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Relationship Marketing Theory: Its Roots and Direction

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This paper participates in the latest discussion on theory formation in the marketing discipline. We argue that some of the novelty and generality claims in current relationship-marketing (RM) propositions are inflated. On the basis of a conceptual analysis of the disciplinary roots of RM thinking, we argue that RM does not form a general theory of marketing, and that actually two types of relationship theory exist: Market-based, more consumer-oriented RM, and Network-based, more interorganisationally-oriented RM. The fundamental differences between these two types of theory are identified and discussed. Theoretical conclusions and managerial challenges originating from the dual nature of relationship marketing conclude the paper.

Introduction

This paper takes a fresh look at relationship marketing (RM) as an emerging subfield of the marketing discipline, and at the ongoing debate about it. We claim that all is not as it seems in this debate by examining the propositions and arguments made about relationship marketing from both theoretical and polemical perspectives. Theoretical refers to analyses of the underlying disciplinary roots of RM, and polemical refers to our critical stance towards the more extreme claims of novelty and differentiation from existing marketing theory made by some of its advocates. We are thus taking a theory development approach to RM, in contrast to those viewing it primarily as a business practice.

Why focus on relationship marketing? It has undeniably become the hot topic of the marketing discipline during the 1990s. Several international seminars (the International Colloquium of Relationship Marketing series – first held at Monash University in Australia; the Emory University conferences which started in 1993; the American Marketing Association seminar in Berlin in 1996, and the Dublin 1997 conference), and special issues of journals such as the European Journal of Marketing (1996), the Journal of the Academy of Marketing Science (1995), the Asia-Australia Marketing Journal (1996), and the Journal of Marketing

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Management (1997), have efficiently created a world-wide forum for discussion on relationship marketing, its issues and promises.

Examining business exchange relationships from a relational, and often enduring perspective, is very important for understanding contemporary marketing. The aspect of long-term relationships with customers and other stakeholder groups has been neglected in mainstream marketing management literature, as pointed out by several scholars (Christopher et al., 1991; Dwyer et al., 1987; Ford, 1990; Grönroos, 1994b; Gummesson, 1997; Håkansson, 1982; Morgan and Hunt, 1994; Möller, 1992, 1994; Parvatiyar and Sheth, 1997; Sheth and Parvatiyar, 1995a). However, as we see it, the current discussion of relationship marketing has been characterised more by rhetoric than by rigorous examination of what the concept actually involves. RM has been hailed as the future, or even the current New Paradigm of marketing (Sheth, 1993; Sheth and Parvatiyar, 1995a). It has been welcomed as a saviour from the detrimental impact of 'traditional marketing' or 'marketing-mix' theory (Grönroos, 1994b; Peppers and Rogers, 1993; Rapp and Collins, 1991), and new scientific empires are being built on its shoulders ('The Anglo-Australian School', 'The Emory School', and 'The Nordic School'). The popularity of RM is so strong that an interesting debate is currently raging about its origins (for a brief example, see Gummesson et al., 1997).

What motivated our paper was the fact that the relationship-marketing concept is currently used to cover a very fragmented set of ideas and theoretical frameworks. Recognising this situation, a number of authors have called for efforts to generate theories or frameworks for the synthesis of RM (Gummesson, 1996; Iacobucci, 1994; Lehtinen, 1996). We would, however, like to question whether RM, at least in its current form, has the potential to constitute a general theory of marketing. To facilitate discussion on this and the other debated issues, three critical questions can be put forward:

- Will RM replace the traditional marketing-management school? Or, phrased differently, will RM make marketing-management theory obsolete?
- Is RM a completely new theory, or does it derive from older traditions?
- Do we need different theories of RM depending on the type and context of exchange relationships?

Our bold objective is to answer these questions through a metatheoretical analysis of the roots of relationship-marketing thinking. We will compare and contrast the assumptions different research traditions make about the nature and the context of relationships. A number of writers have made valuable contributions to RM knowledge by studying how it is practised in various businesses (see e.g. Brodie et al., 1997). Our approach differs from theirs in that it focuses on the analysis of existing research traditions and their contributions to RM thinking.

This kind of metatheoretical analysis is helpful in revealing both the potential differences and similarities in the underlying assumptions each research tradition

makes. It provides an important vehicle for discussing the possibility of relationship marketing forming a general theory within the marketing discipline. By taking a closer look at the disciplinary roots of RM, the analysis also gives it a more theoretical content. With the exception of a few recent contributions (e.g. Barnes, 1994; Brodie et al., 1997; Gummesson, 1996; Iacobucci, 1994; Lehtinen, 1996; Liljander and Strandvik, 1995; Mattsson, 1997; Parvatiyar and Sheth, 1997), many scholars have rushed to launch the RM concept with only scant attention to its deeper meaning – the content and its relatedness to existing theory formation. Moreover, metatheoretical analysis helps to portray the potential future of relationship-marketing theory. A careful examination of the past creates understanding of the current debate and of the future development of RM.

Our point thus is, that if we wish to go forward in generating new and innovative theories of marketing – whether general or partial ones – we also need to look backwards and to try to understand the roots and foundations of knowledge. If there is no good foundation, people easily keep on proposing interesting sounding concepts, claiming that they are 'new'. In the drive to be novel, the rhetoric overtakes strict conceptual analysis that forms the foundation of sound theory development.

It has to be noted that our analysis focuses on market relationships, i.e. on buyer-seller relationships, and we exclude other stakeholder relationships at this phase. After all, buyer-seller relationships are the core issue in relationship marketing, and in the whole marketing discipline.

We begin by discussing what we see as the disciplinary roots of RM: services marketing, marketing channel and business marketing research traditions, and the ideas of database marketing and direct marketing. Then we present the criteria that earlier literature on metatheoretical analysis has put forward, and use them to study the identified traditions. Prototypical aspects of each root tradition are brought out for comparison and to show the contribution that each of them is making to the evolving discipline of relationship marketing. We conclude by making suggestions for how to continue the conceptual development of RM thinking, and by discussing the managerial implications of our arguments.

The Roots of Relationship Marketing

Marketing relationships as phenomena are probably as old as any trade relationship. They have also been examined for considerably longer than the current discussion generally suggests. We propose that the current relationship marketing discussion is primarily derived from the four sources indicated in Figure 1.

The choice of these research traditions as "roots" is based on our own earlier research and reflection (see Halinen, 1994; Möller, 1992, 1994), and on later suggestions by Brodie et al. (1997), Coviello et al. (1997), Gummesson (1996), Morgan and Hunt (1994), and Mattsson (1997). The selected traditions have

emerged and developed within the marketing discipline, and they all put emphasis on the external relationships of a company, particularly on customer relationships. As we see it, these four marketing traditions have contributed most to the shift from viewing marketing exchange as a transactional phenomenon to viewing it as on-going relationships. They have also given theoretical and practical content to the relationship-marketing concept. Only a brief description is given at this point.

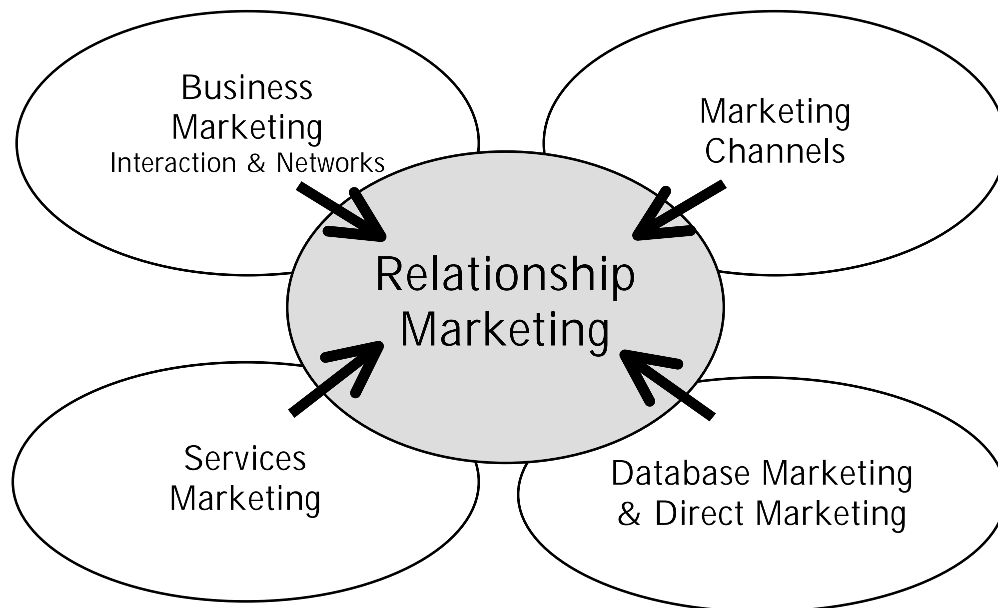

Figure 1. Disciplinary Roots of Relationship Marketing

In the late 1970s, researchers interested in industrial marketing and marketing channels started to develop frameworks and theories focusing on dyadic relationships between business buyers and sellers. This was new compared to the marketing-mix tradition which regarded exchange from a transactional point of view and studied it either from the marketer's or the buyer's perspective. Several research approaches can be mentioned in this context. These include the early dyadic research on buyer-seller relationships (for example, Bonoma and Johnston, 1978; Bonoma and Zaltman, 1978; Frazier, 1983), research employing the political-economy framework (Stern and Reve, 1980), research into channel relationships inspired either by applications of transaction cost economics (Heide and John, 1990, 1992) or by social-exchange theory (Anderson and Narus, 1984, 1990), research on industrial relationships by scholars connected with the Industrial Marketing and Purchasing Group (Ford, 1990; Håkansson, 1982), and research focusing on networks of related exchange relationships (Axelsson and

Easton, 1992; Håkansson and Snehota, 1995; Mattsson, 1987; Möller and Wilson, 1995). For a comparison of these approaches, see Möller (1994).

By the late 1970s, the marketing-management tradition was also beginning to be questioned by researchers interested in services. Their main concern was that the marketing-mix approach did not provide conceptualisations for modelling and managing the service provider-customer relationship. Services researchers argued that consumers' quality experiences and subsequent satisfaction with the service are primarily an outcome of an interaction relationship between the personnel and the consumer – augmented by traditional marketing communications, institutional image, and service delivery technology. The importance of developing and maintaining relationships is emphasised. For good summaries of the development of the services approach, see Berry and Parasuraman (1993) and Fisk et al. (1993).

Within consumer behaviour, early studies on consumers' brand loyalty and supplier or store loyalty date back to the late 1960s (Jacoby and Chestnut, 1978); and, as Sheth and Parvatiyar (1995b) have argued, early consumer learning theories (Hansen, 1972; Howard and Sheth, 1969) also include aspects of consumers' engagement in relational market behaviour. In spite of this development, theoretically-driven analysis of long-term relationships between consumers and marketers and/or distributors have remained scant.

However, from the mid 1980s onwards, rapidly-developing information technology has been creating a primarily practice-based and consultant-driven literature on managing customer relationships through databases (DBM or database marketing) and direct marketing (DM) activities (see Jenkinson, 1995; McKenna, 1991; Peppers and Rogers, 1993, 1997; Pine et al., 1995; Rapp and Collins, 1991; Shaw and Stone, 1988; Shepard, 1995). The buzz words 'mass customisation' and 'one-to-one marketing' have arrived. This 'information technology' approach has a heavy emphasis on marketing communications, and is often also referred to as the integrated marketing communications (IMC) 'school' (see Raulas and Vepsäläinen, 1994; Schultz et al., 1993). DBM and DM practices and research represent our fourth RM root in Figure 1.

The Logic of Metatheoretical Analysis

The fragmented nature of theories pertaining to the evolution and management of marketing exchange relationships creates several problems.

We are facing:

- Multiple research approaches, that are partly independent and partly overlapping.
- Approaches that provide only partial theories or views of the relationship-marketing phenomenon.
- Approaches that draw on different theoretical sources and employ different conceptual frames of reference.
- Approaches that often focus on issues at different aggregate levels and

employ different units of analysis.

In brief, we argue that we do not yet have any developed theory of relationship marketing. What we have is a variety of partial descriptions and theories focusing on the broad content of the phenomena researchers have labelled relationship marketing. The metatheoretical analysis is useful in this kind of situation. It is a systematic evaluation of the basic assumptions and questions that each of the research traditions makes about marketing relationships. This theoretical comparison of the root traditions purports to identify how each approach contributes to relationship marketing. The resulting conceptual description of the prototypical aspects should facilitate our navigation through the diverse research approaches, help us to make conscious and efficient choices of theory, and also provide a direction for the development of the theories.

The rationale for this kind of theoretical comparison is the multiparadigm perspective on theory development endorsed by Morgan (1986), Gioia and Pitre (1990), and Hunt (1991). This suggests that the multiple views created by different research traditions may be linked, or at least compared, to achieve a better understanding of the substance of relationship marketing and of its root traditions. Each tradition provides a particular and partial view of buyer-seller relationships, depending on its assumptions about relationship-marketing phenomena (ontological or 'nature-of-the-world' assumptions), its assumptions on how knowledge about relationship marketing is acquired (epistemological assumptions), and on the issues researchers in that tradition have chosen to bring to the foreground. From the vantage point of a metatheoretical plane, those who have different perspectives can gain a more comprehensive view of relationship marketing, and they can evaluate the benefits and limitations of the source traditions under examination.

How, then, should we carry out a comparison of different research traditions? We will first define a set of descriptive criteria and evaluate existing approaches accordingly, thus creating a profile of the prototypical characteristics of each approach. An alternative, exemplified by Burrell and Morgan (1979) and Arndt (1985), would be to derive a restricted number of highly abstract theoretical dimensions and employ these to develop a typology of relevant traditions, most often in a two-by-two matrix. This typology approach is very powerful, but abstract; the profile method provides a more detailed description, but not such an elegant a classification. We have chosen to use the profile approach because many of the research traditions in relationship marketing are not monolithic, but include constructs and ideas from more than one discipline. This requires an in-depth comparison.

On the basis of our investigation of several theoretical comparisons of research traditions within marketing and management (Anderson, 1986; Arndt, 1985; Brodie et al., 1997; Burrell and Morgan, 1979; Coviello et al., 1997; Easton, 1995; Easton and Håkansson, 1996; Gioia and Pitre, 1990; Mattsson, 1997; Möller, 1994; Tikkanen, 1996; Walker et al., 1987), we suggest that attention should be paid to the following issues when research traditions are compared:

- The basic goals of the tradition; how it perceives relationships, what questions it is asking and what it tries to achieve.
- The disciplinary background and driving forces; i.e. is the tradition primarily linked to some theoretical disciplines which provide its focus, or is it driven by social/managerial questions?
- The key concepts used in describing relationships.
- Explanatory mechanism and methodological orientation; i.e. through what kind of mechanism(s) does the tradition aim to produce new knowledge; can one recognise a primary mode of empirical analysis within the tradition, and what are its benefits and limitations?
- World view; what is the ontological basis, in other words the assumptions about the nature of the phenomenon, including assumptions about the nature of marketing relationships embraced by the tradition?
- Level of focus and unit of analysis; e.g. does the tradition focus on personal or organisational relationships, and does it include their context?
- Time orientation and the focus on structure versus process, or both.

These dimensions are used in the next section to compare relationship-oriented research within business marketing, marketing channels, services marketing, and database and direct marketing. The aim is to increase our understanding of how these contribute to relationship marketing.

A Conceptual Analysis of the Root Traditions

In order to be able to cope with the extensive material available, we first looked at existing state-of-the art reviews and then selected prototypical studies in each root tradition under examination. We aimed at emphasising studies which reflect the typical manner in which customer relationships are handled within the tradition. Which studies can be considered prototypical or representative is naturally a matter of judgement. Ultimately, our selection was based on our reading and on our professional experience in the area of marketing.

We tried to keep the unavoidable element of subjectivity in check by a careful examination of the broad material. Articles providing critical reviews of the research traditions were of great help in conducting the analysis (for Business Marketing see e.g. Easton and Håkansson (1996), Möller (1994) and Mattsson (1997); for Marketing Channels Bögelund and Skytte (1997), Dahlström and Dwyer (1992) and Möller (1994); and, for Services Marketing Berry and Parasuraman (1993), Fisk et al. (1993) and Grönroos (1994a). The following list includes examples of the studies, articles, monographs and collections of articles reviewed for the study:

Business Marketing (Interaction and Network Approach): Axelsson and Easton (1992), Ford (1990, 1997), Gemünden et al. (1997), Halinen (1997), Håkansson and Snehota (1995), Juttner and Schlange (1996), Möller and Wilson (1995)

Research Tradition Characteristics	Database and Direct Marketing	Services Marketing	Channel Relationships	Business Marketing: Interaction and Networks
Basic Goals	Managerial goal: enhance marketing efficiency through better targeting of marketing activities, especially marketing communications.. Strong managerial emphasis, integrated marketing communications (IMC) an important agenda.	Theoretical goal: explain and understand services management and services marketing relationships. Managerial goal: enhance the efficiency of managing customer encounters and relationships through managing the perceived quality of the service offer and relationship.	Theoretical goal: explain governance structures and dyadic behaviour in the channel context. Normative goal: determine efficient relational forms between channel members.	Theoretical goal: understand and explain the functioning of business markets from the perspective of interactive buyer-seller relationships and related networks. Managerial goal: gain a more valid view of reality through network theory.
View of Relationship	Organization-personal customer relationships, often distant and generally comprising discrete transactions over time, handled through customised mass communication.	Personal customer relationships attended by service personnel and influenced through other marketing activities. Earlier a strong focus on the service encounter, later expanded to include the life-cycle of relationships.	Interorganizational business relationships characterised by economic exchange and use of power. Later extensions to social factors. Actors are dependent on each other and behave reciprocally.	Relationships exist between different types of actors (firms. organizations, individuals), who exchange all kinds of resources. Relationships are seen as vehicles for accessing and controlling resources, and creating new resources.
Questions Asked	How to provide value for the customer, how to develop loyal customers, how to adapt marketing activities along the customer's life cycle, how to retain customers?	How to provide value and perceived quality for the customer, how to manage service encounters, how to create and manage customer relationships?	What forms of governance are efficient for what types of channel relationships? How can the more dependent party safeguard against the dominant party? How are the key constructs like cooperation, trust, communication and conflicts manifested and related to each other? In what way is the dyadic relationship contingent on the larger channel context?	How are relationships created and managed; how do nets of relationships evolve, how can an actor manage these relationships and create a position in a net? How do networks function and evolve?
Disciplinary Background	No disciplinary background; driven by information technology, marketing communication applications, and consultants.	No clear disciplinary back-ground: early phase a response to "traditional marketing management", later consumer behaviour applications, operations and human resource perspective and general management outlook. Both empirically- and theory-driven with heavy managerial orientation.	Primarily theory-driven, attempts to combine the economic, political (power, dependency) and social aspects of channels. The tradition relies on transaction cost theory, relational law, social exchange theory, political economy, power and conflict in organizational sociology.	Both empirically- and theory- driven; earlier influenced by channels research, organizational buying behaviour, resource dependency theory, social exchange theory and institutional economics; later by institutional theory, dynamic industrial economics, organizational sociology and resource-based theory
World View and Assumptions about Relationships	Pragmatic – no explicit assumptions; implicitly assumes competitive markets of customers; S-O-R view with feedback. Relatively weak dependency between buyer and seller, as the goods exchanged are relatively substitutable and many buyers and sellers exist.	Primarily the management perspective; dyadic interactive relationship but customers often seen as objects. Interdependence between the seller and the customer varies from weak to relatively strong. The basic service is often relatively substitutable, but the service relationship can be differentiated and individualised.	Both parties can be active; the basic interest is in economic exchange and its efficiency. The relationship is unique and reciprocally interdependent; its substitutability depends on the availability of alternative buyers and sellers and the amount of switching costs related to relationship-specific investments.	The relationship perspective can be of the dyadic, focal firm or network type. Any actor can be active, actors are seen as subjects. Reciprocal interdependence between actors, caused by heterogeneity of resources which makes substitution difficult.

