3b}: The greater the firm's market differentiation advantage, the greater its market performance.

H_{3c}: The higher the firm's market performance, the higher its financial performance.

METHOD

Sample

To test the hypotheses, this study selects the worldwide hotel industry as the empirical setting. Globally, the hotel industry is highly fragmented and characterized by a high failure rate. For example, in contrast with other product categories, the market share accounted for by the top three hotel brands amounts to only 15% (MKG Consulting, 2002), and the survival rate for new hotel brands is slightly greater than 50% (Coopers and Lybrand, 1997). As a result, the industry is highly competitive and companies increasingly pay close attention to their customers' value to achieve better performance (see also Brown and Dev, 2000).

The unit of analysis is the individual hotel property. According to pretesting, the hotel's general/senior managers are knowledgeable about their individual hotel property's market orientation, competitive advantages and performance, as well as customer characteristics.

Therefore, the authors use these managers as key informants to report on their individual hotel

properties. From a sampling frame provided by the Global Hoteliers Club, which publishes the global hotel industry's leading trade journal, *HOTELS* (free for members), the authors send surveys to 558 randomly selected hotel general/senior managers who are Club members.. To increase the response rate, the authors include a cover letter from the CEO of the Global Hoteliers Club with the questionnaire. A total of 184 completed questionnaires are received after two follow-up letters. The response rate (32.9%) is comparable to similar studies using international samples.

The 184 hotels on average employ 433 people, offer 365 rooms for sale, and have been in operation for 23 years. Fifty-four percent of the hotels are independent and 46% belong to 28 different hotel chains. For those hotels that are part of a chain, their parent companies, on average, have engaged in international operations for 28 years, are affiliated with 328 hotels worldwide, and generate 58% of their revenues from international properties. Finally, the hotels represent 56 countries in six continents. All of these statistics suggest that the sample possesses sufficient variance to test the model in an international context.

The responding hotel managers include both expatriates and nationals, depending on each hotel's practice. General managers constitute more than two-thirds of the sample and the others are senior managers, which brings to the survey a rich storehouse of experience with hotel management. Most of the respondents have a college degree, indicating similar educational experiences from hotel management schools. As Global Hoteliers Club members, they are generally fluent in English (the *lingua franca* of the hotel industry), but many speak multiple languages. Most have had standard hotel management training and follow generally accepted industry practices for managing and marketing their hotels. Such managers across the globe exhibit a similar pattern in their answers to survey questions (Dawar and Parker, 1994).

Measures

The authors develop the measurement items on the basis of a thorough review of the strategy literature and pre-test the items with 30 international hotel general managers who attended an executive development program at a major U.S. university. The authors then revise a small number of questionnaire items to enhance their clarity (see Table 1).

Table 1 here.

This research develops six new items to measure two types of customer value: *price emphasis* and *service emphasis*, and adapts measures of *customer* and *competitor orientations* from Narver and Slater (1990) to the hotel context. This study also adapts the seven-item *market differentiation* and *innovation differentiation advantage* scales from Chandler and Hanks (1994) to fit the hotel industry context, and measures *market* and *financial performance* with six items adapted to the hotel setting from Moorman and Rust (1999).

The study controls for *interfunctional coordination*, *competitive aggressiveness*, *entry barriers*, *market potential*, and *firm size*. Interfunctional coordination is another key dimension of market orientation and the measure is from Narver and Slater (1990). This study measures competitive aggressiveness with one item (the aggressiveness of competitors) to reflect the competitive intensity of existing rivalries (Porter, 1985). Entry barriers refer to the relative costs required for a firm to enter and become competitively viable in the market (Porter, 1985). Because location barriers are so critical in the hotel industry, this study considers entry barriers as spatial preemption: a hotel pre-empts its competitors by building properties in prime locations. The authors measure market potential with one item: potential for growth in the hotel market. Larger organizations may have access to more resources that enable them to develop better

markets and generate superior financial performance. The study measures firm size as the logarithm of the room capacity of the informant's hotel.

Measure Refinement and Validity. The study refines the measures and assesses the construct validity in the following ways. First, exploratory factor analyses for each focal construct (i.e., customer value, market orientation, competitive advantage, and firm performance) result in a four, separate two-factor solutions, as expected. Then, the study estimates a nine-factor confirmatory measurement model, including eight focal constructs and one control (i.e., interfunctional coordination). For the multi-item scales, the model sets each questionnaire item to load only on its respective latent construct, and allowed the latent constructs to correlate.