Topics/ Concepts Important for RM	Customer retention, share of a customer, database as a device for managing direct communications, integrated use of channels.	Service encounters, experience and expectations, service and relationship quality, lifetime value of the customer, internal marketing, empowerment of personnel.	Uses of power and conflict behaviour, interdependence, goal congruity, decision domains, transaction-specific investments, switching costs, dyadic governance, environmental influence on dyadic behaviour, communication, dyad outcomes: efficiency, satisfaction, relational norms such as trust and cooperation.	Interaction processes, adaptation and investments in relationships, actor bonds, resource ties, activity chains, relationship outcomes and phases of relationships; nets and networks of relationships; network dynamics and embeddedness.
Methodological Orientation	No conscious methodology, primarily cross-sectional analysis of survey data and customer databases.	Divided methodology; North American emphasis on explanation through hypothesis testing by multivariate analysis; Nordic emphasis on understanding through qualitative research.	Hypothetical-deductive reasoning, explanation through hypothesis testing by multivariate analysis.	Divided methodology, European emphasis (IMP Group) on understanding through historical case analysis; North American emphasis on explanation through hypothesis testing by multivariate analysis (primarily limited to dyads).
Level/Unit of Analysis and Contextuality	Individual consumer, a group of consumers (segment), in applications the latter dominates.. No conscious assumptions about the contextuality of the customer relationship; the competitive situation is the general perspective.	Individual customer, group or segment, service provider-client relationship. Little emphasis on contextuality, history of a relationship generally handled through 'experience'; implicit assumption about the market as the dominant environmental form.	Firm, dyadic relationship in the channel context.. Contingency perspective: dyadic behaviour and efficient forms of governance are dependent on the channel context. Well developed 'environment' theory.	Actor (organization, person), dyadic relationship, net of relationships. Transactions are episodes in the long-term relationship. The emphasis is on the embeddedness of relationships in nets and networks, and in time: the present is understood through history and the future.
Time Orientation, Focus on Structure vs. Process	Rhetoric emphasises the long-term view, no published conceptual or practical tools for handling long-term issues of relationships. The focus is on the content of a customer profile.	Earlier emphasis on short-term encounters, now shifting to a more enduring relational perspective. The process aspect is evident, but empirical research is primarily on the content of relationship characteristics.	Channel relationships range from market-like transactions to long-term reciprocal relationships. Theoretically dynamic, but the majority of empirical research is static; the focus is on structure not process.	Time is an essential phenomenon. Dynamic perspective, focus on both structure (content) and processes (how dyads, nets, and networks evolve).

Table 1. Comparison Matrix of Research Approaches to Marketing Exchange Relationships

Marketing Channels: Anderson and Narus (1984, 1990), Geyskens et al. (1998), Grundlach et al. (1995), Heide and John (1990, 1992), Joshi (1995)
Services Marketing: Bateson (1995), Crosby et al. (1990), Grönroos (1990), Gwinner et al. (1998), Parasuraman et al. (1995), Reichheld and Sasser (1990)
Database Marketing and Direct Marketing: Berger and Nash (1998), Jenkinson (1995), Peppers and Rogers (1997), Pine et al. (1995), Shaw and Stone (1988), Shepard (1995) Wang and Spiegel (1994).

Analysis of our base material enabled us to compile a comparison matrix of the four root traditions of relationship marketing (see Table 1). The matrix was constructed by reviewing prototypical studies with the help of the evaluation criteria defined in the previous section. Reading the table column by column produces a descriptive profile of each research tradition. Reading by rows allows comparison of the traditions according to each descriptor.

The reader should recognise that this kind of comparison involves broad generalisations. In trying to capture the basic themes of each root discipline we have to gloss over many details. There are probably individual studies which do not match our interpretations, and authors who disagree with them.

The Database Marketing and Direct Marketing tradition is perhaps best characterised as a practice, since it has no clear disciplinary background, no clearly defined methodologies nor a premised theory of markets. It has a strong managerial emphasis aiming at enhancing the efficiency of marketing activities, especially communication – its channels and messages. Competitive markets are implicitly assumed. The organisation-customer relationship perspective is fairly restrained, portraying an image of a relatively loose and distant connection. The focus is on interactive communication, where the seller is the active partner who plans offers and communication on the basis of customer status (profile) and feedback. Relationships are seen as long-term in nature, but conceptual or other efforts to tackle the dynamism of customer relationships have been limited. The main focus is on how to keep customers loyal and profitable in an efficient way.

The Services Marketing tradition aims at explaining and understanding service management and service-marketing relationships, paying particular attention to the relationship between the individual consumer and the service company personnel. The major issue in services research has been how to manage service encounters and service quality. The research has been both empirically and theoretically driven, rich in methodology and strong in managerial implications. Customer relationships have also primarily been viewed from a managerial viewpoint, the service company being the active party in an otherwise interactive relationship. The tradition has paid little attention to the context of relationships; it seems that competitive markets are implicitly assumed. The customer is supposed to be able to substitute the service and change the service provider fairly easily, although varying degrees of interdependency between the provider and customer are acknowledged. The

process nature of service encounters and relationships was recognised early, but empirical research in this area is still scant.

The Marketing Channels Tradition draws heavily on existing socio-economic theories in order to provide normative implications for channel management. It aims at explaining governance structures and the nature of dyadic behaviour in the marketing-channel context, using hypothetical-deductive reasoning as the primary methodology. The focus is thus on business relationships, and on economic exchange and its efficiency. Relationships are viewed as strongly interdependent and reciprocal. Some streams of research within the tradition emphasise the economic aspects of channel relationships, and others the social and political aspects, as discussed earlier. The major issues tackled have been the definition of efficient governance forms for different channel relationships, and the modelling of their socio-economic nature. The channel context has been acknowledged and included in theory formation, whereas the process aspect has received little attention.

Finally, in the Interaction and Network Tradition of business markets, three interrelated sets of goals can be distinguished. First, the tradition aims at understanding and explaining exchange behaviour between organisations and relationship development at a dyadic level in a network context. Second, it strives at understanding how nets of relationships between actors evolve, and third, how markets function and evolve from a network perspective. Views on relationships are diverse. They encompass relations between companies, individuals and various organisations such as governmental and research agencies. It is not only goods, but all kinds of resources that are exchanged through interactive relationships, which function as vehicles for accessing and controlling resources, and also for creating new ones. Parties to a relationship (or to a net) may all be active, and relatively strong interdependence is assumed between them since the resources in the market are heterogeneous, thus making substitution difficult. The level of analysis in interaction and network research varies according to whether an actor, a dyadic relationship or a net of relationships is the focus. Some of the research is inductively and empirically oriented, and some draws heavily on theories of organisation science, economics and sociology. Multiple methodologies have been in use, depending on the inclination and nationality of the researcher. The context and the temporal perspective are particularly emphasised, and also integrated into theory construction.

Our analysis of the literature on the roots of relationship marketing reveals considerable differences. We suggest that the most essential aspects are: how the four traditions view and handle exchange relationships, and what kind of assumptions they make about their context.

Close examination of the nature of exchange relationships reveals great variety in their complexity, and particularly in the type of dependencies that emerge between the buyer and the seller. Relational complexity seems to be closely related to whether the research tradition primarily concerns marketer-consumer relationships or interorganisational relationships. Since this division seems most powerful in differentiating the underlying assumptions each tradition

makes about exchange characteristics, we selected it as the basis for further analysis. Table 2 outlines the assumptions behind consumer-related and organisation-related traditions.

Table 2. Exchange Characteristics Assumed in Consumer Relationship vs. Interorganisational Relationship -Focused Research Traditions

Consumer relationships: Low relational complexity	Interorganisational relationships: High relational complexity
• The focus is on marketer-individual customer relationships.	• The focus is on (i) supplier-buyer dyads, and (ii) exchange within focal nets.
• A large number of customers.	• A small number of actors, ranging from profit/non-profit-organisations to governmental organisations, and key persons.
• Low interdependence since resources (relationships, products, information, etc.) are substitutable.	• Mutual interdependence through resource ties, resources are relatively heterogeneous, making switching difficult.
• Switching is relatively easy.	
• The seller is primarily active.	• Any actor can be active.
• The focus is on few episodes – seldom on long-term relationships.	• Transactions are episodes in long-term relationships.
• The emphasis is on managerial, economic, and psychological views of exchange.	• The emphasis is on resource, social, and inter-functional exchange relationships.

Research on consumer relationship-related traditions has focused on the relationship between the marketer and the individual customer, whereas interorganisationally-oriented approaches have focused on exchange between suppliers and buyers of various types – and even between several actors at a time. In the two perspectives on exchange relationships, the assumption about the level of interdependence between the buyer and the seller is a major differentiating factor. Consumer-relationship approaches assume a large number of potential partners, where both buyers and sellers have several alternatives to choose among. Resources exchanged and relationships created are substitutable, since relationships rarely develop into strongly interdependent connections. In the interorganisational case, in contrast, potential partners are fewer and the

resources they control tend to be heterogeneous because of specialisation and historical development. Relationships are therefore characterised by mutual interdependency, which may vary from weak to strong, and which may make switching partners much more difficult. Again, unlike interorganisational approaches, relationships between marketers and consumers are considered to be much looser, the bonds that tie the parties together being weaker and fewer. Social bonds are seen to be of great importance (see e.g. Gwinner et al., 1998; Liljander and Strandvik, 1995), whereas, different economic, technological, planning, social, legal and knowledge-related bonds co-exist and are all seen as essential in interorganisational relationships (see. e.g. Mattsson, 1985; Håkansson and Snehota, 1995, p. 13).

In line with the managerial emphasis of consumer-oriented relationship research, the seller is generally viewed as the active party, and the consumer more as an object, although the interactive character of relationships is recognised. The long-term view is stressed, but remains relatively unexploited as far as the conceptual or managerial tools for mastering relationship development and the effects of history on relationships are concerned. So far, the long-term perspective has been seen in terms of recurring transactions and their successful management rather than of process or other dynamic relationship features.

As a result of the particular emphasis (managerial or theoretical), and the basic difference in relationship focus (individual customer or organisation), the contributions of the two approaches to relationship marketing thinking do vary. Consumer approaches have been dominated by the managerial, economic and psychological view of exchange and relationships, while interorganisational approaches have put more emphasis on resources, and on social and inter-functional exchange within and between relationships.

In addition to examining the characteristics of individual exchange relationships, it is also important to recognise the context in which such exchange takes place or, as Mattsson (1997) emphasised, to examine the assumptions that different authors and traditions make about this issue. The contextual aspect is relevant as it illuminates further what kind of mechanisms are employed for understanding exchange relationships. Moreover, many of the key concepts of relationships, such as trust and commitment, cannot be fully understood without a closer look at the context. Table 3 contrasts the assumptions of Database Marketing and Consumer Services Marketing (both basically assuming a market context) with those of the Network Approach to interorganisational relationships and Channels Research, assuming a systemic exchange context. We are indebted to the ideas of Mattsson (1997) and Möller (1992, 1994) for our analysis.

As can be seen, the underlying assumptions behind the market and network/channel perspectives on exchange relationships are fundamentally different, and represent almost polar views. As such, these contextual assumptions form the critical dividing line between different roots of relationship marketing. The consumer-based approaches clearly stem from the traditional theory of markets as the context of managing customer relationships, where

competition is the dominant force. It seems that this linkage is often not explicitly recognised. Interorganisationally-oriented traditions assume a complex network of interrelated actors, whose actions are shaped by both competition and co-operation. Companies and dyadic relationships between companies are embedded in networks of relationships and channel systems. The world is not transparent, and experience and history matter in understanding any particular relationship as well as the nature of existing networks.

Table 3. Assumptions Concerning the Context of Relationships in Consumer Relationship vs. Interorganisational Relationship - Focused Research Traditions.

Consumer relationships: Market perspective	Interorganisational relationships: Network/Systemic perspective
There are many potential customers who form a market of potential 'relationships'.	There is a limited number of potential partners. Interdependence based on resource heterogeneity forces the actors to cooperate; network environments emerge.
Many customers/ marketers and relatively homogeneous resources lead to atomised markets characterised by low interdependence.	Relationships are embedded in networks and the channel system.
The S-O-R view emphasising customers' response profiles; how they react to marketers' activities.	Mutuality and history are essential in understanding episodes, relationships and the network context.
Markets can be segmented based on response profiles; the ultimate level is individual 'segments'.	There are several 'levels' in network relationships (supplier, supplier's supplier, buyer, buyer's buyer).
The market is generally taken as a given model of competition and it forms the context of exchange relationships.	Competition and cooperation are the primary forces shaping relationships and networks.
The market is a resource allocation mechanism.	Relationships are important in coordinating and creating resources; not only in allocation.
Competition for relationships provides the market dynamics.	Relationships shape networks, network dynamism is relevant.

Our analysis of the assumptions made in the root disciplines of relationship marketing gives a picture of strongly-divided views of the phenomenon. Both the character of exchange and the context in which it takes place have been subject to very different assumptions in consumer-related research traditions on one hand and in interorganisational traditions on the other. The next section elaborates the relevance of these findings from a theoretical perspective.

Theoretical Conclusions

A comparative analysis of the root traditions of relationship marketing revealed that it is misleading to talk about a single 'Relationship Marketing Theory' without any reference to the fundamental distinctions exposed above. In fact, there seems to be a good reason to distinguish between two basic types of relationship-marketing theories: Market-based Relationship Marketing and Network-based Relationship Marketing. The former deals with fairly simple exchange relationships and assumes a market context, whereas the latter examines complex relationships and presumes a network-like business environment (see Figure 2).

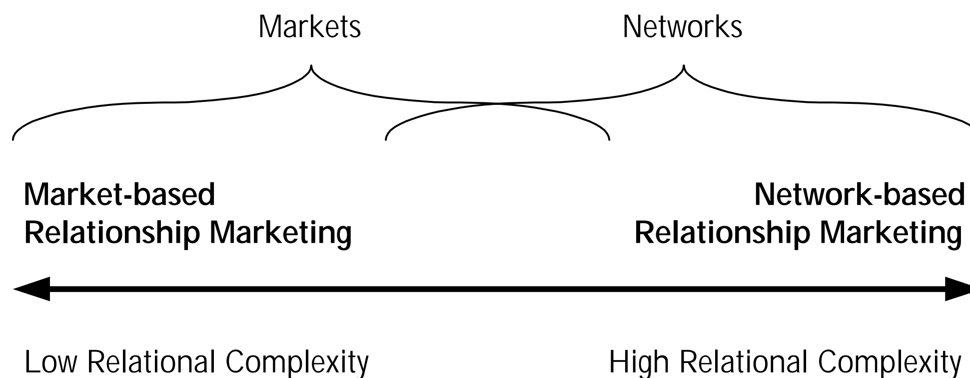

Figure 2. Two Types of Relationship Marketing Theories

Buyer-seller relationships rarely exist in pure types and are therefore better portrayed on a continuum of varying degrees of relational complexity. Complexity refers to the number of actors involved in exchange, to their interdependence, intensity and nature of interaction and to the potential temporal contingencies in the relationship. Complexity is closely related to the kind of task that is exchanged or taken care of through the relationship, how standardised the task is, and how complex and novel it is.

What, then, is the relationship between relational complexity and the context of exchange? On the basis of our research-tradition analysis, we contend that complex exchange relationships generally take place in a network context, whereas less complex relationships are characterised by a market-like exchange

context, as depicted in Figure 2. There are several reasons for this. Complex exchange tasks demand a high level of mutual understanding which is not fostered in market-governed relationships. Through increased mutual learning and relationship-specific investments, actors become interdependent, which makes switching difficult. When these conditions characterise exchange behaviour, the exchange context also tends to become network-like. There are generally several acceptable alternatives for customers at the low complexity end of the exchange continuum. This makes switching possible, and leads to less interdependent relationships. These kinds of relationships tend to be more efficiently governed by markets.

Following on from this discussion, we suggest that it is useful to distinguish between two relationship-marketing theories: Market-based Relationship Marketing and Network-based Relationship Marketing. These theories have unique features and they are efficient in explaining the particular relationship-marketing phenomena that exist in the domains of exchange described above. Although these theories are closely related to consumer-directed relationship marketing and interorganisational relationship marketing, their theoretical bases are anchored in exchange characteristics and the exchange context, not in the 'consumer-business' division.

This basic conclusion has important implications for future theory development in relationship marketing, and also sheds light on the current debate on its role within the marketing discipline.

We would argue that the uncovered dualistic roots of relationship marketing propositions help us to understand some of the seemingly contradictory notions in the RM debate. The proponents of different schools of thought have been criticising each other for insufficient interaction and discussion, for disregard of the achievements of other traditions and a reluctance to accept their concepts, models and methods. It is much easier to understand these contradictions in terms of the fundamental differences in the premises of each research tradition. Since the key concepts of relationship marketing have roots that are over a decade old, it is also obvious that the novelty claims made by some RM proponents are inflated.

The underlying views or bases of the different RM theories are so discrepant that we do not expect to see any unification into a 'general theory of relationship marketing', which is contrary to Gummesson's (1995) proposition, for example. The differences in world view, particularly with respect to the nature of relationships (complex or standardised, individual vs. organisational, seller-maintained vs. mutually dependent) and their context (atomised and competitive markets vs. strongly interconnected and often co-operative networks) are so fundamental that theory-level unification is not useful. On the contrary, Market-based RM and Network-based RM are specialised, contingency-type theories, which provide stronger conceptual tools and explanatory mechanisms for the kind of relationship marketing phenomena that exist in the different domains of exchange than any other theory at the moment. By increasing the abstraction level, it is always possible to create a general theory, but that would mean losing

much of the knowledge content which is valuable in the two existing, distinct theories of relationship marketing.

Another important theoretical issue concerns the relation between traditional (and typically transactional) marketing management (TMM) and the modes of relationship marketing dealt with here. Emerging conceptual and empirical studies (Brodie et al., 1997; Coviello et al.1997; Möller, 1991; Pels, 1999) suggest that most firms have to master several modes of marketing: traditional aspects of marketing management such as brand management and competitive segmentation, targeting and positioning, as well as consumer-targeted and interorganisational relationship marketing. Companies operating in fast-moving consumer packaged goods industries, consumer durables, industrial goods and services often employ at least two marketing modes.

The existence of multiple modes of marketing means that we always need several theories in order to reach a comprehensive understanding of the marketing activities of most firms. In other words, we do not believe in propositions that suggest that RM will replace traditional marketing management or make it obsolete. These theories pertain to unique types of exchange behaviour, they have unique theoretical cores and can be applied in a complementary fashion to issues which match their knowledge content.

To conclude our theoretical discussion, we suggest that, by examining the specific content of Market-based RM and Network-based RM, scholars can in the future develop more rigorous conceptual and analytical tools for relationship marketing, and avoid the confusion caused by mixing these different types of theory.

Two Types of Relationship Marketing: Managerial Challenges

The two distinct modes of relationship marketing identified pose different challenges for customer-relationship management. Table 4 presents what we perceive are the core managerial problems/questions within each mode. These questions represent challenges which, we feel, need urgent attention from both practitioners and researchers. The lists of issues are not symmetric because Network-based Relationship Marketing involves more managerial 'levels', and also more open issues. It is also important to note that some of the issues resemble each other. This means that same analytical tools are potentially applicable in both ends of the RM continuum.

In a nutshell, Market-based Relationship Marketing can be characterised as the management of the firm's customer base, where the major challenge is to treat large numbers of customers individually and still profitably. The key managerial tasks concern first and foremost the internal procedures of the company, such as planning marketing activities for regular customers, mastering customer portfolio analyses, using databases and new information technology to manage the customer interface, and restructuring the marketing organisation according to RM thinking.

Table 4. Managerial Challenges of the Two Modes of Relationship Marketing

Market-based Relationship Marketing	Network-based Relationship Marketing
• Developing and managing a portfolio of customer relationships. Issues: identifying criteria for classifying customers, measuring customer states, responses, expected revenues and costs of customer care. • Managing marketing activities per customer group (segment). Issues: organising the integrated use of marketing activities, including personal and non-personal contact patterns. • Managing individual customer relationships: initiation, development, maintenance, conclusion. Issues: expected revenues and costs, monitoring customer needs and responses, integrated use of marketing activities – all across the customer life-cycle. • Managing multiple contact channels in an integrated fashion (communications and sales channels). • Creating interfunctional business process solutions for handling the above issues. • Creating advanced flexible information systems and databases for operating the above crafted customer-care systems. • Applying traditional planning and control for monitoring efficiency and effectiveness.	• How to manage the firm from the perspective of a nexus of resources and exchange relationships. Issues: identifying criteria for classifying what resources to develop and govern internally, what to exchange through what kinds of relations. • Developing and managing a portfolio of exchange relationships enabling the firm to extend its control of critical resources. Issues: identifying criteria for classifying relationships according to the type of 'governance' or management needed in successful exchange. • Creating, maintaining and concluding network positions. Issues: how to mobilise resources and actors in order to attain (maintain, change) a critical mass of relationships required of a viable network position. • Developing interfunctional organisational solutions for the coordination of exchange relationships (teams, key account managers). • Managing individual relationships: initiation, development, maintenance, conclusion. Issues: expected benefits and opportunity costs, monitoring actor expectations and responses, integrated use of relationship care activities – all across the relationship life-cycle. • Initiating and developing strategic partnerships. **Cont/d...**

Market-based Relationship Marketing	Network-based Relationship Marketing
	• Intentionally constructing supplier nets/customer nets. Issues: how to mobilise actors, solve conflicts, create an efficient monitoring and control system, including social norms. • Traditional planning is difficult and not sufficient. Issues: how to create and sustain strategic flexibility, and intraorganisational and interorganisational forms of management.

Network-based Relationship Marketing, in contrast, can be briefly described as the management of interdependencies between business actors. There the tasks and challenges of management involve broader and deeper interaction with external partners, both customers and other stakeholders. The key questions concern how to coordinate activities with different actors and how to mobilise and control critical resources through relationships with them. Customer relationships are treated more individually, and are also more complex than in the case of Market-based RM.

Four sets of analytical tools seem most relevant to Market-based RM. The first is the microeconomics and management science-based tradition of optimisation. The development of customer databases, the decreasing costs of collecting, storing and using information, and information systems technology have all rendered problems such as the segmentation of customer relationships and the efficient management of marketing activities by increasingly smaller segments solvable. Paradoxically, this is exactly what classical marketing management theory, so abhorred by some proponents of RM, suggested more than twenty years ago (Kahane, 1977; Kotler, 1971; Massy and Weitz, 1977). There are, in fact, high hopes that the advancement in information and computing technology will make the microeconomic principle of efficient resource allocation a managerially viable approach, replacing cruder 'rules of thumb' (see Berger and Nash, 1998; Blattberg and Deighton, 1996; Payne and Frow, 1997; Storbacka, 1997; York and McLaren, 1996). This would also be helpful in solving the problem of the efficient use of multiple channels.

In order to avoid misinterpretation, we emphasise that we do not regard traditional marketing management (TMM) and Market-based RM as similar. The fundamental difference is that RM uses the customer relationship as the focal unit of interest, whereas TMM focuses on transactions. However, the analytical tools developed within TMM are very suitable for handling the problems of

Market-based RM; a fact which many of the proponents of relationship marketing seem to have overlooked.

The second set of tools comprises the conceptual frameworks developed primarily within services marketing for handling customer episodes and individual customer relationships. These include the expected/perceived quality frame leading to the GAP model of quality in customer relationships (Parasuraman et al., 1985), emerging views on the dimensions of customer relationships, and the work on customer retention.

The frameworks developed to serve organisational forms of managing customer relationships, including internal-marketing suggestions (Grönroos, 1990) and the 'part-time' marketing aspect (Gummesson, 1990), represent the third tool kit for Market-based RM. The fourth is to do with the traditional planning and control theory of organisational activities.

The managerial problems confronted in Network-based RM are even more complex than in Market-based RM, and the analytical tools available for managers are less developed. The complexity and the embedded character of management problems means that most important issues and decisions are unique. In other words, there is only a relatively limited set of problems which recur in reasonably similar forms. Therefore, there are also fewer analytical tools available for managers to use.

One particular area where some analytical tools have been suggested is the management of customer/supplier portfolios. The basic challenge is to develop customer portfolios that enhance the long-term competitive advantage of the firm. This presumes that we are able to assess the life-cycle value of a particular customer and then handle different types of customers in a diversified (optimal) manner. This complex issue was addressed earlier by Campbell and Cunningham (1983) and Fiocca (1982). We also expect the marketing-science type of segmentation and modelling tools to offer new opportunities for portfolio management in business relationships, see e.g. Turnbull and Zolkiewsky (1997) and York and McLaren (1996).

The unique historical character of the more complex network-marketing issues has so far been mainly encapsulated in broad conceptual frameworks such as "industries as networks" and the related general "actors-resources-activities framework" (Håkansson and Snehota, 1995). Frameworks and process models of interorganisational relationship development (Halinen, 1997, 1998; Möller and Wilson, 1995), and network dynamics (Håkansson and Lundgren, 1995; Halinen et al., 1999) have also been presented. These can be used by management for expanding their understanding of the industry-market context of companies, and for understanding the creation of network positions (Mattsson, 1985) and operating in networks. In the future we expect to see more utilisation of the more normatively developed tools within strategic alliances literature, and of the resources, capabilities, and learning-based view of the firm (Grant, 1995; Mahoney, 1995).

We have argued in this article that different exchange characteristics and exchange contexts require different types of relationship marketing. These

varying business conditions also pose different challenges for management and create a need to develop and use various types of analytical tools to manage relationships. In real life, companies rarely face only one kind of business condition, which means that they cannot follow the ideas of Market-based Relationship Marketing or Network-based Marketing alone. Most firms have to master several modes of marketing: traditional aspects of marketing management (TMM) as well as the Market-based and Network-based Relationship Marketing proposed here. What companies actually need is a broad knowledge of different modes of marketing and an ability to use them in an integrated manner. We hope that our theoretical examination of relationship marketing will provide an impetus to promote the conscious development of more powerful partial theories in these dominant modes of marketing.

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Implementing Marketing Strategy Through a Market Orientation

The adoption of specific marketing strategies is related to several factors in an organization including the organization's mission, objectives, resources, and market orientation. We report an exploratory study in which we define relationships between market orientation and marketing strategy in a high technology environment - the telecommunications industry in the United States. Market orientation is defined as a culture that influences how employees think and act. Our results indicate that a market orientation provides a context for the implementation of specific marketing strategies by serving as a moderator of operational marketing strategy. For example, those organizations who possess a strong market-oriented culture (high-spirited cultures) engage in value creation strategies such as market segmentation, developing new products/services for new markets, and product or service customisation. Those organizations possessing low market orientations (ineffectual cultures) generally practice less aggressive and internally focused strategies such as charging lower prices, providing limited customer service, product/service standardization, and undertake limited market research.

Introduction

Organizations have long sought how to achieve a competitive advantage in uncertain and changing environments. Some believe that gaining a competitive advantage will be achieved by placing a renewed emphasis on delivering superior quality products and services to customers (Bitner 1992; Day and Wensley 1988; Parasuraman, Berry and Zeithaml 1985). Others feel

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that organizations should take a more pragmatic approach by considering tradeoffs between the external environment and strategic initiatives in search of 'best practices' (Miles and Snow 1978; Bourgeois 1980; Snow and Hrebiniak 1980; McKee, Varadarajan, and Pride 1989; Venkatraman and Prescott 1990; Narver, Park, and Slater 1992). Finally, some have suggested a more cerebral and cultural approach which involves organizations to engender a market orientation in efforts to support strategy implementation (Kohli and Jaworski 1990; Narver and Slater 1990; Jaworski and Kohli 1993; Day 1994).

Our research and consultancy work tells us that the current key challenge for management in achieving a competitive advantage lies in the implementation of strategy, as opposed to the formulation of it. The first stages in defining implementation contexts lies in the linking of marketing-related employee behaviours to strategies. This is most recently supported by Day (1998) who reports on what it means to be market oriented, but yet also comments on its elusiveness.

This article presents initial considerations in the development of implementation contexts in a high technology environment. It links operating behaviours to marketing strategies by focusing on the relationships among general behaviours manifesting the overall market orientation of the firm and specific operational behaviours within the marketing domain of the firm. This focus is particularly interesting since competition in high technology industries is fierce and technological advances are rapid, making the development and sustainment of an aligned market orientation even more acute.

We report an exploratory study in which we discuss the concept of market orientation, then proceed to delineate the relationships between market orientation and marketing strategy using the United States telecommunications industry as the context. In this process we also discuss proposed relationships, describe the procedures used to test our propositions, discuss results and managerial implications, and conclude with further research directives.

Market Orientation

Market orientation is a culture that is believed to have far reaching effects on organizations as it influences how employees think and act. It has been defined as "the organization wide generation of market intelligence pertaining to current and future needs of the customers, dissemination of intelligence horizontally and vertically within the organization, and organization wide action or responsiveness to it" (Jaworski and Kohli 1993: p. 54).

Others have been less specific yet equally consistent in defining market orientation. Deshpande, Farley and Webster (1993) defined its principal features as an organization's belief that it should put the customer's interest first, and Shapiro (1988), Narver and Slater (1990), and Narver, Park and Slater (1992) generally described it as the coordination and integration of the firm's resources, human and other, directed toward the creation of superior customer value. Other academics have characterized market orientation as an organizational atmosphere or culture that must create superior value for its customers. This is based on the premise that for an organization to achieve above-normal market performance on a consistent basis, it must create a sustainable competitive advantage (Porter 1985; Aaker 1989).

The competitive advantage afforded by a market orientation is resident in an organization's culture. It is this culture that drives a business to create and maintain the atmosphere that will produce the necessary marketing-related behaviours for the creation of superior value for buyers (Peters and Waterman 1982; Kotler 1984; Peters and Austin 1985; Kotler and Andreasen 1987; Aaker 1988; and Webster 1988). It should not come as a surprise then that many academics have concluded that the desire to create superior value for its customers drives a business to create and maintain a culture that will produce the necessary strategic and operational behaviours to foster superior value (Desphande and Webster 1989).

By definition, one might expect organizations who are market oriented to focus on operational strategies that support preoccupation with the customer. Indeed, market orientation represents superior behaviours in understanding and satisfying customers (Day 1990). These behaviours, and the challenge according to Day (1994) is to identify the integrative relationships among factors manifesting the overall market orientation and specific marketing actions of an organization. Once identified, they can be converted into capabilities and strategies that represent sustainable competitive advantages for organizations. Simply put, a market orientation provides a context to facilitate the implementation of strategy.

Relationship Between Culture and Strategy

To further understand a market orientation's role in driving strategy (and subsequently performance), one must understand the relationship between culture and strategy. The importance of considering culture in the study of strategy and performance has been argued by a number of different researchers. Peters and Waterman (1982), Deal and Kennedy (1982), Wilkins and Ouchi (1983), and Schein (1984) have all proposed the existence of a relationship between culture, strategy, and performance. They postulate that ultimately, organizational performance cannot be accurately understood

without an understanding of the culture and strategy of the organization. Weick (1985) went so far to suggest that organization culture is synonymous with strategy. Although current perspectives are far from unanimous regarding the way in which organization culture should be defined, recognition has been given to the relevance of culture and its influence on strategy.

The literature to date supports the proposition that there is a fit between culture, strategy, and the context in which an organization must operate. This context can include the external environment (Hofer 1975; Bourgeois 1980; Jauch, Osborn and Glueck 1980; Hitt, Ireland and Stadter 1982; Anderson and Zeithaml 1984; Prescott 1986), organizational characteristics such as structure (Chandler 1962; Rumelt 1974), organizational systems (Lorange and Vancil 1977; Galbraith and Nathanson 1978), and managerial characteristics (Gupta and Govindarajan 1984). Chatman and Jehn (1994) also provided evidence that the external environment affects organizational culture. It has been determined that there are significant implications for performance if coalignment between the environment, culture and strategy is achieved. These include an increase in business profitability, increases in ROI, new products success, sales/market share growth, customer retention, and reducing buyers' emphasis on price (Narver and Slater 1990; Narver, Park and Slater 1992; Heiens, 2000).

Although there are different perspectives concerning the impact of culture in organizations, there are signs of movement toward a consensus of accepting culture as an internal variable that is controllable by organizations (Smircich 1983; Aaker 1984). For example, in Aaker's (1984) framework for analysing organizations, culture is considered to be just another internal variable within the organization, subject to change as organizational strategy changes. Of related interest is Wilkins and Ouchi's (1983) finding that some organizations have less unique cultures than others, and that organization culture can be altered more easily than previously thought.

Given what we have learned about organizational culture, we concluded that market orientation is a culture that is comprised of a number of behavioural variables, and it is such a culture, when considered in an integrative context, that manifests the strategic orientation of the organization. Knowing this, an organization's market orientation may be thought of as a range that could extend from zero to some maximum amount, depending on how it is measured.

Relationship Between Market Orientation and Marketing Strategy

The culture resident in a market orientation motivates behaviours that ultimately forge the strategic orientation of an organization. In fact, market

orientation and strategic orientation are closely linked. Research on market orientation and organization strategic type utilizing the Miles and Snow (1978) and Porter (1980 1985) typologies has concluded that organizations with high market orientations tend to be more strategically proactive and connected to their customer within their environments than their counterparts with low market orientations (Walker and Ruekert 1987; McDaniel and Kolari 1987; McKee, Varadarajan and Pride 1989). These same studies also provided an understanding of the types of strategies that are followed by organizations with different orientations. Narver, Park and Slater (1992) further defined these associations by testing the relationship of market orientation to specific marketing strategy elements. In their study of the forestry industry, they were able to relate orientations through the examination of business level strategy actions, and concluded that market orientation is related to differentiation strategies, focus strategies and market information strategies. They also suggested that this research be extended to other industries.

Market orientation appears to provide a strong explanation for strategy, and strategy is related to performance. Previous research has linked a market orientation to several outcomes including improved market and financial performance, and certain strategy orientations. It has also been determined that a market orientation is the foundation for certain marketing strategies (McDaniel and Kolari 1987; McKee, Varadarajan and Pride 1989; Narver, Park and Slater 1992) however, specific relationships between operational level strategy and market orientation has not been delineated until now.

We propose that a market orientation is the catalyst for determining how a business unit competes. We postulate that there is a robust relationship between the degree of market orientation, and marketing strategies practiced by organizations.

Proposition: There are definable relationships between the level of market orientation and the types of operational marketing strategies engaged by organizations in high technology environments. Organizations with high market orientations will engage in operational strategies that are externally focused on the customer, emphasizing such things as customization and quality. Conversely, organizations with low market orientations will engage in operational strategies that are internally focused, emphasizing cost leadership and standardization. These relationships (P1 thru P22) are outlined in Table 1.

Table 1. Proposed Relationships Market Orientation - Market Strategy

	Market Orientation	
Marketing Strategy Elements	High-Spirited	Ineffectual
P1 market sensing/research (customer, industry, competitor)	(+)	(-)
P2 offering products/services of superior technical quality	(+)	(-)
P3 emphasizing company/brand reputation	(+)	(-)
P4 being first in with new products/services and technologies	(+)	(-)
P5 being at the leading edge of industry developments	(+)	(-)
P6 offering broad product/service lines	(+)	(-)
P7 providing high levels of customer service	(+)	(-)
P8 advertising, promotion and image management	(+)	(-)
P9 prestige pricing	(+)	(-)
P10 developing new products/services for new markets	(+)	(-)
P11 market segmentation	(+)	(-)
P12 product/service customization	(+)	(-)
P13 developing new products/services for existing markets	(+)	(-)
P14 research and development	(+)	(-)
P15 penetrating new markets with existing products/services	(+)	(-)
P16 charging lower prices than competitors	(-)	(+)
P17 providing no frills service	(-)	(+)
P18 minimizing marketing expenditures	(-)	(+)
P19 offering prepackaged or standardized products/services	(-)	(+)
P20 rigorously pursuing cost reductions	(-)	(+)
P21 discounting prices	(-)	(+)
P22 offering narrow product line	(-)	(+)

Generally, it is proposed that market-oriented organizations will embrace strategies which can be considered customer focused and information-based. Correspondingly, those organizations which exhibit low levels of market-oriented activity will be internally focused and reactive. For example, one would expect organizations with high market orientations to be well informed about the customer, industry and competitors, and be at the leading edge of industry developments. These actions would be systematically supported, using market research as a strategic tool. As a result, one might expect the strategic orientation of these organizations to be one of differentiation, innovation or focus. One might also expect this group to be connected to the customer. This would involve a positive relationship between market orientation and providing high levels of customer service, market segmentation, developing new products and services for new markets, customizing existing products and services, involvement in market segmentation practices, and staying in the limelight through extensive advertising, promotion and image management. Finally, it would be contradictory for market-oriented organizations to engage in practices of cost leadership such as discount pricing, providing no frills service, minimizing marketing expenditures, and to a lesser degree, standardizing product and services, and offering narrow product lines.

Alternatively, organizations with low market orientations would be positively correlated with actions consistent with standardization and cost leadership such as providing no frills service, discounting prices, product/service standardization, minimizing marketing expenditures, offering narrow product lines, and pursuing cost reductions. One might expect this group to be negatively correlated with those marketing strategies that either connect them to the customer or are associated with differentiation, innovation and focus orientations.

Empirical Analysis

The target population for this research included Regional Bell Operating Companies (RBOCs), general telephone companies outside the RBOC designation, and independent phone companies operating in the United States of America. This industry was selected for two reasons. First, it was considered to be a high technology industry, dynamic in nature, and characterized by rapid products and services introduction rates, intense competition and high technological obsolescence. Second, it provided a single industry context which allowed us to logically frame questions that had a common meaning among respondents. This was consistent with the

approach suggested by Harrigan (1983). [3] The primary unit of analysis was the strategic business unit (SBU) within the organization. For the purposes of this investigation, an SBU was defined as an organizational unit with a defined business strategy and a manager with sales and profit responsibility (Aaker 1988).

A sample list for the survey was obtained from a listing services organization with access to the 'Americas Network' database. Names of 28,000 executives were available for extraction. However, when controlled by industry and managerial rank, just over 5,000 names were revealed. From this total, 1,000 names were randomly selected to represent the sample for this study. Managerial rank included Vice-presidents, System Managers, Directors, and General Managers. The criterion of management level required each of the respondents to be familiar with the business unit's marketing strategies, policies and culture.

Input was sought on a single informant basis from the strategic business units (SBUs) represented by the sample. It is important to note that the sample was not restricted to marketing managers, rather it included both marketing and non-marketing managers. This incorporates the insight of Kohli and Jaworski (1990) that a market orientation involves the efforts of virtually all departments in an organization, and addresses the concern of Narver and Slater (1990) where they suggest that marketing is not the sole responsibility of the marketing department. These insights are reaffirmed if one considers the components of market orientation from an organizational perspective.

To facilitate this analysis, it was important to be able to confidently measure an SBU's market orientation and marketing strategy practices. The measure of market orientation was accomplished through a factor analysis, the results of which are discussed under *findings*. To determine marketing strategy practices, twenty-two standardized strategy elements were derived from Miller (1987), Miller and Friesen (1986) and Bowen, Siehl, and Schneider (1989). Each question used a seven point Likert-type scale that measured the extent to which market orientation and marketing strategy was practiced. Given the sources of our constructs and measures we were extremely confident in the validity of the research instrument.

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[3] Single industry studies are characteristic of a large body of research in the strategy literature because they also provide for some degree of control over environmental peculiarities that confront individual organizations (Snow and Hambrick 1980; Harrigan 1983). These constraints enhance the internal validity of this research, however it may reduce the extent to which the findings can be generalized to other industries and environments. This is countered by the fact that the telecommunications industry is large, and the findings of this study will have wide ranging applicability across one industry.

The final sample was composed of 236 usable responses from 256 returned questionnaires. The sample characteristics displayed good representation demographically, geographically, and in the primary business function of the SBU. Comprehensive representation was gained from both marketing and non-marketing personnel.

To test the relationships, bivariate correlation analysis was undertaken. This procedure computed a correlation coefficient (in this case, Pearson's coefficient) for each normally distributed bivariate association. Each correlation measured how variables were related, and the coefficient provided a measure of linear association. Correlation coefficients range in value from -1 (a perfect negative relationship) to +1 (a perfect positive relationship), where a value of 0 indicates no linear association. In this analysis, two-tailed tests of significance respecting probabilities was chosen since the direction of associations were proposed, but unknown. Therefore, it was possible for the associations to be either positive or negative. Correlation coefficients significant at the .05 and .01 levels were reported.

Respondents (236 in all) were assigned a market orientation score based on their responses to sixty-one operational level behaviours. These scores, representing the overall market orientation of the SBU as determined by the factor scores, were subsequently standardized for further analysis. To facilitate the analysis it was necessary to bifurcate the respondents into mutually exclusive groups. The respondents were separated into groups exhibiting low scores and high scores on the standardized market orientation (overall) score. This was achieved through the QUICKCLUSTER option in SPSS, using the K-Means non-hierarchical clustering method.

Findings

Market Orientation Factor Analysis

A great deal of effort was spent on extracting a factor solution that eventually resulted in seven market-oriented factors derived from sixty-one underlying measurement constructs of operational-level behaviour. The 61 constructs used in this study are believed to be ones that best represented a market orientation and were derived from scales developed and tested by Kohli and Jaworski (1990), Narver and Slater (1990), Kohli, Jarowski, and Kumar, (1993), and Deng and Dart, (1994). Given the large number of underlying constructs, the ability to reduce data through a factor analysis was a key component in facilitating market orientation profiling for this research, and will prove to be a useful measurement tool for organizations wishing to profile their own orientations in the future.