To assess the model fit, Hair et al., (2006) suggest using several alternative fit indices such as χ^2 and the associated degrees of freedom, comparative fit index (CFI), and root mean square error of approximation (RMSEA), as well as considering model complexity. After dropping two items that possess a low factor loading, the confirmatory model fits the data satisfactorily ($\chi^2(453) = 619.02$; CFI = .92, RMSEA = .05), given that the sample size is 184 and the number of observed variables is 30 (see Table 1). All factor loadings are statistically significant ($p < .001$) and the composite reliabilities of each construct exceed .69 (see Table 2), well-above the usual .60 benchmark. Thus, these measures demonstrate adequate convergent validity and reliability. To assess discriminant validity, the authors examine whether the average variance extracted for each construct is greater than its highest shared variance with other constructs (Fornell and Larcker, 1981). As Table 2 shows, all the diagonal elements representing the square root of the average variance extracted are much greater than the off-diagonal correlations, in support of the measures' discriminant validity. Overall, these results show that the measures in this study possess adequate reliability and validity.

Table 2 here.

RESULTS

To test the hypotheses, the authors employ structural equation modeling with maximum likelihood estimation. The model contains eight focal variables and five controls. Customer value emphasis is the exogenous construct, with market orientation and competitive advantage as intermediate endogenous constructs, and performance as endogenous outcomes. The model links control variables to competitive advantage and performance. For model fit ($\chi^2(477) = 709.93$; CFI = .90, RMSEA = .05), the CFI is slightly lower than the .92 cutoff. However, as Hair et al. (2006, p. 753) suggest, “more *complex models* with *smaller samples* may require *somewhat less strict* criteria for evaluation with the multiple fit indices.” Because the 13-construct model is relatively complex and the sample size (184) is relatively small, the model fits the data adequately if using less strict benchmark of .90. Table 3 summarizes the parameter estimates used to test the hypotheses.

Table 3 here.

H1 pertains to the effects of customer value on firm orientation. The results in Table 3 show that service emphasis leads to greater customer orientation (.42, $p < .001$) and competitor orientation (.51, $p < .001$), as anticipated in H1a and H1b. In addition, price emphasis is not significantly related to the firm’s customer orientation (.09, $p > .10$) but positively affects competitor orientation (.35, $p < .01$), in support of H1c and H1d.

H2 deals with the relationship between market orientation and competitive advantage. The results indicate that the greater the firm’s customer orientation, the greater the firm’s innovation advantage (.48, $p < .001$) and the better its market differentiation advantage (.41, $p < .001$),

thereby supporting H2a and H2b. Consistent with H2c, competitor orientation has no significant effect on innovation advantage (.04, $p > .10$), but does have a significant, negative influence on market advantage (-.24, $p < .05$), as predicted in H2d.

Consistent with H3a, a firm's innovation advantage is positively related to its market performance (.32, $p < .01$). Further, market differentiation advantage is positively related to market performance (.24, $p < .01$), supporting H3b. In addition, a firm's market performance is positively associated with its financial performance (.41, $p < .001$), as predicted by H3c.

Additional Investigation. Because studies on the direct effects of market orientation on performance are extensive, this paper focuses on the underlying processes (i.e., differentiation advantage) through which market orientation affects performance. This study also runs additional analysis that adds the direct links from customer and competitor orientations to market performance. The results show that customer orientation relates positively to market performance (.21, $p < .01$) whereas competitor orientation has no significant impact on market performance (.06, $p = .58$). Thus, differentiation advantage appears to fully mediate the effect of competitor orientation and partially mediate the effect of customer orientation on market performance.

H3 posits that in service industries, differentiation advantage affects financial performance only *indirectly* through market performance. To assess whether the direct effects exist, the authors run additional analysis that adds the direct links from innovation/market differentiation to financial performance. The results show that neither an innovation (.14, $p = .18$) nor market differentiation advantage (-.07, $p = .62$) is significantly linked to financial performance. A further comparison shows the model with direct links is not significant better than the model without these links ($\Delta\chi^2(2) = 3.07, p = .22$). Therefore, market performance fully mediates the relationships between differentiation advantages and financial performance.

DISCUSSION

The findings provide strong support to the hypothesized relationships depicted in Figure 1. As a result, this study contributes to the literature in three ways. First, this research represents the first effort that takes a demand-based perspective to examine how customer value heterogeneity affects a firm's market orientation and consequently its competitive advantage. The findings generally support the basic tenet of the demand-based view that customer heterogeneity significantly influences a firm's strategic choices (Adner and Zemsky, 2006; DeSarbo et al., 2001). In particular, the study finds that if a firm perceives its customers as emphasizing what they "get" (i.e., they emphasize service), the firm is more likely to adopt both a customer and a competitor orientation. In contrast, if the firm thinks its customers as valuing what they must "give up" (i.e., they focus on price), the firm tends to develop a competitor orientation.

In the hotel industry, customers typically choose where to stay based on two primary criteria: service or price. Service sensitive customers look for location (better located hotels often cost more due to higher land costs in prime areas), service quality (better service often implies more employees per room costing more), and amenities provided. To acquire and retain these customers, hotels focus primarily on service by touting their service offerings and quality levels (e.g., Four Seasons or Mandarin-Oriental). Price sensitive customers, on the other hand, are looking for the best deal: The lowest "give" for the highest "get." To target these customers, hotels often use competitive pricing as a primary way in their advertisements (e.g., Motel 6--using the tag line "the lowest price of any national chain"--or Microtel). Consistent with these observations, the findings enrich the demand-based view by demonstrating the importance of customer demand heterogeneity in explaining a firm's strategic choices.

Second, the findings add to the market orientation literature by uncovering the underlying process through which customer and competitor orientations affect performance. Previous studies suggest that customer and competitor orientations are two distinct aspects of market orientation (e.g., Lukas and Ferrell, 2000) and some have posited that a competitor orientation can even be antithetical to a customer orientation (e.g., Desphande et al., 1993). The examination of the market orientation-competitive advantage link reveals why this case may happen. The results suggest that customer orientation seems to be the dominant factor responsible for achieving a competitive advantage in a service industry. Customer orientation is not only linked to a firm's innovation differentiation advantage, but also associated with a greater market differentiation advantage. Competitor orientation, in contrast, has a negative impact on a firm's market differentiation advantage and no significant influence on its innovation differentiation advantage. Therefore, a customer orientation appears to be a better choice for a service firm (e.g., hotel) to achieve a differentiation advantage. Overall, these results explain the seemingly counter-intuitive observation of why customer and competitor orientations can be antithetical to each other, and enrich the market orientation literature by revealing how market orientation affects performance (Hult et al., 2005).

The third contribution is that, in addition to financial performance, the study extends previous research by investigating market performance. This dimension of performance explicitly considers customer reactions to the firm's market offering, which is parallel to the "added value" and "value creation" concepts described in the demand-based framework (Adner and Zemsky, 2006: 218-219). These results indicate that a firm specializing in innovation or market differentiation can attain higher levels of market performance (i.e., superior service quality, higher customer satisfaction). However, neither innovation nor market advantage has *direct*

significant impact on financial performance; rather, competitive advantage affects financial performance *indirectly* through market performance. This finding suggests that the importance of making customers happy in enhancing financial performance of service firms.

The findings of this study provide several important implications for managers in service industries. Firms should be aware that their perceived customer value (i.e., service/price emphasis) significantly influences their orientations. Service firms tend to follow both a customer and a competitor orientation if they think their customers being service sensitive. Firms tend to follow a competitor orientation solely if they believe customers being price sensitive. More important, firms must fully understand the benefits and limitations of each orientation in achieving competitive advantage and superior performance. A customer orientation helps service firms achieve innovation and market differentiation advantages. However, firms that pursue a competitor orientation may face difficulty in developing market differentiation advantage. Further, both innovation and market differentiation advantages help service firms enhance customer satisfaction as well as service quality, and consequently, better financial performance. However, service firms should understand that differentiation advantages boost financial performance only indirectly through enhancing market performance such better customer satisfaction. Therefore, service firms should pay special attention to how to deliver quality service and win customer satisfaction.

Limitations and Further Research

As an initial enquiry of a complex phenomenon, this study is subject to several limitations. First, building on demand-based perspective, this study assesses how customer value perceived by firms affects firms' orientation. However, firms' orientations and strategies can also influence customer values. For example, the more customer-oriented a firm, the more likely the firm

attracts customers that emphasize services. But the cross-sectional nature of this study does not allow us to examine this intriguing issue. Related, customer value changes over time. How those changes affect a firm's orientation and competitive advantage requires further research, especially using longitudinal designs.

Second, this paper does not examine one important aspect of competitive advantage — cost advantage. While the results indicate that a customer-oriented strategy leads to the innovation differentiation and market differentiation advantages, a competitor-orientation may enable a firm to gain a cost advantage. Similarly, this study only considers one key aspect of demand factors, customer value heterogeneity, and views this in terms of two key aspects — customer service emphasis and price emphasis. Future studies should examine how customers' decreasing marginal utility from product performance improvement, the other key demand factor (Adner and Zemsky, 2006), affects a firm's strategies, orientations, and competitive advantages. Further research could also consider the specific elements of customer value desired. For example, in the hotel industry, these might include lodging services, food and beverage services, and conference and meeting services, etc.