Table 2. Market-Oriented Behaviours - Factor Descriptions

Behavioural Factors	Description
1. Response Design and Implementation (19 items)*	Response Design describes the extent to which organizations design targeted responses or strategies in respect to the information (formally and informally) generated and disseminated, the willingness to empower employees, and alter structure and processes. Response Implementation considers also the ability to respond and the timeliness of implementation.
2. Formal Intelligence Generation (14 items)	Is the extent to which the organization's employees and systems formally generate intelligence on customers, competitors, and industry for use in generating business plans, and identifying products/services modifications and new offerings.
3. Intelligence Dissemination (15 items)	Is the extent to which an organization is inter-functionally co-ordinated and its respective level of dynamism in respect to the sharing of market intelligence. Essentially, it is a measure of the effectiveness of internal communication.
4. Informal Intelligence Generation (5 items)	Is the extent to which the organization's employees informally generate intelligence on customer, competitors and the industry. Intelligence might be gathered through relationships, at conferences, and via the grapevine.
5. Planning and Profit Orientation (3 items)	Is the extent to which organizations engage in formal business planning and policy generation in the pursuit of profits over the longer term (5 years).
6. Customer Orientation (3 items)	Is the extent to which employees interact with customers in efforts to determine needs and enhance service levels.
7. PSI Factor (2 items)	Is the extent to which internal politics and technological advances (outside the control of the strategic business unit) affect business plans of the business unit.

*represents the number of behaviours that loaded on to and subsequently derived the factor. Factor analysis statistics are provided in Table 2.

A number of extraction and rotation methods were considered in efforts to optimize the final factor solution. In the final analysis, the solution using

unweighted least squares factoring as the extraction procedure and varimax rotation as the extraction method was considered to be most interpretable. The final factor solution was extremely encouraging, accounting for nearly 50% of the explained variance and displaying high reliabilities, eigenvalues and inter-item correlations (see Tables 2 and 3).

Table 3. Factor Analysis of Market-Oriented Behaviours

Factor Descriptive Title	Eigen value	% Variance Factor	% Variance Cumul ative	Reliability Coefficient Alpha	Mean Inter-Item Correlation
1. Response Design and Implementation	8.97	14.71	14.71	0.9394	0.4812
2. Formal Intelligence Generation	6.42	10.53	25.24	0.8917	0.373
3. Intelligence Dissemination	6.33	10.38	35.63	0.9062	0.4013
4. Intelligence Generation - Informal	2.88	4.73	40.37	0.6573	0.2926
5. Profit Orientation	2.12	3.48	43.85	0.8369	0.7203
6. Customer Orientation	2.05	3.36	47.21	0.7134	0.3714
7. PSI Factor	1.54	2.53	49.75	0.5529	0.2854

Kaiser-Meyer-Olkin Measure of Sampling Adequacy: .909
Bartlett's Test of Sphericity: Chi-Square: 8185.654
df: 1830
Sig.: .000

Extraction Procedure: unweighted least squares
Rotation Procedure: varimax

Cluster Analysis

Consistent with previous research testing behavioural repertoires (Dobni, Zerbe, and Ritchie 1997) clustering was used to group the sample into mutually exclusive groups - consistent with their relative emphasis on market orientation. In this case, the sample was bifurcated using a nonhierarchical procedure based on nearest centroid sorting (i.e. a case is assigned to a cluster for which the distance between the case and the centre

of the cluster - the centroid - is the smallest). This procedure was repeated specifying two seeds until cluster assignments were stable and subsequent iterations of the procedure failed to produce a decrease in pooled within-cluster variance. This was achieved on the sixth iteration. Multivariate analysis of variance was used to test for differences among final clusters' profiles. Table 4 contains the cluster statistics which indicates that the two clusters were statistically different and distinct. External validation was achieved by comparing the clusters on measures of market orientation described earlier. The clusters were also named in accordance to their relative emphasis on market orientation. Members in the high score market-oriented cluster were appropriately named *"high-spirited"* while the other cluster became known as *"ineffectual."*

Table 4. Market Orientation Clusters

	Membership	**Final Cluster Centers**	**Distance Between Centers**
Cluster 1: High Spirited	125	.27	.572
Cluster 2: Ineffectual	111	-.30	.572

Cluster Anova

	Cluster		**Error**			
	Mean Square	**df**	**Mean Square**	**df**	**F**	**Sig.**
MO-Standardized Scores	17.111	1	4.934E-02	234	346.111	.000

Correlation Analysis

Correlation analysis was performed to delineate the relationships between the market orientation clusters and operational level strategies. In respect to strength of linear association, the correlation coefficient is used as a quantitative descriptor. Although interpretations of strength vary, it is generally agreed that coefficients between +/- .10 and +/- .20 are indicative of weak relationships, while anything below +/- .10 is not generally reportable (Hair, Bush, Ortinau, 2000). Moreover, the strength of relationships are primarily affected by sample size and the validity of the research instrument being used. Given the exploratory nature of this research and the researchers' confidence in the research instrument, we considered coefficients between +/- .21 and +/- .30 to be average, between +/- .31 and +/- .40 moderate, and above +/- .40 to be strong. An a priori

decision was made not to report coefficients below +/-.20.

Table 5. Correlation Coefficients Market Orientation - Market Strategy Relationships

Strategy Elements	Market-oriented Activity: High-Spirited	Market-oriented Activity: Ineffectual
1. market sensing/research (customer, industry, competitor)	.332*	-.230*
3. emphasizing company/brand reputation	.339*	
4. being first in with new products/services and technologies	.309**	-.282*
5. being at the leading edge of industry developments	.259**	
7. providing high levels of customer service		-.459*
8. advertising, promotion and image management	.270*	
9. prestige pricing	.307*	
11. market segmentation	.405**	-.243*
12. product/service customization	.244**	-.240*
13. develop new products/services for existing markets		-.216*
14. research and development	.382*	
15. penetrating new markets with existing products/services	.279*	.419**
16. charging lower prices than competitors		.312**
21. discounting prices		.283*

*correlation is significant at the 0.05 level (2-tailed)
**correlation is significant at the 0.01 level (2-tailed)

High Spirited Cluster and Marketing Strategies

The results of this analysis offer direct support for ten of the twenty-two proposed relationships. As might be expected, SBUs in this cluster had significant positive relationships (p = .01) with the marketing strategies of being first in with new products/services and technologies, being at the leading edge of industry developments, market segmentation, and product/service customisation. This group also had a significant positive relationship at levels of (p = .05) with undertaking research and development, advertising, promotion and image management, emphasizing company brand name/reputation, penetrating new markets with existing products/services, prestige pricing, and market sensing/research.

Organizations with high-spirited market orientations are more likely to

engage in information based strategies that are designed to create customer value. In a sense, they could be considered to be preoccupied with anticipating and meeting the needs of the customer, and intently focused on promoting and managing their image. These cultures also understand the environment in which they operate, and make efforts to connect to the customer through market segmentation, more than likely at the expense of internal efficiency. The return on investment for these efforts come in the form of market share, market retention, loyal customers, and the ability to charge higher prices. By the nature of the definition of what a market orientation is, actions from high-spirited organizations may not be surprising.

Ineffectual Cluster and Marketing Strategies

The group identified as having lower levels of market-oriented behaviour also presented some interesting relationships, many of which were in direct contrast to the high market-oriented groups. In this group, there were nine relationships that were directly supported by the propositional framework. These included a significant positive correlation ($p = .01$) with penetrating new markets with existing products/services, charging lower prices than competitors, and discounting prices ($p = .05$). Significant negative correlations (all at $p = .05$) were reported for market sensing/research, being first in with new products/services and technologies, providing high levels of customer service, market segmentation, product/service customization, and developing new products/services for existing markets. Of the correlations not reported, six of the thirteen coefficients were in the direction proposed while seven were not.

Although this group was positively correlated with strategies that were internally focused such as offering a narrow product line, rigorously pursuing cost reductions, offering prepackaged or standardized products/services, providing no frills service, minimizing marketing expenditures, and pursuing cost reductions, and negatively correlated with externally customer-focused strategies such as product and service customization, prestige pricing, advertising, promotion and image management, and emphasizing company/brand reputation, the relationships were not statistically significant. On some levels, the analysis portrayed a different action portfolio, with the correlations going in the opposite directions as proposed for these activities, although again none of the relationships were statistically significant. For example, this group reported positive relationships with emphasizing company/brand reputation, prestige pricing, and research and development, and were negatively correlated with providing no frills service, minimizing marketing expenditures, and offering a narrow product line, when in fact the opposite was proposed. In one sense, this is encouraging as these organizations may

be more customer and competitor focused, and less strategically inept that initially given credit for. It is possible that for these organizations, transitions to higher levels may not be as difficult as might be imagined.

Discussion of Findings - Market Orientation and Marketing Strategies

This analysis provides initial, strong support for the propositions presented. There are definable relationships between a market orientation and the operational marketing strategies enacted by an SBU. Simply stated, organizations with similar market orientations have a tendency or aptitude to engage in similar strategies when in the same industry, and the types of strategies chosen are related to the operational behaviours manifesting a market orientation. Analysis of other industries (Narver, Park, and Slater 1992 - forest products)[4] also revealed similar patterns.

What is encouraging is the contrast in actions between the extremes, particularly as it concerns market sensing/research, being first in with new products/services and technologies, market segmentation, and product/service customization. For these strategies, significant relationships were reported for both clusters in the direction proposed, and reporting extreme opposites between the clusters, as anticipated. Even in cases where the correlation coefficients were not diametrically opposed at statistically significant levels for both clusters (i.e. one of the relationships was statistically significant while the other was in the direction proposed, but not statistically significant), the differences remain very encouraging. There is evidence of a clear and strong distinction between the activities of the two groups and the differences we observe permit the inference that a market orientation may serve as a moderator of (or a context for) operational strategy.

We already know a number of things for sure. First, it is possible to profile the market orientation of an SBU, or an entire organization for that matter. Second, successful organizations are those that most effectively interact with their environments (McKee, Varadarajan, and Pride 1989), and third, a business that increases its market orientation will improve its market

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[4] Our study differs in the context that it considered both a different industry context and a broader range of operational marketing strategy options than those posited by Narver, Park and Slater. Further, it considers these relationships at varying degrees (bifurcation) of market oriented behaviour. As well, some of the strategy elements used differ in that we specifically concentrate on marketing strategy at the operational level while the other study considered some corporate level strategies directed at management of contextual environmental forces i.e. gain special advantage access to supply, or perform value analysis for the control of costs.

performance (Narver and Slater 1990). These are not new revelations. In fact, recent empirical evidence suggests that a market orientation contributes substantially to the competitive success of a business in both non-commodity and commodity environments, and at different levels of competitive intensity (Narver, Park, and Slater 1992).

The results of this research begs two related questions. First, is it possible to manage strategy through a market orientation? And if so, what is the optimal level of market orientation? We believe that the answer for the first question is yes, and the second question depends on the competitive context, managerial values and available organizational resources.

When it is referred to as a behavioural concept, then market orientation is synonymous with the capabilities approach to strategy as described by Day (1994), thus the degree of market orientation possessed by an organization would be displayed through its capabilities to support and sustain behaviour conducive to the development of this orientation. Capabilities emanate from individual employees and include complex bundles of skills and accumulated knowledge that enable firms to coordinate activities and make use of their assets. On an aggregate level, an organization's core competencies support positions of advantage. The real challenge for management is to identify and develop these behaviours or capabilities, and then subsequently harness them so that they are deployed in a manner that will foster the development of a sustainable competitive advantage. Profiling of market orientation will go a long way to determine which behaviours to emphasize in respect to desired marketing practices and external challenges faced by the organization.

Managing operational level marketing behaviours is critical to the success of organizations, and the linkages provided in these findings will help managers guide and control appropriate enactments. Unquestionably, the ability to profile market orientation opens up a number of possibilities for managers. For example, it allows managers to identify and categorize marketing related behaviours, and reinforce behaviours that manifest desired strategy. Where identifiable gaps exist between desired and actual behaviours, efforts can be made to customize employee training and development programs or realign the compensation and reward system to reinforce desired behaviours and cull those that are not. As well, a market orientation model could be used to reduce strategy ambiguity suffered by many operational level employees. This dysfunction exists when employees are uncertain about what managers or supervisors expect from them and how to satisfy those expectations (Naylor, Pritchard, and Ilgen 1980). Managing strategy through a market orientation will work to further define expected behaviours of employees, effectively and covertly directing strategy initiatives.

Clearly, there are optimal degrees of market orientation. The degree of market orientation pursued by an organization will, as already discussed, be tempered by competitive dynamics, managerial values and goals, and organizational resources. Because of this, it may not be possible for all organizations to attain desired or ideal levels. Accordingly, managers need to think long and hard about the level of market orientation they should pursue, and to understand the factors of a market orientation that can be most impacting for them.

Managers will have to consider a number of factors. First, they will have to consider what, if any, resources will be committed to the pursuit or sustainment of truly market-oriented behaviour. For example, in environments where a market orientation is proposed to have a limited impact (for example in mining, health care provision, dedicated manufacturing, or commodity based industries) is it desirable or even necessary? Or is the fact that it contributes to culture management that facilitates employee commitment and spirit enough to warrant expenditures on resources? Nonetheless, careful consideration in respect to costs versus the benefits have to be given as change efforts are likely to be protracted and successes difficult to measure in the short term.

If the decision is made to pursue enhanced levels of such an orientation, then the process of implementation becomes the focus. The choice of which capabilities/behaviours to nurture and which investment commitments to make must be guided by a shared understanding of the competitive context, the needs of the customers, the current organizational culture, managerial values, the competitive positioning sought, any trends that may be occurring or upcoming, and the organization's ability to support and sustain change. To varying degrees, it is likely that each organization may require its own unique configuration of behaviours and standards. Fine tuning will be inevitable. On this point, managers may need to change how they manage, changing their focus from a strategy-outcome focus to a behaviour-strategy focus. Organizational systems supporting compensation and evaluation may likewise have to be revised.

Transitions to a market orientation (or different degrees of market-oriented behaviour) can only be facilitated by cultural shifts. Just the idea of toying with organizational culture requires one to consider the risks and consequences associated with the dynamics that behaviour modification could potentially present. Certainly, senior management's feel for the current organizational culture, and the ability and desire of operational level employees to change will direct the focus of efforts necessary to ready the organization or business unit. It is the expectation that senior management commitment, communication, trust and employee involvement will dominate the key success factors in transitional efforts. Following this, the

issues become the pace of change and considerations to refreeze the new orientation as the desired culture. This pace will be affected by the elements noted above, as well as the size of the business unit, the current culture, the current organizational structure and reward systems, the perceived urgency for change, and the characteristics (market and competitive) of the context in which the organization operates currently, or will potentially encounter. Again, these all have to be carefully considered by the proponents of the change effort. Proponents have to be prepared to make tough decisions, display leadership, and alter systems that are within their control, for example, organizational structure and reward systems, to facilitate shifts.

It is also significant to note that deliberate engendering of a market orientation is also possible, and in some cases even necessary. There are two considerations here. First, managers can attempt to change their culture to suit the context if indeed there is a perceived gap between actual and desired orientations - this can be achieved through profiling. Alternatively, it may be possible to engage competitive contexts that suit the organization's current orientation. The presumption here is that they (the strategists) are aware of the fit between culture and context, and they have a pulse on their current organizational culture. Consider an organization that possesses a culture that supports proficient segmentation of the marketplace, and customizing products or services for these segments, strategies which are supported by diligent market sensing behaviours. Such organizations, when considering growth alternatives might pursue markets, acquisitions or alliances in competitive contexts where such an orientation has proven to be successful even though it might be unrelated to their principally served market segments. Accordingly, the ability to profile market orientation will reduce some of the risk associated with this type of strategic manoeuvring. Finally being aware of ideal profiles may prevent managers from making unfocussed or unnecessary changes to current organizational cultures. At the very least, it would be prudent for managers to consider development efforts aimed at culture alignment with ideal profiles.

Limitations and Conclusions

Although this research addressed a major limitation of past studies, that being the lack of empirical models for profiling market orientation and operational strategy, it does not consider these factors in a contextual co alignment perspective. Specifically, the result adds to the body of theory in that it links market orientation to operational marketing strategy, but does not draw any conclusions respecting market orientation and performance or operational strategy portfolios and performance, nor whether market orientation or marketing strategy are moderated by the environmental context. In fact, the latter have been established in previous studies and

managers need to internalise the notion that a market orientation results in better performance overall including higher profitability. This research provides a critical link as it contributes a piece to the puzzle by addressing implementation issues not previously considered at this level. We do suggest that this is an excellent base from which to undertake subsequent research on the coalignment between behaviours, actions and performance in diverse environmental contexts across multiple industries.

It is also recommended by the researchers that follow-up studies be conducted on other high technology and science industries (for example, the biotechnology and pharmaceutical industries) with the goal of expanding the examination of the market orientation - market strategy relationship. It would also be beneficial to test these relationships in a coalignment perspective, considering performance implications.

In conclusion, we emphasize that operational marketing strategy is attributable to the level of the market orientation of an organization, and as a result provides a significant implementation-orientation context that managers should consider. This research reinforces the notion that there are specific relationships between market orientation and operational marketing strategies practised by the organization.

For managers, this research has provided some preliminary evidence linking the fit between behaviour and marketing action. As a result, managers must give due consideration to important contextual variables (environment and moderating factors) dealing with matters related to the design, development and ongoing management of market-oriented behaviour. This takes on even greater relevance for managers in competitive contexts where the only thing that is constant is change.

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What is Differentiation and How Does it Work ?

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In this article we provide a basic review of the relationship between differentiation and profitability. In particular we address the misconception that the reward of differentiation must be a price premium. We conclude with the following:

> *Differentiation is when a firm/brand outperforms rival brands in the provision of a feature(s) such that it faces reduced sensitivity for other features (or one feature). Through not having to provide these other features the firm has an avenue to save costs. The firm benefits from the reduced sensitivity in terms of reduced directness of competition allowing it to capture a greater proportion of the value created by exchange.*

We observe that real world differentiation is a pervasive feature of modern markets, but seems to be largely due differences in distribution and awareness, and occasionally design. Brand level differentiation on functional features is less common due to competitive matching.

Introduction

Differentiation is an old concept (Chamberlin 1933; Robinson 1933; Smith 1956) and one that is very basic to modern views of markets and marketing, which perhaps begs the question: is this article necessary? Do strategists not already know the answers to the two questions in the title? Are not the answers common knowledge, plainly established in the marketing, economics, and strategy literatures? We would argue no. Differentiation is a concept, like many in the business literature, which has very fuzzy meaning(s). The term is usually used without reference to any formal definition, and there exist a number of alternative definitions, along with non-complementary operationalisations/measures. Even in industrial economics, a discipline where there is more of a tradition of providing formal statements of theoretical concepts, two eminent industrial economists felt compelled to write an article for the *Journal of Industrial Economics* titled

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"What is Product Differentiation, Really?" (Caves and Williamson 1985).

This article will make reference to that work, and others, as it seeks to explain what differentiation is. This article goes further though, to address a question which is fundamental to the strategy discipline, and of great interest to marketing and marketers: *how, and why, can differentiation allow a firm to earn superior profits ?* Again this would seem like a basic question, the answer to which should be well known. However, again we argue that this is not the case; most business people and academics simply inherently believe that it is better to be in a market where there is considerable differentiation than in a commodity market. This belief exists in spite of the fact that healthy profits have been earned in so called commodity industries such as mining and oil, and that agricultural commodities have been the basis of the wealth of a number of countries. Therefore, even though there is some apparent empirical support for this notion (eg Buzzell and Gale 1987 p.124) it would be wrong to infer that this belief is based simply on empirical observation.

The issue of whether differentiation leads to superior profits is clearly not solely an empirical question. Theory also impacts on empirical research because it affects how we choose to operationalise (measure) these two abstract concepts (*differentiation* and *superior profits*). Even if we observe a positive correlation between our measures of differentiation and profitability we need an explanation why. At present when theoretical explanations are called for they are varied, as the following examples illustrate (developed from an expert panel survey[2]).

- Differentiation makes the product desirable, therefore you will make more sales and more profit;
- Differentiation makes the product unique, therefore price comparisons are difficult and you can get away with charging a higher price;
- Differentiation means the offer is unique and highly valued, therefore demand will exceed supply and you can charge a higher price;
- Differentiation causes brand loyalty therefore marketing costs will be lower because it is cheaper to sell to existing customers.

We also consulted the literature to establish how the concept is usually defined and what the benefits are purported to be. We used a sample of current marketing management textbooks published since 1990. These excerpts are grouped into two themes, (a) relating to the reduction of price

[2] Colleagues (research and teaching staff) independently responded to the question "Why does differentiation potentially allow a firm to earn profits ?". They were requested not to discuss the question with others. The survey was conducted via email.

sensitivity; and (b) distinguishing the brand from competing offers / reducing the directness of competition. Obviously there is some overlap between these themes, but some authors, as we shall see, plainly emphasise one over the other. The results are shown in Table 1.

Table 1. Definitions and Explanations for the Link Between Differentiation and Profitability

Reduce Price Sensitivity / Earn a Price Premium
Baker (1996) cites Smith (1956): "product differentiation is concerned with bending of demand to the will of supply. It is an attempt to change the slope of the demand curve for the market offering of an individual supplier".
Mercer (1992) "[differentiation and focus] rely on using factors other than price to contain competition" (p184). "[differentiation is] the practical 'positioning' of products or services so that they are recognisably different from their competitors'" (p264). "The epitome of this process [product differentiation] is 'branding'". [proceeds to cite Watkins 1986]: "The firms' strategy is to make its products different from its competitors in such a way that customers can be convinced they are superior" "in general the more that products or services are differentiated the less direct the competition will be" (p173)
Boyd, Walker and Larreche (1995) "Over time competitors become more alike. The index of product differentiation [from PIMS studies] drops substantially from the growth to the decline stage. It is understandable why price differences between competing products also decline" (p 102).
Powers (1991) "The major thrust of a differentiation strategy is on the customers' perceived difference between the firms offering and that of the competition… Oftentimes, the differentiation strategy allows the firm to receive a higher price….. Differentiation strategies are usually the result of the seller's wishing to establish a firm market position or to insulate itself from price competition" (p119)
Dickson (1997) "Product differentiation is the act of distinguishing a product from its competitors on one or more basic performance or image features" (p 333) [under the heading "Product Differentiation"]: "the more distinct the image positioning and performance of a product or service on dimensions desired by the segment, the lower the price sensitivity of the segment will be" (p179) **Cont'd/…**

Reduce Price Sensitivity / Earn a Price Premium
Keegan (1995) "competitive advantage may be achieved when a firm puruses a strategy of low costs… may also be gained by a strategy of differentiating products so that customers perceive unique benefits that justify a premium price" (p. 375)
Bradley (1991) "there are only two types of competitive advantage that a firm may possess: low cost or differentiation. A firm following a pure low-cost strategy will.. attract custom by offering lower prices. The firm which seeks to be unique …follows a strategy of differentiation and obtains a premium price… The firm that achieves .. such a difference will be an above average performer .. if its price premium exceeds the extra costs in being unique" (p. 103/104)
Distinguishing the Brand from Competition / Reducing the Directness of Competition
Kotler et al (1996) "Differentiation is the act of designing a set of meaningful differences to distinguish the compay's offer from competitors' offers" (p 365)
Guiltinan and Paul (1991) "differentiated positioning – this is a strategic option in which head to head competition is avoided by offering unique benefits. Rather than offer the same features, price, convenience or other attributes a manager employing this marketing strategy offers one or more *different* benefits. (p176) This is different to what is termed a "head to head strategy" where "a firm offers basically the same benefits as the competition but tries to outdo the competition"(p175). "A firm can attempt to acquire customers in three ways – head to head strategy, differentiated positioning, or niching"(p175)
Saunders, in Gower (1995) "The differentiator wins by offering a product or service which is unique or superior to competitors'"(p85)
Zikmund and d'Amico (1993) "A promotional campaign aimed at developing product differentiation focuses on some dimension of the product that competing brands or competing products do not offer or accents some way in which using the product provides some solution to a consumer problem" (p586)
Trout (2000) "since differentiation takes place in the mind, specialists .. can focus on one product, one benefit and one message. Eveready … didn't specialise. Duracell grabbed a brilliant name, pre-empted the "long lasting' attribute, and ran off with their business" (p. 131).

One can see from Table 1 that common themes in current literature are that

differentiation can (a) reduce the directness of competition and (b) reduce price sensitivity. However we can also see that it is used in quite different ways, including being synonymous with *superiority*, as part of *marketing communication*, and as *offering something the competition does not offer*. We believe some of these are useful contributions, but there is scope for further understanding the concept and its association with profitability. Therefore our purpose of this article is to:

- to provide a formal definition of *differentiation*
- to explain how *differentiation* can possibly lead a firm to earn superior profits

In doing so we address some common incorrect beliefs that are introduced above. Namely,

- That the benefit of differentiation is a price premium.
- That differentiation must increase a firm's costs.

We also challenge the view that differentiation is an *optional* strategy, that is nevertheless chosen by most firms. Instead we observe that differentiation is a pervasive feature of modern markets and this is in spite of the main thrust of competitive activity being to match competitors' features rather than to be different.

A Basic Explanation of Differentiation

We begin with a basic definition of differentiation, necessary in order to begin discussion:

> Differentiation[3] exists when a firm's offering is preferred, on some buying occasions (or by some customers all of the time), over rival firms' offerings[4].

This preference presumes that there is some difference between brands and

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[3] This statement avoids the use of the older *product differentiation* term because the addition of the word product is unnecessary and has undesirable connotations. For instance, does product differentiation apply to services ? What if customers view the product as identical but have a preference for one firm's brand because of its after sales service ? Can product differentiation be achieved via distribution/availability ? Can loyalty schemes (eg Frequent Flyer programs) create product differentiation? Can price promotions create product differentiation? Using the formal definition provided above the answer to all these questions would be yes; the inclusion of the word "product" would make the answers less clear.

[4] We use "preference" to mean behavioural preference, i.e. choice in competitive markets, rather than attitudinal preference.

that buyers react to these differences. Without this preference brands would be perfectly substitutable. There would be no need for more than one brand in a product category, and this is what the market would immediately lapse to should any one brand gain the slightest price or quality/feature advantage over the others.

Importantly our definition does not stipulate product feature differences – as we discuss later, product heterogeneity may lead to differentiation and it may not. Differentiation can also occur without product feature differences between brands. The mainstream marketing reality is that brand choice is a trivial concern because, for consumers, the feature differences between competitive brands are not great. Whether it is Ford or Chrysler, Kodak or Fuji, either will usually do. Purchase preference certainly exists but it is often a function of *salience* (each buyer knows some brands better than others), *habit* ("this is the one we usually buy") and/or *availability* ("this one has my size"), rather than product differences between the brands.

The issues of how or why this difference in preference comes about, and why it should be associated with the potential to earn economic profits are explored in this article.

Conventional Thought on Differentiation and Profits

Several disciplines have had a long standing interest in profit differentials. The Strategy discipline is concerned with why some firms are able to earn greater profits than rivals on a sustained basis. Industrial economics is essentially concerned with why some industries are able to earn higher average profits than others on a sustained basis (and the associated welfare implications).

Both of these disciplines have seen differentiation as a potential cause of these profit differentials, and marketers as a potential cause of the differentiation. The argument that marketing activities increase firm profitability has been welcomed by business people; less welcome has been the industrial economists' attribution/accusation that marketing causes sub-optimal (social) efficiency differentials between industries, in other words that it reduces society's welfare.

Strategy, industrial economics, and marketing appear to be in agreement as to why differentiation might lead to greater profits. Stated simply the rationale is that differentiation can allow a firm to command higher prices. We have seen this as a common theme in marketing management, but it is also common in other disciplines: strategic management - Thompson and Strickland (1995 p. 126); industrial economics - Scherer (1990 p. 360) and mainstream economics - Jackson and McConnell (1988). Now while most managers and students accept this statement as valid at face value, it is clearly an incomplete explanation, or at least one full of unstated

assumptions. As any accountant knows, price does not equal revenue (price x volume = revenue) and revenue does not equal profit (revenue less costs = profit). Therefore the degree to which differentiation results in higher prices must be linked to the alteration in revenue it provides, relative to the costs incurred or decreased as a result. Viewing higher price as the prime reward for differentiation will lead to myopic strategic decision making. This is because - as we will see - differentiation can help the firm to de-sensitise customers to *various* features (not only price) that might otherwise be costly or difficult to deliver.

According to industrial economics the ability to command higher prices depends on either collusive practice and/or the erection of barriers to new entrants, with differentiation cast as a potentially formidable barrier (e.g., Bain 1965). Industrial economics research seeking to explain persistent industry profit differences has endeavoured to show a link between high differentiation in an industry and high barriers to entry with corresponding high average levels of profitability (e.g., Comanor and Wilson 1967; Bain 1971). Such research is questionable because differentiation has usually been operationalised by industrial economists as the *advertising to sales ratio* (Koch 1980). While advertising might increase differentiation, it also often seeks to reduce perceived differences between competing brands. For example, Microsoft's advertising to reduce the perception that the MacOS is more user friendly that Windows. Also, such research ignores the very substantial differentiation efforts undertaken by sales representatives in many low advertising industries. Such an operationalisation of industry differentiation level appears to be measuring (or at least confounding) the effect of a scale barrier of entry rather than the extent or effect of differentiation itself.

More precise conceptualisations (of differentiation) should result in better operationalisations. We now discuss the economic definition of product differentiation and show why the achievement of a price premium is the most widely accepted (though inadequate) explanation for differentiation leading to superior profits.

What is "Product Differentiation"?

Product differentiation has been described as a well defined theoretical concept in economics that rests on two conditions (Caves and Williamson 1985). Firstly, that buyers consider that brands within a product-market are close substitutes, but poor substitutes for brands in other product-markets. Secondly, that the brands within the product-market are sufficiently imperfect substitutes that firms face downwardly sloping demand curves for

their brand[5].

The theoretical conditions which would produce differentiation were first discussed by Chamberlin (1933). Caves and Williamson (1985) discuss the two current economic models that describe the structural situations necessary to bring about product differentiation. In an empirical study they found support for both models causing product differentiation (brands facing *downward sloping demand curves*). The first set of conditions can be termed the bundle of benefits model, developed from work by Rosen (1974) and Lancaster (1979; 1984). Differentiation is said to be brought about by brand heterogeneity with brands being made of distinctive bundles of attributes. Also necessary is market heterogeneity where customers vary in their tastes, that is, they vary in the benefit they derive for these different attribute bundles. Relative prices determine the bundle of attributes (brand) a buyer chooses among those offered. Although each buyer may make discrete switches between brands as relative prices change, buyers generally differ in their reservation prices for a given configuration. Therefore, downward sloping demand curves are likely to result when the preferences of individual buyers are aggregated.

The other theoretical model which would result in product differentiation (downward sloping demand curves) is based on variations in information and transaction costs, developed from work by Stigler (1961) and Nelson (1970; 1974; 1975; 1981) among others. The result again is differences in consumer behaviour and different perceptions of brands, even if consumers held identical underlying preferences/tastes. Although less well developed than the attribute models a considerable amount of attention is now being devoted to information economics, which is illuminating the manner in which competition operates (see Akerlof 1970; Shapiro 1982; Fombrun and Shanley 1990; Wernerfelt 1990). In particular, the apparent ability of brand awareness and brand salience to affect brand choice without necessarily influencing brand attribute perceptions is gaining attention in marketing and consumer behaviour literature[6] (see Hoyer and Brown 1990; Nedungadi 1990; Macdonald and Sharp 2000).

Both of these models require variation in the market demand structure in order to support the variation in products (ie, different features) – if everyone's tastes are the same then differences in product features won't be

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[5] Downward sloping demand curves simply being consequence of a brand's customers having preference for a brand but not "100% loyalty", each has a different "reservation price" a measure of the degree of enticement required to shift their preference to another brand.

[6] This is one reason why we use the term preference in a behavioural sense, see footnote 1. A consumer may "prefer" brand x over another simply because they are aware of brand x and not the other offering.

supported by the market. An unusual proposition is to use the term product differentiation to describe an *alternative* strategy to that of offering differentiated products to particular segments (Smith 1956; Wind 1978). Dickson and Ginter (1987) provide an analysis of this proposition which concludes that such a use of the term really refers to firms' attempting "demand function modification", that is, the changing of consumer tastes such that they move closer towards favouring the distinctive attribute bundle of a particular product. The effect of "demand function modification" can be to either increase or decrease the amount of demand variation/heterogeneity within the market.

Differentiation and Price: The Legacy of the Neo–Classical Economic Perspective

Most views on product differentiation are based upon neo-classical economic theory. It is thus normal to construct all analyses with price and product clearly segregated. The conceptualisation of product differentiation subsumes firms "facing a downwards sloping demand curve". The suggested objective of product differentiation is to reduce the substitutability by competing offerings and so steepen the slope of the demand curve. By doing so, the firm is said to be able to enjoy higher prices with a less than corresponding reduction in volume, hence it is potentially able to earn superior profits. Its customers are less sensitive to price rises or to competitors' price drops.

The separation of "product" attributes from the attribute of price encourages the view that offering low prices is a fundamentally different form of differentiation to that of differentiating on "other features". In this vein, the former industrial economist, Michael Porter's (1980) definition that a firm (or more correctly, brand) is differentiated "when it provides something unique that is valuable to buyers beyond simply offering a low price" is quoted frequently, reinforcing the view that price can not be used to differentiate. Yet paradoxically other moves to reduce the costs of purchase for a customer (eg home delivery for takeaway pizza) are classed as differentiation attempts. There does not appear to be a valid justification to distinguish price from other features of an offering. It follows then that differentiation is not an *optional* strategy for superior profits as is popularly thought (e.g. Porter 1980; Dess and Davis 1984; Porter 1985; Narver and Slater 1990).

This discussion raises the question, why have economists (and others) always equated price as a dependent variable in their discussions of the nature of differentiation, when it appears sensible to include it as a component ? The reason can be traced back to the objectives of economics itself. Economics has always been concerned with the efficient allocation of

scarce resources. The question of how resources should be allocated was answered by whether resource use attracted an inflow of money - the mode of exchange - from the marketplace sufficient to cover costs and earn at least normal profits. If an entrepreneur allocated resources to a particular sector of the economy, the efficacy of that decision would be reflected in whether consumers would "vote" with their spending dollars, that is, sacrifice monetary value for value in goods or services.

This, together with the fact that price is easily measurable and highly divisible, led to the implicit assumption that price, or the financial aspect of purchase cost, was the sole measure of value "exchanged" between buyers and sellers: a sum of money for an equivalent value of goods. It was a logical step, then, to construct measures of resource allocation (supply and demand curves) based on price and quantity.

It is true that purchase price (money paid) is a highly visible "cost" or impost to the buyer; and is also easily understandable as value in exchange to the seller. In other words, the buyer *parts with* something and the seller *receives* something. *Ceterus paribus* a reduction in purchase price means less value in exchange for the seller and more value in exchange for the buyer.

In contrast, some other variables which influence demand, such as advertising for example, could certainly be seen as a cost to the seller to undertake, but unlike price not something that the buyer parted with, or which if reduced, would not increase any benefits to the buyer (other than if the firm chose to channel the money it saved on advertising to lower prices, an approach seen by many economists as highly desirable). Therefore a variable such as advertising was not seen as comprising value in exchange, particularly for the buyer, indeed the presence of such variables was seen as an "imperfection". This meant that the other components of an offer which influenced demand (such as advertising, or style) did not fit with the neoclassical economist's notion of efficient resource allocation and so were not included in the supply/demand equation.

However, there are components (other than price) to any offering which are both "costs" to the buyer and constitute value either preserved or given away by the seller. To continue the example, advertising, or more correctly its effect, can be seen as a component of value in a purchase that both the buyer and seller "part with" or "give up" in exchange. A buyer may choose to forego the value(s) provided by a luxurious brand image, for example hedonistic pleasure, reassurance, or self projection/signalling, in favour of other features such as quicker service or shorter travel time provided elsewhere[7]. The seller parts with advertising funds and other expenses to

[7] This is not to say that these are mutually exclusive or that a firm cannot offer both. They may merely be aspects of competing offerings which competitors choose to emphasise.

create a luxurious brand image in an effort to attract custom. The more this costs the seller to undertake, the less value the seller is able to preserve in exchange. Alternatively the buyer might forego the value of quick service, a cost among other costs, to obtain a luxurious brand image.

In other words, from a customer's perspective, price is only one aspect of the cost of purchase and/or consumption, and many other features of the offering contribute to the cost of gaining the benefits which are desired. These costs include delivery, ease of use, and after sales service.

From the firm's perspective price is often thought to be different from "other features" because of its relationship to profitability via the profit margin, but expenditure or savings on "other features" has the same relationship. A firm may gain extra custom from offering quicker service, for example, but this can have the same effect on company profit margins as lowering price.

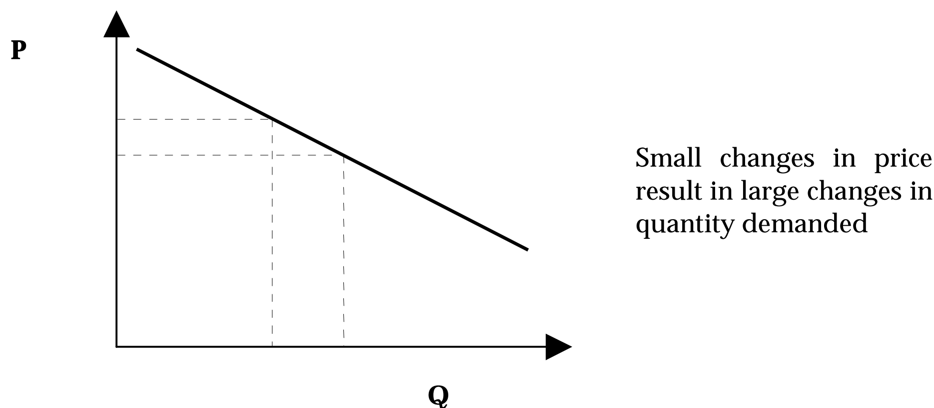
Similarly, distinguishing between firms that differentiate on price and firms that differentiate on "other features", as Porter (1980; 1985) did, appears problematic. The obvious consequence is a demarcation between up-market and down-market offerings. This implies, according to Porter's framework, that the middle ground is associated with a low profitability "stuck-in-the-middle" strategy. Porter stated this was likely to occur if the firm had neither a clear differentiation advantage leading to premium prices, or did not have a clear cost advantage, often synonymous with very low prices. However, this does not appear to fit the empirical world where many "down-market" firms are poor profit performers as are many "up-market" firms, and the middle ground can be occupied by firms earning superior profits. The other implication of this widely adopted framework is that differentiation must increase costs (since differentiation is the alternative to low costs); a viewpoint echoed by many marketing authors (e.g. Bradley 1991 ch. 4; Mason and Ezell 1993 ch. 3; Saunders 1995) and also strategic management scholars (eg. Pearce and Robinson 1991 ch. 7 ; Wheelan and Hunger 1998 ch. 5). Yet evidence shows that many firms achieve low costs yet also have differentiation strategies (Miller and Freisen 1986).

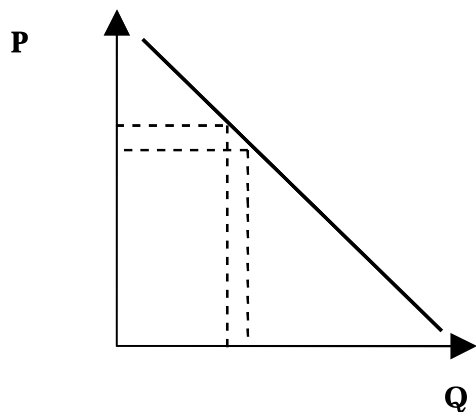
As we have stated differentiation has been very much associated with obtaining a price premium. This is intuitively attractive in helping to explain increased profitability but it is overly simplistic. Just as price premiums have been rejected as ways of measuring brand equity (Blackett 1991), price premiums are an inadequate way of measuring differential advantage. Many offerings do not have generic equivalents from which the premium can be calculated. Does a Mars bar sell at a price premium? A premium over what? Decisions to sell at a low or a high price depend upon the firms desire for sales volume and other strategic considerations and so will often not serve as an identifier of profitability. Obviously the relationship between

price and profit depends on cost. Very often firms opt for lower prices which will in turn lower their selling costs (e.g., advertising and costs of gaining distribution), and so in this situation, low price can certainly not be tied to low profitability or vice versa. Can any offering which sells at more than the average within the category be said to have a differential advantage? What if it is over-priced and sales are poor? Do brands priced "below product category average" have no differential advantage (e.g., Bi-Lo – a low-priced Australian supermarket brand, Wal-Mart, Daihatsu)? In the 1990s, in many industries, there has been a trend towards realistic pricing of leading brands (e.g., Proctor and Gamble's "everyday low pricing" policy). These brands/firms can certainly still be said to possess a differential advantage because they have a collection of features which is attractive to buyers and which earns superior profits for their owners.