Third, this study focuses on the mediating process of market orientation – performance relationship. Further research could examine the boundary conditions of market orientation. For example, the role of customer orientation may be particularly salient in service industries. Samples from manufacturing industries are necessary to compare and contrast the roles of customer/competitor orientations in different industries. It would be also intriguing to examine how market-based strategies (e.g., market orientation) interact with non-market-based strategies (e.g., network ties) to affect organizational performance (Li, 2008; Li, Poppo, and Zhou, 2008).

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FIGURE 1

The Conceptual Model

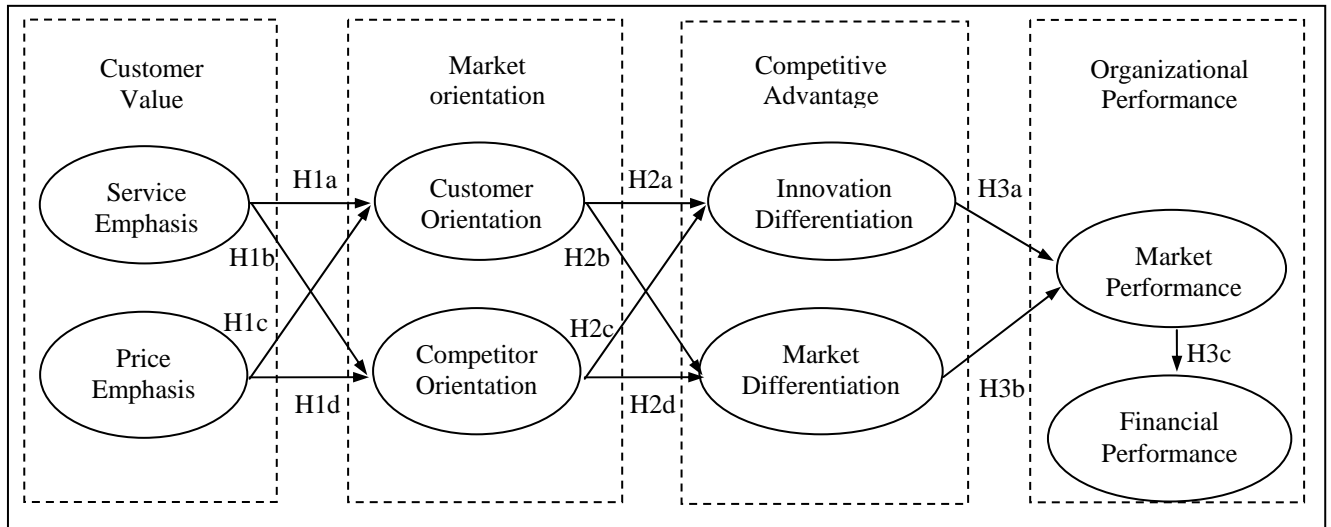


Table 1: Measurement Items and Validity Assessment

Overall model fit: $\chi^2(453) = 619.02, p < .01$; CFI = .92; RMSEA = .05; p(close fit) = .84		Loading
Customer Value		
<u>Service Emphasis</u>		
1. Our customers belong to a very exclusive class whose needs are unique		.66
2. Our customers are very particular about the service they receive		.81
3. We would not succeed in this market without providing excellent service		.59
<u>Price Emphasis</u>		
1. Our target market is price sensitive		.82
2. There is great pressure on us to have competitive prices		.77
3. Our customers choose hotels based on prices		.54
Market orientation		
<u>Customer Orientation</u>		
1. Our hotel believes in total commitment to the customer		.54
2. Our compensation plan rewards employees and managers who are committed to customer satisfaction		.54
3. We regularly measure customer satisfaction		.69
4. We spend a great deal of effort trying to understand customer needs		.83
5. We do whatever it takes to create value for our customers		.72
6. We continuously monitor our customers' needs		.79
<u>Competitor Orientation</u>		
1. Our sales and marketing people share competitor information with other departments		.51
2. We respond rapidly to our competitors' actions		.79
3. We are constantly looking for opportunities to gain an advantage over our competitors		.66
<u>Interfunctional Coordination</u>		
1. The various departments in our hotel share a great deal of information with each other		.80
2. Our hotel's strategy emphasizes co-ordination of the various departments		.84
3. Resources are frequently shared by different departments		.56
4. Tightly coordinating the activities of all departments adds customer value		Dropped
Competitive Advantage		
<u>Innovation Differentiation</u>		
1. We are constantly investing in generating new capabilities that give us an advantage compared to our competitors		.72
2. If ever there was a new way of serving customers, our company would be able to offer that		.69
<u>Market Differentiation</u>		
1. It is difficult for our competitors to imitate us		.52
2. Our services are unique and nobody but our company can offer them		.65
3. It took us several years to build our brand name reputation – nobody can easily copy that		.68
4. Our advantages are embodied in the company and not in individuals – nobody can copy us by stealing our employees away from us		.65
5. Nobody can copy our corporate routines, processes and culture		.59
Organizational Performance		
<u>Market Performance:</u> Compared to your direct competitors, how well did your hotel do in terms of the following measures?		
1. Repeat business		Dropped
2. Service quality		.78
3. Customer satisfaction		.88
<u>Financial Performance:</u> Compared to your direct competitors, how well did your hotel do in terms of the following measures?		
1. Occupancy		.72
2. Gross operating profit		.56
3. Market share		.83