Almost any unique bundle of features will have some customers who are willing to pay a high price for it. The actual price a firm charges depends on which customers, and how many, it desires (together with cost constraints). Sometimes it is more profitable to give discounts to gain business, other times it is more profitable to change some other feature of the offering. The simple point is that the more similar a firm's offering to that of a competitor the greater the need to change *something*. There are many routes to differentiation and changing the monetary cost of acquisition (price) is just one of them. The strategy discipline needs to move to a less restrictive definition of differentiation - one that sees it simply as the development of loyalty, or more correctly, customer preference for one offering over another.

As discussed, the traditional idea of differentiation being able to deliver a price premium is derived from demand curve analysis. Differentiation results in some customers having a preference for the offering (assuming the differentiation matches some demand heterogeneity which exists in the market) and they are therefore less sensitive to price drops of competing offers. The firm (or rather the brand) therefore faces a steeper demand curve:





The steeper the demand curve the smaller the change in quantity demanded after any price change i.e. demand for the brand is less price sensitive

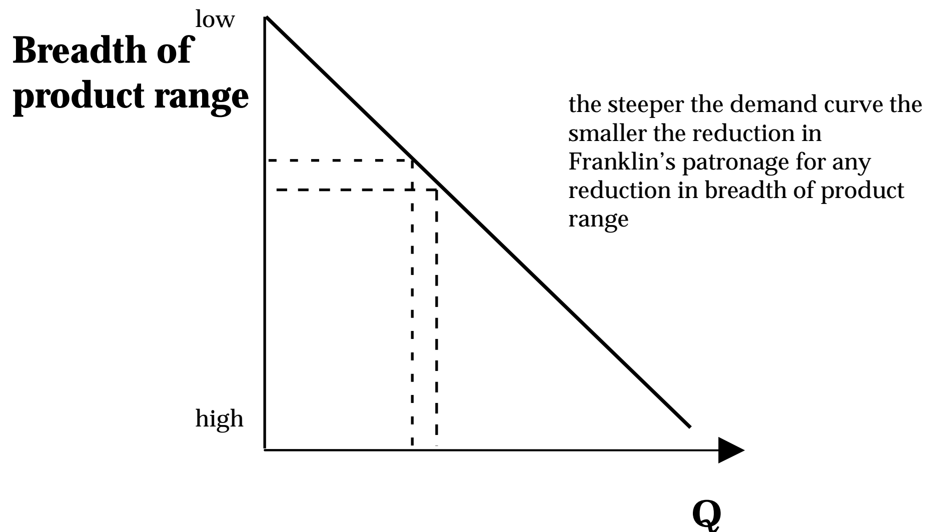
This analysis is mathematically elegant, but it simplifies the true effects of differentiation and has had the effect of misleading decades of practitioners and academics. The implication that a price premium is the reward of differentiation is a gross simplification. Customers, if they value the firm's offer will be less sensitive to aspects of competing offers, and price may, and may not, be one of these aspects. This can be illustrated easily with the example of Franklins, for many years, a star performer amongst Australian supermarket chains. Franklins was differentiated, appealing to a particular market demand, one which highly values low financial costs of purchase (i.e., the price sensitive segment) but is less concerned about other features, and it is this latter aspect which allows for the possibility of successful (profitable) differentiation. Franklins enjoyed sales from this segment because the customers in this segment have a lower sensitivity to other features of the typical supermarket: availability of parking, range of products, width of supermarket aisles (ease of shopping). Franklins only stocked dry goods (i.e. no fresh food), which are served straight out of their packing boxes, the range is limited, and the stores themselves were typically small and cramped. The point of this example is that Franklins did not enjoy reduced price sensitivity because of its differentiation[8]. Its customers are still highly price sensitive, and on a simple price-demand curve it would not show a highly sloping demand curve. Franklins benefited not from reduced sensitivity to price, but reduced sensitivity to other features of the offering. Its sales were translated into healthy profits because it operates within a market segment sensitive to factors which Franklins was in a good position to satisfy; this segment also being insensitive to other factors which Franklins

[8] A peer reviewer claimed that Franklins " **did not** offer differentiation" because it does not "offer something unique that is valuable ...beyond simply offering low price". This illustrates the ingrained association between differentiation and price premiums that this article endeavours to refute.

chose not to satisfy (thus saving costs) and was not in a good position to satisfy.

Profit from Reduced Sensitivity

This view of differentiation can be illustrated with modified demand curves, which substitutes price for other features of the offering, eg breadth of product range (Franklins had a smaller product (and brand) range than most of its competitors).



The implications of this example are not limited to firms that target price sensitive consumers. A firm will benefit from reduced sensitivity to any feature that incurs costs to deliver. It is therefore strategically sensible to differentiate on an aspect of the offer which some customers value (that the firm has some advantage in delivering) and that results in decreased sensitivity to something that is relatively costly for the firm to deliver (or expressed another way, relatively cheap for competitors to deliver).[9]

To re-cap, profits flow from being able to mitigate the effects of competition, being different is a **pre-requisite** for this, and the closer other firm's marketing efforts are to one's own the more intense is the competition one faces and the potential for earning "monopoly" profits are reduced. To

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[9] It thus makes little sense to say that one firm has a cost advantage over another without specifying in relation to what. Certainly it costs more to deliver a Porsche to the market than it does a Volkswagen but Porsche may still have a cost advantage over Volkswagen in producing and marketing Porsches (but not necessarily any other type of car).

understand competitive advantage and why some firms earn more profits than others a framework is needed for understanding the ways in which firms make themselves (their brands) different from each other and how this impacts on the volume they sell, the price they are able to obtain, and the costs of providing this difference. Sometimes being very different is a route to profits, it certainly mitigates the effects of competition, but it can also limit market share. Differentiation is a necessary but not sufficient condition for above average profitability.

Differentiation has a positive effect on profits when the difference that is valued by the market is cheap/easy for the firm to deliver. Downward sloping demand curves (whether they are constructed with price or any other feature on the Y axis) do not guarantee superior profits. Reduced sensitivity to a feature provides the firm with little benefit if that feature is not costly to deliver. Similarly, excelling in the delivery of a feature (the differentiation basis) is of little advantage if the firm is not better equipped than competitors to provide that feature. In other words a firm's resource differentials matter just as much as the differentials in firm offerings. Market demand structure also matters. Profits are derived not only from the degree of reduced sensitivity to features provided better by competitors but from the number of customers which have this reduced sensitivity. Reducing customer sensitivity to price is only one of *numerous* ways in which firms can gain in profits - depending on the match between their asset base and the attributes they choose to differentiate on.

Differentiation in the Real World

Given that there are multiple avenues for differentiation, and the many features that a firm can decide to over or under perform in providing, one might expect markets to be full of wildly differentiated brands. But we observe two factors that change this picture.

Firstly, differences in customer awareness, brand familiarity, knowledge of product features, situational factors and distribution all combine with habits (e.g., brand loyalty) and variety seeking to produce brand preferences. So differentiation becomes a fundamental aspect of most markets, even if firms do not try to differentiate their brands. This differentiation is often buying situation specific rather than being a permanent feature of the brand, eg, sometimes the store is closest to the customer, sometimes it is not (dependent on where the customer is at the time).

Secondly, there are few substantial feature differences between brands. This is because firms work very hard to match their competitors. If any brand brings out a product variant that is different (eg, airbags, a caffeine-free version, a new colour) competitors quickly add this to their brand's

portfolio of variants (Ehrenberg, Barnard, and Scriven 1997).

Therefore we have the situation akin to differentiation being "everywhere and nowhere". Substantial and meaningful product feature differences between brands is not as common as one might expect. Brands typically enjoy some differentiation, usually from things other than product feature differences, but this differentiation is more a market feature than a brand specific feature. Firms may strive for extra differentiation for their brand but the second point noted above (imitation) makes this difficult. In addition many firms are wary about being too different: no firm wants to "cut itself off" from part of the market. Being "cut off" can be a consequence of offering something that appeals to a segment (and hence not others).

This view of differentiation is supported by recent research on segmentation and price elasticities. Competitive brand user profiles do not appear to differ, that is to say, brands sell to much the same types of buyers (Kennedy and Ehrenberg 2000). If brands were substantially differentiated then we might expect some differences in the types of buyers they appealed to. Likewise price elasticities seem remarkably consistent between brands with a predictable difference between large and small brands (Scriven and Ehrenberg 1999).

If some brands in a category were more or less differentiated than other brands we should see some partitioning in the market, where some brands competed less, or more, closely. The widespread fit of the Dirichlet model of repeat-purchase, which assumes no partitioning, is solid empirical evidence than partitioning is rare and slight. This is supported by the widespread fit of the 'Duplication of Purchase law' (Ehrenberg 2000).

Therefore, we have a picture where brands are differentiated, but the degree of differentiation is fairly standard within the product category. Each brand competes with the same 'closeness' to any other brand.

This is not to say that there are not reasonably common examples of *across buying situation* differentiation, that is, brands that are preferred for the same reason by buyers in different buying situations. Our Franklins example earlier is such an example and in most categories there are competitive brands at slightly different price/quality points. Other than this, major functional differences between brands are unusual because most functional differences can be copied. Even patented technological advantages seem to be matched extraordinarily quickly. An interesting observation we make (one that deserves some empirical investigation) is that many of the cases of relatively enduring *across buying situation* differentiation seem to involve differences in design. For example, Apple's iMac, Alessi kitchenware, Volkswagon's VeeDub, and Herman Miller's Aeron chair. Perhaps this is because design is a subjective thing and competitors are unwilling to copy something that is not universally liked. Alternatively, perhaps it is because

quality design is extraordinarily difficult to match – good creativity is genuinely original.

Conclusion

In this article we explained why differentiation is a necessary, but not sufficient condition to earning superior profits. In doing so we have clarified some misconceptions concerning the mechanism through which this profit is achieved, i.e., it need not be via a price premium. We have presented a view of differentiation that is about making the offer different in response to differences in demand (demand heterogeneity). This may be achieved through altering any aspect of the offering (not just produce features), including the financial cost of acquisition (i.e., price charged).

Along the way we have refuted a number of widely held, or at least widely published beliefs:

- differentiation is synonymous with product feature differences (page 744)
- the reward of successful differentiation is simply a price premium (pages 743 and 745)
- differentiation is primarily a function of advertising to sales ratios (page 745)
- differentiation always results in higher costs (page 749)
- differentiation is optional, rather than being a pre-requisite, for earning economic profits (page 747)

The purpose of this article is to move strategy thinking beyond its simplistic view of the nature of differentiation. The explanation of differentiation and how it works can be summarised as:

> Differentiation is when a firm/brand outperforms rival brands in the provision of a feature(s) such that it faces reduced sensitivity for other features (or one feature), through not having to provide these other features the firm has an avenue to save costs. The firm benefits from the reduced sensitivity in terms of reduced directness of competition allowing it to capture a greater degree of exchange value.

Thus differentiation provides a firm with something of a “mini” or weak monopoly. However, as a final note, we reject (in line with Hunt and Morgan (1995)) the pejorative connotations of the term “monopoly”. Differentiation is not a sign of sub-optimal markets, nor of socially undesirable firm strategy, but is a natural reaction to heterogeneous market

demands and heterogeneous firm resources. A lack of differentiation could mean less customer utility and sub-optimal utilisation of firm (society's) resources. But this seldom if ever happens, instead differentiation is a pervasive and almost unavoidable aspect of real competitive markets.

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International Marketing Environment Analysis

Academic international marketing researchers have drawn attention to the lack of research into, amongst other things, the international marketing environment. This can seriously limit the practicality of international marketing plans. The usual domestic environmental audit is not sufficient for the more complex international environment. This paper proposes a more complex framework of twelve variables and three elements and presents this new IMEA (international marketing environment analysis) framework as a blueprint for international marketing auditing and scanning.

Of the twelve variables, seven are new: that is they are presented as important enough to be considered in their own right rather than as subsections of the existing domestic audit. Three of these variables are investigated further to elaborate on elements that need to be reviewed to provide a rigorous and comprehensive IMEA for successful international marketing in a turbulent environment.

Keywords: international marketing management, environmental analysis, auditing and scanning, teaching, practitioners

Introduction

Leaders in the field of international marketing have indicated over the past five years that the discipline had failed to be taken seriously by the practitioner community (Czinkota and Rokainen 2003); that its core topics are being sidelined by more pervasive developments in the marketing mainstream (Kotabe 2001, Katsikeas 2003) and that it had lost its working dynamic (Walters 2001). As a result of such self-criticism a number of agendas were put forward (Czinkota and Rokainen 2001, Kotabe 2001, Walters 2001) recommending that International Marketers pay particular attention to:

- relevance of research to businesses undertaking international marketing (Czinkota and Rokainen 2001),
- Attention to the international marketing environment and other macro- issues (Young 2001; Kotabe 2001)

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- Development of more inclusive models, not just those confined to the Northern and Western economic and trade paradigm (Walters 2001; Rugman 2001; Hyman and Yang 2001)
- Development of valid, reliable and generalisable research instruments to feed into a comparative database of marketing variables such as consumer behaviour and media response .

To some extent these problems are intertwined and an agenda for the resolution of one will alleviate the problems in another area. This paper focuses on the lack of attention to the international marketing environment and the relevance of such research to businesses undertaking international marketing. It introduces and develops a more comprehensive framework for international environmental auditing and scanning. Furthermore, it provides an overview of several factors not usually included in an international environmental audit and/or scanning exercise.

Literature Review

Schelegelmilch (2003) identified two dimensions of the international marketing domain, based on a review of one and a half thousand papers taken from five journals over the ten-year period 1993-2003. The dimensions identified are management/marketing and business environment. Given that these dimensions help to distinguish between types of research, it is clear that business environmental research is an important area of study; more usually addressed by business and management rather than marketing journals. This shortfall in environmental research output makes for a lack of relevance in the spectrum of research, obviously needed by those carrying out international marketing. Other issues related to environmental analysis that need to be investigated further include the impact of the changing environment on individual companies of different sizes and from different sectors (Young 2001). Furthermore, Forlani et al. (2003) refer to market definition as being a dynamic concept, that changes over time. Market definition parallels the activity of environmental scanning and supports the notion that historical analysis is important to an understanding of development, trade and international relations.

Of equal importance is a contemporary framework to understand how changes in the economic, political, social, technological, legal and environmental context of doing international marketing impacts on the results and success of a company's or sector's international marketing strategies and programmes. (Walters 2003) For example, marketing to Iraq in the wake of the recent war would most certainly have meant that contingency planning became paramount in marketing departments operating in this market. Forecasts become redundant, distribution channels may have been completely destroyed; networks are broken up and the market has been seriously undermined. Some companies will have ceased operations altogether for the duration.

Under these circumstances, the contextual elements of the international marketing environment can have massive and disruptive effects on marketing strategies and operations. Nonetheless, there is a continuous stream of modelling that insists on taking these circumstances for granted i.e. ceteris paribus. Theories need to incorporate the effects caused by the actions, not only of the uncontrollable environment e.g. weather, climate but also the governmental and non-governmental organisation (NGO) decisions that can seriously effect marketing operations.

The International Environment in Context

The reason why marketing plans need an environmental analysis is because marketing is an open system (Morello 1993) and therefore elements of that system are unpredictable when interacting with the business environment. A system becomes closed when the circle between production and consumption is complete. Within a democratic capitalist framework, closing the system is difficult. Nevertheless, environmental analysis assists in the system becoming less 'open'. From a business point of view 'less open' means more success in delivering goods and services to consumers and therefore more profit. Not for profit organisations benefit by achieving stated values or targets.

From an international marketing perspective the 'marketing' system becomes even more complex. The environmental analysis within a domestic environment reads cues from outside the organisation that will affect its business performance. The environmental analysis tells the marketer whether there is volatility or stability in the system and, therefore, whether marketing plans will need changing within the time frame rather than updating at the end of the time period. In conjunction with a market and internal analysis this provides indications of the marketing direction for the business.

The international marketing plan needs more than this. The environmental audit may be mistaken for environmental scanning. Essentially the former looks to support the development of an international marketing plan, while the latter is used to develop segmenting and targeting opportunities within the plan. Nevertheless both types of desk research feed into the marketing information system and what is collected for one can be used for the other.

Identifying the factors that are important both in environmental analysis and environmental scanning are the objectives of this paper because they both provide a common information source that can be used to form sound, current and rigorous judgements about foreign markets. The term 'foreign' is used to define all markets outside the domestic market. There are many other similar terms, such as 'overseas', 'abroad' etc. but these are not appropriate when the emphasis needs to be placed on the *universal* attributes of 'foreignness', whether marketing from Germany or Cambodia; Argentina or Iceland.

A New International Marketing Environmental Analysis (IMEA) Framework

International marketing practitioners and teachers have relied on general frameworks for strategic marketing management and planning to audit the international marketing environment. As with domestic strategic marketing planning, the usual method employed to systematically evaluate the risk and opportunity potential for varying market entry or market player strategies is to conduct an external audit in the form of a PESTLE analysis, where PESTLE stands for Political, Economic, Social, Technological, Legal and Environmental factors. The emphasis, however, for systematic screening of foreign markets lies more in areas which may be overlooked if solely concentrating on these labels.

For example, why are some countries easier to export to than others? An *historical* perspective is relevant to analyse the 'sentiment' towards a country. While economic factors are considered in the domestic context, this area of study is too wide ranging and sub sectors of economics, like *finance* and *demographics* need to be remembered specifically. In a similar vain, *language* and *culture* are separate but important aspects of foreign societies and for analytical purposes should be analysed individually.

On the global stage, international politics is a far more complex subject than domestic politics and law. Within the business and exporting domain, international trade *rules*, in particular, should be examined comprehensively when profiling foreign markets and the international environment, Finally, one major differentiator of market accessibility is *infrastructure,* and knowledge about both physical and technological infrastructure will reduce time wasted on un-executable plans that have not taken these two factors seriously into account.

If a mnemonic is required for International Marketing Environmental Analysis (IMEA) then HELPS FREDICT is a more complete framework.

H History **F Financial**
E Economic **R Rules –International Trade**
L Language E Environmental
P Politics **D Demographic**
S Social **I Infrastructure**
C Culture
T Technology

Within a simple analytical grid, these twelve factors are addressed according to relevance, probability and impact. Relevance is introduced as an international dimension of analysis and judged according to the analyst's subjective but knowledgeable understanding of foreign markets and/or regions. Table 1 presents these 12 dimensions of the international environment and 3 aspects of analysis.

Table 1. International Marketing Environmental Assessment (IMEA) Grid

Column A	Column B	Column C	Column D	
Environmental Aspect	**Relevance**	**Probability**	**Impact**	**Total**
Score	1-10	1-10	-5-+5	
History				
Economic				
Language				
Politics				
Social				
Financial				
Rules(International Trade)				
Environment				
Demographic				
Infrastructure				
Culture				
Technology				

The following sections look at three of these factors in greater depth.- History, Finance and international trade Rules Looking at the extra dimensions, individually, will give an overview of what is considered important for environmental auditing and scanning for international marketing.

Historical Analysis

If there have been trade relations with a country for many years, there is an established 'exporting services' infrastructure both in the public and private sector that can deal with new export deals. 'Sentiment' describes the overall attitude towards a country It is not necessarily quantifiable but is nevertheless an important indicator of the likelihood of success within a potential foreign market.

Historically, while imperialist history, both recent and ancient, can have a negative effect on the reputation of the imperialist nation in the subjugated nations, other factors also have to be considered. Imperialism is not the only form of historical interaction that can cause affective waves within a country, so as to adversely or beneficially impinge on the general attitude of consumers, both business and personal.

An indicator of 'sentiment' is the emphasis placed by country advisors on certain target markets. A comprehensive historical perspective both from the host and target country's point of view defines the 'sentiment' towards the exporting country's products. Sentiment is an important factor in country of origin effects.

While it is relatively easy to provide a synopsis of historical trade patterns from the home country perspective, it is a different matter to

understand the historical context from the target country's perspective. To gain insights into other perspectives on historical development requires reference to the historical topics prioritised within the country or culture being targeted. To illustrate this , British history teaches that the Kikuyu, Mau Mau rebels in Kenya, a British colony for 60 years, were terrorists, whereas the Kikuyu view these people as freedom fighters. They are their national heroes (Ferraro 1994)

Table 2. Factors Contributing to Sentiment Towards an Exporting Country

1.	personal memory of historical events between the countries if the events are recent.
2.	memory of learning about the historical events if the events are further back in the past.
3.	emphasis on that history within the country's education system
4.	promulgation of those events by the media within the target nation.

This list is not exclusive. Other forms of historical interaction that may increase or decrease the level of sentiment towards a company within a country trying to export to a target nation are wars, trade exclusions, treaties, alliances, ententes and détentes. Obviously, wars will cause extreme reactions depending on whether the target nation was the victim or the oppressor, winner or loser. Recently, US businesses have launched a $1 million global market research campaign to help combat rising anti-Americanism. The study has been commissioned by the US Business for Diplomatic Action (BDA) in response to rising anti-American sentiment in Asia, Latin America and Europe because of the war in Iraq. US brands are feeling the pressure and are reporting stuttering sales growth in France and Germany-their two major opponents of the invasion in 2003 (Research 2004).

Past trade exclusions include embargoes imposed for non-compliance of treaty requirements and again the level of sentiment will depend on who was excluded and why. One type of exclusion is protectionism; a national policy imposed to assist home industries compete in their own and overseas markets. Instruments of protectionism include tariff and non-tariff barriers as well as legal and cultural constraints on opening markets to foreign competition. Protectionism has a long history and the propensity towards protectionism is a surprisingly robust policy re-visited again and again by some nations. Ultimately, it supports the nation's right to exclude all others according to its own dictates. The trend to look on protectionism as a international 'wrong' will be discussed further under

International Trade *Rules.*

Treaties and ententes are formal and informal versions of agreements between nations. However some treaties are arrived at by coercion usually at the end of a war e.g. Treaty of Versailles 1919. Alliances are also a form of friendship pact between nations, and are a means of securing national political, military and commercial goals. Within a historical analysis, past treaties and alliance may be very important in determining the present sentiment towards an exporting country.

Financial Analysis

Financial trends, including currency trends, are more important in the global arena, because they make successful marketing in foreign countries more complex. A company can deliver goods to an overseas market at a profit, which is then eliminated by currency devaluations or interest rate fluctuations. There are also situations where a company chooses to establish an overseas subsidiary to support a new low-cost manufacturing base and also finds itself within a large indigenous market but is subjected to financial restrictions such as a limit on the repatriation of profits.

On the other hand, many countries actively support inbound foreign direct investment. Grants to aid domestic employment can attract many overseas companies. Financial incentives to invest in foreign markets are usually given to companies that are seeking low cost operational efficiencies and who are looking for a cheaper source for labour- intensive processes. Therefore, global companies may appear to be undertaking global marketing but are in fact seeking to standardise *all* their operational processes, including marketing, for the pursuit of efficiency gains, lower overall costs and, therefore, more profits. This is not specifically an international marketing orientated approach to international business development as the market is distorted by grant aid.

Volatility in Currency Markets

To reduce risk in international marketing requires an understanding of general currency trends and underlying causes of currency volatility. The supply and demand for a currency is a complimentary process to the supply and demand for commodities and comes from two sources: firstly, the demand for imports and exports of the 'home country'. Imports will cause the value of a currency to fall, all things being equal, because it creates a supply of the home currency to the international currency market in exchange for the demand for the foreign currencies supplying the imports.

In fact, many companies in foreign countries prefer to hold their business savings in international or global currencies. Global currencies include, foremost, the US $, followed by £ sterling but also more recently by the euro €. More recently with the falling value of the $, there has been a flight to the traditional 'store of value' – gold. This flight of demand from currencies to 'precious' commodities alters the global balance of economic power.

The other factor that affects the value of a currency is speculation. The exchange value of a currency which is subject to speculation can be driven by a 'flight away from' or a 'flight to' that currency. Although a 'flight to' a currency increases its international value and, therefore, the currency assets of the country, the corollary of this event is that it makes that country's exports more expensive and so less competitive in foreign markets. To illustrate, the current falling value of the $ ($1.92=£1 @ 10.12.2004) means that products exported in $s are relatively cheaper in the UK. This also has an impact on tourism: UK £s can buy more $s for tourist visitors to USA.

The international financial environment is made more stable by extensive co-operative agreements such as the European Union (EU) which reduces several currencies to just one. In the case of the EU many currencies are now converted to the Euro and so there is generally less inter-currency speculation.

Another factor which affects currency stability is the rate at which it is offered to the market. In some instances a government will alter the rate at which the currency is offered to the international currency market. This is called *re-valuation* and can involve a *devaluation* or a *revaluation* of the currency. Although this government interference is becoming less problematical for businesses, it is important to understand the dynamics of currency devaluation and revaluation. For example a devaluation in a currency will affect the country's terms of trade. This is the ratio of the general import and export price levels and translates into an index of 'ability to export' .

Assessing Volatility in Currency Markets

Establishing the match between risk of market entry and likelihood of uninterrupted payment is one aspect of environmental scanning of prospective international markets that can be judged by referring to the changes in currency values of that market. Is the level of prosperity likely to improve as a result of currency stability? Has the level of prosperity gone up or down in the last year or two? Countries such as Vietnam, China, India, Turkey and South Africa are now considered to be key growth markets, providing increasing opportunities for international marketers.

Internal dynamic economic forces such as inflation can increase currency volatility because they are connected with external debt, which means that much of the country's wealth is used to pay interest on the debt to foreign banks. This creates a demand for the foreign or international currency and causes a supply of the domestic currency to the international currency markets, reducing it's comparative value. A result of this situation reduces the value of the debtor currency and thereby makes imports relatively more expensive

In some areas, there are black markets for a country's currency. This will not only affect the value of the currency in the international currency markets and therefore the potential total revenues obtainable from business activity in the country, but will also interfere with the free flow of

the currency within the economy and distort the propensity to consume; that is the ability to purchase expressed as a percentage of total income. Another consideration for IMEA is that some countries use different official rates of exchange to make imports more expensive and exports cheaper. Russia and China are countries that have recently used differing official exchange rate for protectionist purposes.

Other Financial Factors - Stability of Stock Market

Capital funds can be obtained direct from shareholders, or indirectly from shareholders, through banks. Internationally, this is a very diverse and interconnected market. Investment companies, venture capitalists and unit trusts support each other globally by maintaining significant levels of funds within the international financial arena. Thus, banks will invest in other banks, insurance companies, investment companies and unit trusts, as well as utilities, construction and media companies, for example.

Newer stock markets such as the NASDAQ in New York are also a means to supply technology start ups with funds. While the value of a stock is a reflection of the company's performance, in reality the price fluctuates according to the level of investor confidence. So internet company stocks reached absurd prices before the crash of 2001 and speculation plays a significant role in this bubble and bust phenomenon. Recent history can explain much about the cyclical and irregular patterns of stock market activity.

Other Financial Factors - International Payment Guarantees

Changes in the global financial and technology environment that include electronic payment transfers and immediate payment mechanisms have reduced the risk of paying for foreign goods or offering goods over the internet to foreign customers. On the other hand, internet hacking has proved to be a significant threat to payment security over the web. Some would say that the threat has increased. Assessing the risk of electronic payments is not easy. For very small businesses immediate credit transfer ensures payment before despatch.

In business markets, payment regimes are usually specified in the negotiations. Commercial payment insurance is usually an option for known and established destinations, but may not be available for emerging markets where the attitude to debt and debt payment may be different. Many credit management companies offer credit insurance as well as market information, offering to reduce risk and expand opportunities for their clients.(EBG 1999)

Governments may underwrite payments insurance where they consider the exports to be in the national interest. They may also provide the exporters with a mix of loans and payment guarantees and this can cause an export credit war between countries as they outbid each other in their efforts to promote their goods internationally. (Letovsky 1990)

International Trade Rules

Politics, as an environmental factor for international marketing purposes, can be divided into two spheres - Domestic and International. Domestic politics of a particular country or region impose restrictions or allowances on trade with other countries; impose restrictions or allowances on its citizens in respect of their consumption activity; both personal and business and impose restrictions and allowances on individuals and businesses in terms of their business and employing activities.

International Politics involves agreements between nations. These can be economic in content e.g. customs union or they can be political in nature e.g. alliances and ententes. It also involves membership of International Institutions e.g. United Nations {UN) and again these can have either economic or political content or both. International *Rules* of Trade, at present, predominantly extend free trade and the reduction of barriers to trade on the theoretical basis that free trade is more beneficial to all the world than protectionism.

Global Trade Agreements and Rules

The major body now dealing with trade rules and regulations is the World Trade Organisation, (WTO). It is a legal entity in international law. It should be indicated, at this point, that the domicile of global governance organisations themselves, are a focus of international marketing activity. The United Nations and World Bank are domiciled in the USA; the WTO is domiciled in Switzerland. Although many of the agencies operating under these umbrellas have offices in other countries, there is no doubt that the economic activity and benefits that derive for this domicility are significant.

The WTO was established in 1995 to replace GATT - the General Agreement on Tariffs and Trade; a non-legislative precursor to the WTO. It has 148 members. Its specific functions are to administer the WTO agreements, act as a forum for trade negotiations, handle trade disputes, monitor national trade policies, provide training and assistance for developing countries and cooperate with other international organisations.

There has been much international opposition to the WTO round of negotiations from NGOs (see below) involved in poverty reduction and environmental monitoring. The latest round of trade negotiations is known as the DOHA round. The WTO, itself, was established by the Uruguay round of negotiations. Much media attention has been focused on WTO meeting around the worlds for example in Prague 2002 and Geneva 2004.

Essentially the WTO attempts to reduce barriers to trade, on the premise that free trade benefits all nations. This is not a proven fact and free trade, it can be argued, only benefits the powerful. Furthermore the proposition that economic theory, such as the law of comparative advantage, provides sound scientific evidence that free trade is more beneficial is belied by the facts that over the last few decades, when free trade has been foisted onto poorer nations, the gap between the rich and poor countries of the world has been widening. Since 1994 the share of

global income of the poorest people on earth has dropped from 2.3% to 1.4%.(Hollendsen 2003)

Similarly the western capitalist approach to international trade regulation does not account for other national and regional models based on socialist and humanistic foundations. For example in China, imitation is regarded as a means to mastery and is a cultural tradition. Intellectual property rights protection required by for-profit corporations to maintain their income stream are at odds with Chinese ideas about licensing. The Chinese view licence payments as instalments to intellectual property ownership and this creates a barrier for companies exporting to China, reluctant to lose their copyright fees. (DeBurca et al. 2004)

NGOs make a significant counter-contribution to the free trade debate and this is encouraging, because it shows that small voices can be heard. The changing structure and functions of the World Bank Group are a case in point. (World Bank Group 2005)

At present trade rules attempt to:-

- drive down tariff barriers between trading nations
- reduce quotas and other non-tariff barriers
- outlaw trading activities such as *dumping* – Anti –Dumping Code
- protect copyright laws across borders, TRIPS Trade in Intellectual Property

Furthermore bilateral trade agreements can develop legal frameworks that will deal with, for example, the protection of brand names; measures to prevent and eliminate product counterfeiting and to stop smuggling, considered to be illegal and, therefore, unfair competition.

Regional Trade Agreements and Rules

Regional trade agreements include custom unions and free trade areas. They affect international marketing because they set commercial and legal frameworks and rules for trade in commodities, products and services between members and between members and non-members. The free trade area removes barriers to trade between members. No specification about the treatment of non-members is usually made. On the other hand a Customs Union such as the European Union {EU) not only reduces and eventually abolishes tariffs between members but sets a common external tariff and a common trade policy for all members in respect of non-members.

Common markets go one step further to regional economic integration by removing barriers to the free flow of labour, capital and technology between members. The European Union is again the best example of a common market but trends in regional cooperation are growing. Economic union of countries such as those within the EU requires an integration of economic and monetary policies. For the core members of the EU this was achieved by the Maastricht Treaty 1994 and the € Euro was adopted in 2002. by 12 of the existing 15 members. From 2004, the EU has grown to 25 members.

Other types of regional agreement exist. For example APEC is a formal institution and ASEAN is a limited trade and cooperation agreement. It is very likely that countries such as America, Canada and Australia and Japan will seek to strengthen their regional trade agreements against the countervailing economic power of the EU. Note, nevertheless, that there are still many trading nations that are not in any formal regional or global trading bloc. i.e. Russia., Iran. An IMEA should take account of global and regional membership of these types of agreements, as there may be significant impact on market entry, segmentation and competitiveness.

Non-Governmental Organisations NGOs

The main non-governmental organisations that are active in the international trade arena can be divided into two groups, by reference to their broad areas of commitment. The first group oppose the WTO agreements because they discriminate against poorer nations. The second group oppose the WTO because it takes no account of environmental pressures creating climate change. In terms of international trade rules, NGOs can affect, amend and change trade rules by lobbying and public relations activities.

The lobbying outside the WTO meeting in Prague in 2002 created serious problems for free traders from capitalist governments shocked to confront a multinational body politic that did not embrace free trade as an assumed pre-requisite of further trade negotiations. The groups involved in these demonstrations encompassed both humanists and environmentalists. However, the argument against free trade for developing nations included the need to protect infant industries, the rife use of protectionist policies by more powerful nations to protect home industries and the obvious need of developing nations to secure mechanisms to develop without incurring further foreign debt.

Given volatility in currency exchange markets, many poor countries must pay most of their export earnings to foreign investors: governments and commercial banks – as interest on their debt. This debt legacy was a phenomenon of the last three decades and essentially was a way for capitalist governments and banks to earn income on debt repayments, which formerly had been given to poorer nations as multilateral development aid. The era of post-World War 2 euphoria to make the world a better place unravelled as energy prices rose in the 1970's. United Nations multilateral aid agreements were abandoned in favour of bilateral trade agreements, whereby aid was given to a poorer nation in exchange for large scale project contracts. Many of these private commercial contracts involved the poor national governments privatising their utilities, much in the same way as utilities were privatised in the UK and then Europe in the 1980's –history again!

Promoting this capitalist model of government has cost many poor countries control over essential services. In order to pay off national debts, the World Bank has encouraged this trend. For example, commercial water companies operated in 12 nations in 1990; by 2000 they were operating in 100 nations. Their commercial orientation;

providing dividends for shareholders and large executive salaries, makes water purification and distribution a more expensive business. Water bills consistently rise and the end user must pay for these essential services The UN, itself, has forecast that water availability per capita could decline by as much has a third in twenty years.(Louma 2004)

Environmental NGOs lobby against WTO agreements that foster the power of existing global corporations and maintain the status quo. They argue that unless there is a dramatic reduction of greenhouse gases used to fuel industrial and post-industrial economies, climate changes will ensue, causing catastrophic consequences for all nations, but disproportionately endangering the survival of poor nations and drastically reducing the earth's bio-diversity. Many of these pressure groups, themselves, now have a global presence e.g. Greenpeace, Friends of the Earth. They expose global corporation deals concluded in secret, but affecting many poor consumers. An IMEA should analyse the ability of NGOs to change trade rules in the present and the future. Whether such activity affects the international marketing operations of a company can be assessed under 'relevance'. (See table 1)

Conclusion

While many textbooks on International Marketing present much background information on the international and global environment they do not present this information in a structured way to assist in international marketing operations. The need for a more complex treatment of the environmental audit within the international domain is presented as an IMEA (International Marketing Environmental Analysis). This contains 12 elements and 3 spheres of analysis: relevance, probability and impact. Apart from the traditional political (and legal), economic, social and technological and environmental elements of the domestic audit, historical, financial, cultural analyses are also recommended. The framework mnemonic is: HELPS FREDICT and also includes analyses of language, demographics, trade rules and infrastructure The main aim of presenting a more thoughtful consideration of international environmental scanning elements is to promote a more rigorous approach to preparing international marketing plans.

Historical and financial analyses have been considered and areas of background research elucidated. To estimate the sentiment towards an exporting country requires an investigation of both political and economic historical relations; traumatic e.g. wars as well as harmonious e.g. ententes and alliances. Financial analysis includes an estimation of currency stability, the level of speculation in both currency and stock markets and the state of international payment guarantees generally and from the target country/region perspective. Finally a report on the impact of current international trade rules on both the exporting and importing country and with reference to the commodity group being marketed is a further requirement to make an IMEA rigorous. There has not been room here to provide detailed consideration of other elements necessary for an

IMEA. Further study of language, culture, demography, and infrastructure elements are needed to support a full IMEA.

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Market Orientation and Firm Value

Several studies in the market orientation literature demonstrate a positive relationship between a market orientation and firm performance. However, the mechanisms of this relationship have yet to be explored in detail. This article addresses such a gap by proposing a conceptual model that links market orientation to wealth creation in firms. The model posits that a market orientation guides investment in market-based assets that may be deployed to create customer value. The realisation of customer value helps to both capture and retain customers. Quicker and more extensive market penetration, shorter sales cycles, and decreased marketing and sales costs enhance the cash flow of a market-oriented firm. This may be recognised in higher valuations, which ultimately translate into higher share prices and wealth creation for the owners of the firm. This model is used to describe the creation of value in the Major Business Division of BT, a large information technology service company. Recent success in this Division of BT is attributed to the creation of a market orientation and customer value-based strategy and processes. The experience of BT provides a clear illustration of how a market oriented firm creates value for both customers and shareholders.

Introduction

An important theme in contemporary marketing theory is the potential for market orientation to positively influence business performance (Narver and Slater 1990; Jaworski and Kohli 1993; Deshpandé, Farley and Webster 1993).

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The logic of this influence is that a market orientation facilitates the collection and use of market information, and focuses the co-ordination of resources to deliver superior customer value (Slater and Narver 1994, 1995).

The veracity of this logic is tested in empirical studies that hypothesise market oriented firms perform better than their internally focused rivals on financial measures such as profit, relative profit, return on investment or assets, and non-financial measures such as new product success and innovation (Morgan, McGuinness and Thorpe 2000). Empirical results generally confirm a positive relationship with these measures of performance (Ruekert 1992; Deshpandé, Farley and Webster 1993; Jaworski and Kohli 1993; Slater and Narver 1994; Pelham and Wilson 1996), though occasionally the relationship is not statistically significant (e.g., Diamantopoulous and Hart 1993; Greenley 1995).

We argue that existing explanations of how market orientation influences performance are incomplete. Extant theory focuses on the processes whereby market orientation creates customer value, but then makes a substantial leap in positing a relationship between value for customers and the creation of value for the owners of the firm (i.e., through increased profitability and returns). The processes that underlie this relationship are largely treated as a black box, though the improbability of a direct causal link (e.g., as postulated by Narver and Slater 1990 and Ruekert 1992) is acknowledged by exploration of potential moderators (e.g., Day and Wensley 1988; Diamantopoulos and Hart 1993; Greenley 1995, Jaworski and Kohli 1993).

The purpose of this article is to present a conceptual model that makes explicit the processes whereby a market orientation and an emphasis on customer value can create wealth for the owners of firms. While many researchers have focused on specific and limited areas of market orientation research (e.g., the refinement and validation of the MARKOR scale [Matsuno, Mentzer and Rentz 2000]), this model adopts an eclectic perspective to explain the effects of market-based assets on the cash flow of a firm (Srivastava, Shervani and Fahey 1998). By focusing on cash flow, specific mechanisms are identified whereby a market orientation can influence the financial position of the firm, and thus create wealth for shareholders. This line of inquiry is part of an emerging theme within the marketing literature (c.f. Marketing Science Institute 2000), which seeks improved metrics for assessing marketing and its impact within the firm (Ambler 2000), and attempts to better understand the role of marketing in creating shareholder value (Doyle 2000).

The framework developed in this article enhances the theory of market orientation by providing a more detailed account of the market orientation-firm performance relationship. It also contributes to management practice by:

(1) phrasing the effects of a market orientation in the nomenclature of

cash flow which is understood by managers in all functional areas of the firm,
(2) emphasising that marketing expenditures are investments, and
(3) providing a framework that can be used to guide and analyse the strategies of market-oriented firms.

To illustrate the usefulness of this model as an analytic framework, we apply it to interpret the case of British Telecommunication PLC's (BT) Major Business division (BT–MB), which deals with major organisational purchasers of IT products and services. This unit has undergone a transformation from a product oriented business to a market oriented one with a focus on customer value-based strategies. Our knowledge of this transformation and the business practices of BT-MB are based on participant observation by one of the authors, and published accounts.