TABLE 2
Construct Measure Descriptive Statistics

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Service emphasis	.69												
2. Price emphasis	-.27**	.72											
3. Customer orientation	.28**	-.05	.70										
4. Competitor orientation	.25**	.15*	.33**	.66									
5. Innovation advantage	.27**	-.27**	.47**	.25**	.66								
6. Market advantage	.28**	-.23**	.39**	-.17*	.43**	.73							
7. Market performance	.36**	-.20**	.41**	.15*	.33**	.30**	.83						
8. Financial performance	.03	-.14	.21**	.13	.23**	.24**	.29**	.71					
9. Interfunctional coordination	.30**	-.19**	.43**	.37**	.35**	.21**	.24**	.00	.74				
10. Competitive aggressiveness	.03	.22**	-.03	.11	-.05	-.20**	-.13	-.09	.15*	—			
11. Entry barrier	.17*	.03	.21**	.20**	.24**	.41**	.04	.27**	.10	-.01	—		
12. Market potential	.02	-.16*	.10	.02	.10	.20**	.07	.19**	.00	-.13	.08	—	
13. Firm size	-.27**	.27**	-.04	.04	-.17*	-.06	-.29**	.02	-.22**	.16*	.02	.16*	—
Mean	3.82	3.68	4.13	4.04	3.70	2.88	4.02	3.79	3.88	3.82	2.76	3.08	5.75
Std Dev	.70	.79	.59	.61	.75	.78	.68	.72	.67	.90	.97	1.07	.58
Composite Reliability	.73	.76	.85	.70	.69	.76	.82	.75	.78	—	—	—	—

Notes: n = 184. Bold figures on the diagonal are the square root of the average variance extracted for the constructs.

* p < .05 ** p < .01

TABLE 3
Standardized Structural Equation Parameter Estimates (t-value)

Independent Latent Construct/ Control Variable	Endogenous Latent Construct					
	Customer Orientation	Competitor Orientation	Innovation Differentiation Advantage	Market Differentiation Advantage	Market Performance	Financial Performance
Service Emphasis	.42*** (3.68)	.51*** (4.01)	—	—	—	—
Price Emphasis	.09 (.97)	.35** (3.15)	—	—	—	—
Customer Orientation	—	—	.48*** (4.38)	.41*** (3.64)	—	—
Competitor Orientation	—	—	.04 (.38)	-.24* (-2.32)	—	—
Innovation Differentiation Advantage	—	—	—	—	.32** (2.88)	—
Market Differentiation Advantage	—	—	—	—	.24** (2.58)	—
Market Performance	—	—	—	—	—	.41*** (4.21)
Interfunctional Coordination	—	—	.25** (2.72)	.22* (2.38)	.09 (.96)	-.11 (-1.15)
Competitive Aggressiveness	—	—	-.05 (-.56)	-.23** (-2.84)	-.02 (-.22)	-.04 (-.53)
Entry Barriers	—	—	.16* (2.12)	.41*** (4.66)	-.19* (-2.29)	.30*** (3.83)
Market Potential	—	—	.10 (1.35)	.14 (1.88)	.00 (.06)	.17* (2.16)
Firm Size	—	—	-.13 (-1.63)	-.01 (-.07)	-.21** (-2.62)	.09 (1.05)
<i>R-Square</i>	.16	.25	.46	.47	.34	.28

*** p < .001 ** p < .01 * p < .05

Notes:

1. Model fit: $\chi^2(477) = 709.93$, $p < .01$; CFI = .90; RMSEA = .05; P(Close Fit) = .36.
2. Additional analysis shows that common method bias is not a major concern.
3. The effects of control variables do not alter the conclusions drawn from the theoretical model.