A Model of Market Orientation and Firm Value

The emerging consensus is that the concept of a market orientation constitutes a fundamental strategic approach to understanding markets (Morgan and Strong 1998; Vorhies, Harker and Rao 1999). This orientation can be described as an organisational culture focused on understanding the market, which helps firms to develop customer value strategies that take advantage of opportunities and repel threats (Woodruff 1997). The dimensions of this orientation have been extensively studied (e.g., Narver and Slater 1990; Kohli and Jaworski 1990; Ozkowski and Farrell 1998; Matear, Boshoff and Gray 1997). The most consistent dimensions are an emphasis on gathering market intelligence about customers, monitoring of competitors and dissemination of market knowledge across departments and work groups. The implication for performance is that the presence of these characteristics enables market-oriented organisations to build a sustainable competitive advantage by:

(1) learning what customers want,
(2) creating business models that deliver the value customers desire,
(3) monitoring and reacting to current and potential competitors, and
(4) adapting the value generating process as market conditions change (Day 1994; Hunt and Morgan 1995; Morgan, Katsikeas and Appiah-Adu 1998).

Thus, the natural point of theoretical departure for a conceptual model of market-oriented wealth creation is the dimensions of market orientation. Figure 1 presents a conceptual model that maps a path from market orientation to firm value. This model has four main components: a market orientation, market-based assets, customer value and firm value. We develop

arguments to link each of these components.

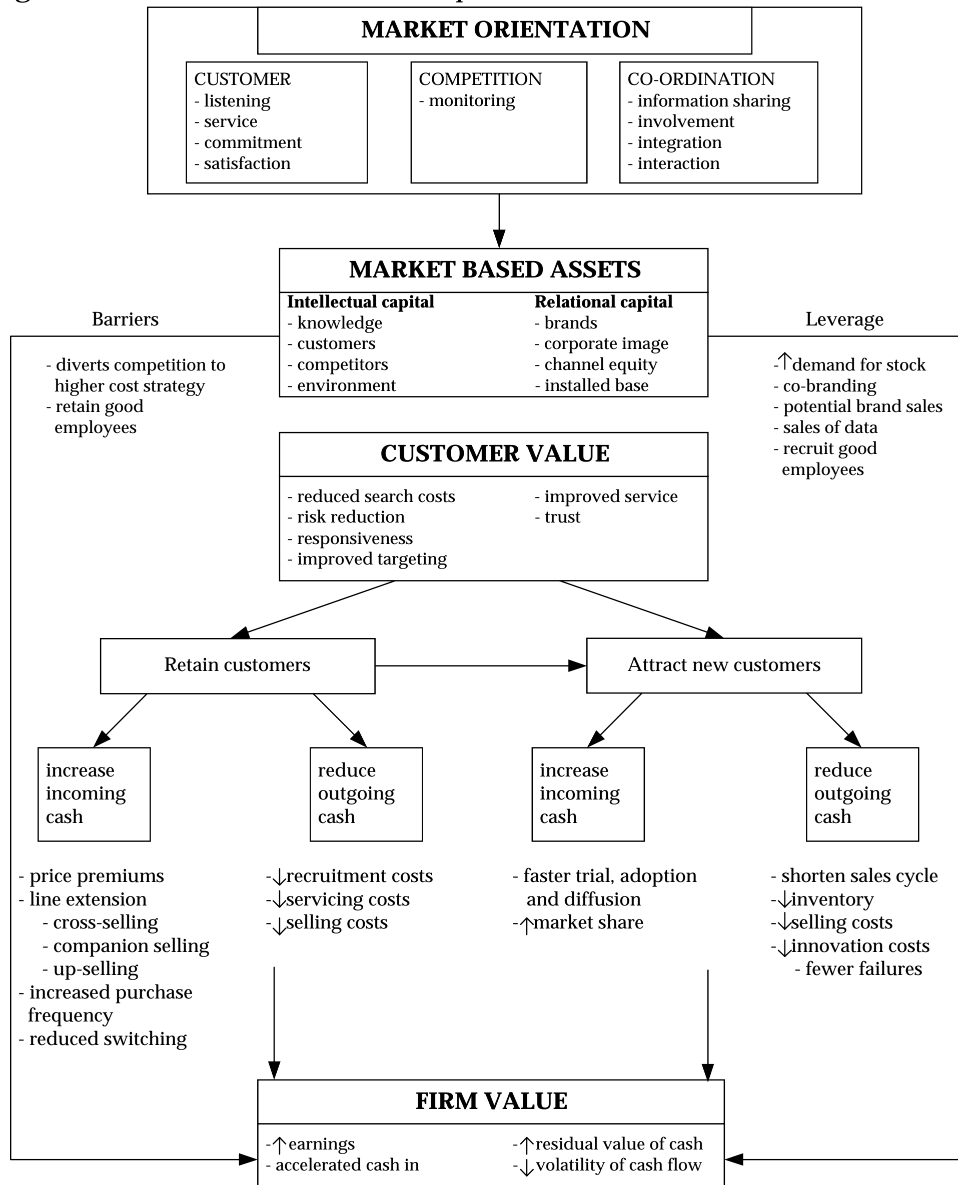

Figure 1. A Model of the Influence of a Market Orientation on Firm Value

The established logic is that a market orientation provides the basis for devising a customer value strategy, and that such a strategy provides the foundation for a sustainable competitive advantage that contributes to financial performance. (For example, see the hypotheses related to business

performance developed by Jaworski and Kohli 1993, or by Deshpandé, Farley and Webster 1993.) This explanation masks as much as it reveals by not articulating the mechanisms by which a firm can realise value for its shareholders when pursuing a customer value strategy. These mechanisms are not readily apparent within the literature. Kohli and Jaworski (1990, 1993), for example, found that an emphasis on profitability was "conspicuously absent" as a component of a customer value-based business strategy. Thus, the relationship is unlikely to be direct. Indeed, only relatively recently has the literature on market orientation been extended to consider its organisational consequences such as the business strategies that are pursued (Matsuno and Mentzer 2000).

A customer value-based strategy can be logically linked directly to the creation of market-based assets (Huber, Herrmann and Morgan 2001). Market-based assets are largely intangible, and consist of intellectual assets (knowledge about the market), relational assets (outcomes of relationships with stakeholders including channel members, customers, and other players), and the interaction between these asset forms (Srivastava, Shervani and Fahey 1998). Market-based assets accumulate by developing knowledge, skills and resources that are unique and difficult to imitate (Barney 1991; Hunt and Morgan 1995). They can be built or acquired through various forms of investment, including staff time spent in relationship building, databases, advertising and promotion, sponsorship and such like. Market-based assets can create value for a firm by:

(1) building strong barriers to entry that divert competitors to higher cost or less effective strategies (Grant 1991, 1996),
(2) leveraging the asset (Srivastava, Shervani and Fahey 1998) and,
(3) deploying the asset to create customer value (Slater 1997).

The last of these is of most interest to us as it is the method by which a market orientation influences the way in which a firm interacts with its customers. One of the most useful frameworks for understanding value in service markets is the customer perceived value ratio that has evolved from pricing theory (Monroe 1991). This measure is the ratio between perceived benefits and perceived costs or sacrifice; where the ratio favours the former over the latter, it can be claimed that value has been generated. Customer perceived benefits might include factors such as a product's physical (core) attributes, service (intangible) attributes and technical support available, the purchase price, and relative quality characteristics of the product offering. On the other hand, customer perceived sacrifice includes the specific costs the buyer is faced with upon completion of the purchase and ownership of the product offering (e.g., acquisition costs, order processing and handling,

risk of service failure or poor performance, and the opportunity costs involved in the purchase decision.)

The components of the ratio recognise that it is the total cost of ownership that is of importance and not purely the purchase price. In service markets this is particularly relevant as the total cost of ownership can be a critical ingredient in the purchase decision (Ellram 1993). In considering the role of marketing in this respect, the means have to be established to determine how the perceived benefits and/or the total costs of ownership can be increased and/or decreased respectively. Importantly, the potential scope for marketing arises in that both the numerator and denominator in this customer value equation should be considered 'relative' to competitors. As Christopher (1996, p. 59) explains: "In seeking to deliver significantly superior customer value the marketer must clearly define, communicate, and deliver a "value proposition" which is recognised by the target market as a better proposition than that presented by competitors. It should also be recognised that in most markets there will be different value segments but that to be successful in any one of them the customer value ratio must be seen to be superior to competitive offerings."

Focussing upon both benefits and costs provides marketers with opportunities, especially since the process of value determination is a consequence of a perceptual process implying that positioning, presentation and communication are all fundamental properties of the value proposition. Market-based assets can be used in many ways to generate value for customers, and to leverage value from a firm's tangible assets. Each firm's business model is at least partially unique in both the character of assets and the way they are deployed. Ways in which market-based assets can create value for customers include lowering search costs, better matching of performance requirements and price (Day 1994), improved service, trust, innovative new products (Slater and Narver 1994), and risk reduction.

The growing literature on customer value is fragmented with limited consensus as to what is meant by terms such as benefits, utility, customer worth, and customer value. In specifically addressing the nomenclature surrounding customer value, a number of advances have been made centring on how customers articulate value (e.g., Gardial, Clemons, Woodruff, Schumann and Burns 1994 and Richins 1994a/b). These authors use a definition that encompasses both desired and received customer value, and draw upon the notion that value is derived from the learned perceptions, preferences and evaluations of customers. Furthermore, an association is made between product offerings *per se* and the context in which they are used (Woodruff and Gardial 1996). Woodruff (1997, p. 142) proposes a definition of customer value that is inherently customer-driven: "Customer value is a customer's perceived preference for and evaluation of those

product attributes, attribute performances, and consequences arising from the use that facilitate (or block) achieving the customer's goals and purposes in use situations."

A customer orientation is a central ingredient of a customer value-based proposition. The link between these concepts is that "…customer orientation places the highest priority on continuously finding ways to provide superior customer value" (Han, Kim and Srivastava 1998, p.33). While customer orientation is combined with competitor orientation and inter-functional teamwork in a market orientation (Narver and Slater 1990), others consider it to be the single most crucial element of a firm's corporate culture (Lawton and Parasuraman 1980; Deshpandé, Farley and Webster 1993). There are three trigger points in which customer orientation can add value to a proposition:

(1) Firm-customer interface (external marketing). Traditional marketing activities take place by means of marketing research driving research and development, which in turn determine the marketing mix program of product, price, distribution and communication.
(2) Firm-employee interface (internal marketing). Viewing employees as a market in their own right stimulates an innovative view of value perception and encourages the firm to evaluate how value can be provided to the customer via the functions in the value chain.
(3) Employee-customer interface (interactive marketing). Face-to-face interaction and other forms of encounter with the boundary spanners representing the firm are critical agents in the value creation and delivery process.

The ultimate goal of a customer orientation program focused on value creation is customer satisfaction. Customer value and customer satisfaction are concepts that are related to one another. The literature postulates that firms providing customer value have more satisfied customers who demonstrate stronger brand loyalty (Aaker 1991). This has a number of potential effects on cash flow that can both increase incoming cash and decrease outgoing cash. For example, loyal customers are less likely to switch and require less ongoing marketing effort to retain (Reichheld and Sasser 1990). Thus, there is a growing pool of customers who by word-of-mouth act as marketing agents that help to attract new customers.

The possible effects on cash flow of a growing share of loyal customers are numerous (Figure 1). The literature on both brand equity and customer satisfaction, for example, reveal that loyal or satisfied customers will pay price premiums (Farquhar 1989), adopt line extensions more readily (Keller 1993), try and refer products more frequently, and have lower sales and

service costs (Reichheld and Sasser 1990). The overall effect of these processes is to speed receipt of cash, widen the gap between incoming and outgoing cash (for marketing related expenditures), and reduce working capital and fixed capital requirements. All else being the same, this should create higher earnings for market-oriented firms, reduce the volatility of their cash flow, and increase the residual value of their cash flow (Srivastava, Shervani, and Fahey 1998). These characteristics of cash flow are key levers of firm value (Day and Fahey 1988).

The Organisation of Marketing in BT's Major Business Division

Over the last twenty years information technology (IT) companies such as BT-MB have generally pursued a common approach to business marketing. The focus has been commonly product-centric, and heavily focused on technological innovation. Due to the increasing turbulence of the IT climate and an enormous proliferation in customer demands and expectations, those organisations adopting a product-centric approach are now performing below the competitive bar within the industry. Identifying competitor referents and strategic group analysis are problematic when considering this sector given that competitive boundaries change regularly because of market shifts, strategic alliances, and breakthrough changes in infrastructure, systems and methods of going to market.

BT–MB deals exclusively with major corporate customers and government agencies. Within BT–MB a goal of shareholder value dominates but more recently is juxtaposed with an emphasis on customer value creation. BT–MB now recognises that marketing has an essential role to play, and this is illustrated by the corporate slogan "marketing makes the difference". The creation of a new marketing unit within BT–MB is part of a recent strategy to improve the company's performance by making it more responsive to its customers. This *Marketing Directorate* is an example of the company's shift away from a traditional product orientation to an organisation focused upon the value propositions offered to customers.

In the following sections we apply our model to describe BT-MB's market orientated organisational structure. We begin by focusing on how BT–MB transformed itself from a product oriented to a market oriented company. The difference in these orientations is that a product-oriented company sells on the basis of technological advancements/functionality and pricing, while a market-oriented company focuses explicitly on the business drivers of their customers and builds tailored propositions to address those concerns. A market-oriented company will deploy the best available technology, but will not overemphasise this when the customer does not value it.

Pricing is difficult for both the product and market oriented IT firm, and

for MT-MB pricing remains a process of competitive bidding. But, a market-oriented firm can build IT that stimulates demand. Furthermore, BT-MB has introduced some "risk and reward propositions", in which payments are linked to savings or productivity gains experienced by customers. Such contracts penalise under-performance and reward demonstrable productivity. Most examples are in the area of supply chain management outsourcing where percentage fees are charged based on ultimate savings.

The transition from product to market orientation at BT-MB was clearly marked in 1999 with the creation of an organisation structure to facilitate "proposition selling in marketing". This superstructure is designed to deal with major businesses, which are typically customers that spend more than US$1m per annum with BT-MB on IT/Telecommunication services. The organisation is commonly referred to as *Central Marketing* because it has both marketing- and sector-based teams in all lines of business, and is responsible for creating pan-functional propositions (propositions that work across all different types of business). For example, energy management propositions designed to save customers expenditure on lighting, electricity and like utilities using telematic devices. Central Marketing plays a lead role in setting direction and stimulating demand for IT services focused on "new wave" activity. These are propositions designed to stimulate revenues in the mobile, data and internet arenas. The new marketing structure that has developed is aimed at increasing the customer base and providing new solutions that add value for corporate customers. We next consider how the dimensions of market orientation – customer, competition, and co-ordination – are implemented in BT-MB's approach.

Market Orientation

There are multiple entry points within Central Marketing for information about customer requirements. A new initiative is the development of *Insight Interactive*. This is a Web-portal designed to explain the propositions BT–MB has to offer. Within these propositions, customers can tailor their own requirements. Most propositions are in the form of case studies that can be adapted. The portal also provides the primary research media for white paper development. These white papers are one avenue for market requirement definitions to be completed and feasibility studies made. Customer needs and requirements can also be collected from:

(1) *Product lines* such as *BT Ignite* and *BT Openworld*, which are corporate engine houses for all of BT-MB's products and services. These organisations primarily function by analysing demand fluctuations for their services and building accordingly.
(2) *Relationship Marketing* divisions, which are designed to introduce

customers into various business driver scenarios and industry events. Here BT-MB typically invites academics from leading research institutions and industry gurus to work with customers in business planning and solution scenarios.

The main interface for customer commitment resides with the BT-MB account manager. This is a "one-stop-shop" for customers for both sales and service. Satisfaction is measured through scorecards and various Internet media.

The "COMBAT" Internet portal group who diagnose competitor service offerings carefully monitors competition with BT-MB through various news portals. Also media analysis is performed, so the company develops a comprehensive database of competitor information, features, products, propositions and pricing.

Co-ordination is a main feature of BT-MB's new marketing practice. Information sharing takes place via a regular forum and internal relationship marketing events. An example of these is *Changing Perspectives* events where Marketing makes presentations about the power of new propositions and introduces new ways of selling. Information sharing now occurs over the Web via static content and video streaming. Marketing engages sales in developmental discussions with product houses and the relevant industry. More trials now result. Projects to integrate functional areas are underway, and interaction between previously disparate groups result from this activity.

Market-Based Assets

BT-MB has market-based assets in two primary forms: intellectual capital and relational capital. To manage its intellectual capital BT-MB has invested heavily in knowledge management applications based on Intranet/Extranet technology to share information on customers, competition and the business climate. BT-MB also provides this as a commercial capability, so customers can do the same. *Infopower* is another medium which is a news based services/prime corporate communications vehicle designed to keep everyone in the sales and marketing community apprised of organisational news.

Most of BT-MB's relational capital can be found in the Relationship Marketing and Marketing Communications units which have a remit to group headquarters to ensure that messages being sent out are consistent, regulatory approved and are compliant with the holistic strategic direction of the company. Corporate image is crucial and the company has established a *Brands and Reputation Directorate* to address these needs. An example of corporate image is the latest business marketing campaign "*BT You Can*".

This branding is of major significance and the associated logo is displayed at all times in communications to the business community. This ensures that BT has a harmonious business marketing practice. Within this *You Can* strategy advertisements can only come from Marketing. Consequently, product lines are no longer able to advertise in the business press, and must fit into one of four approved themes. This represents a significant departure from the traditional product-marketing route, and demonstrates the emphasis placed on marketing over products and services and the marketing of propositions.

In terms of leveraging market-based assets, more focus is now placed on the integration of the information obtained for wider marketing campaigns. BT-MB has strong capability in data warehousing and data mining, for example, that results in unique call centre/supply chain activity. Due to the strict regulation of the industry, BT needs to satisfy its regulator on the dissemination of certain information that it holds on customers. Analysts estimate that corporate branding within BT generates approximately $US14 million of business revenue year-on-year. Brands are also leveraged through affinity marketing.

Customer Value

Customer value is key to all activity within the Marketing organisation. Where BT-MB add value needs to be demonstrated, mostly by fiscal measures such as economic value equations that measure customer benefits. Risk and reward related propositions are increasingly common as the margins on IT services are becoming much tighter and the market saturated with product/service offerings.

BT-MB categorises customer value strategies into four key proposition areas that either drive cost out of the customers' organisations or contributes to revenue. These four areas are Customer Relationship Management, Supply Chain Management, Organisational Effectiveness and Knowledge Management. We describe each of these briefly, as the propositions are also applied to create customer value within BT-MB.

Customer Relationship Management

Customer Relationship Management (CRM) is a company-wide business strategy to deliver a highly personalised service that exceeds customer expectations and creates and maximises customer lifetime value. CRM underpins an organisation's relationship with its customers. The framework BT-MB uses to understand CRM is based on three main areas:

(1) *CRM Strategy.* This concerns the strategic vision required at Board level to adopt and implement a Customer Relationship Management approach. Financial investment and business process re-engineering

to challenge and change current business thinking across all of its operations are required.

(2) *Customer Information and Profiling.* This is the process of collating, managing and analysing customer information held across the business to understand customer profitability and lifetime value. By harnessing this customer knowledge, organisations are able to implement targeted one-to-one marketing programmes that deliver long and profitable relationships through acquiring new customers, retaining customers and managing less profitable customers.

(3) *Customer Contact Solutions.* This concerns the personalisation and integration of the multiple touchpoints that every company has with its customers, for example, retail branches, direct operations (customer service or telemarketing), Web sites, digital TV, Internet mobile phones, kiosks, etc. to provide a seamless view of interactions/transactions.

The main issue addressed by the CRM proposition is how organisations can optimise customer loyalty using e-business solutions while integrating the Web with their existing legacy business (e.g., retail branches). This requires an understanding of the dynamics of multiple routes to market and co-ordination of the communication and operational channels. To manage this effectively, BT-MB helps organisations to review internal process management to both build and manage customer intelligence systems and integrate back-office enterprise resource planning (ERP) systems. The dramatic growth of the Internet means that companies face customer demand for their products on a global scale. This creates issues in managing order fulfilment processes, billing and maintaining customer service levels in domestic markets and overseas. In this context, enhanced customer service skills are critical to deepen customer interactions and build long and profitable relationships.

Supply Chain Management

Recent advances in the convergent technologies of telecommunications and computing together with the growth of information processing has led to an unprecedented change in the way in which business-to-business and business-to-consumer transactions are conducted. Nowhere is this more evident than in the area of Supply Chain Management (SCM). Innovative technological solutions are reducing time to market and costs, while enabling greater responsiveness to customer demands. This results in an increased awareness of how the company does business, of possible threats to it from competitors and new entrants radically altering the existing model.

Supply chain strategy provides the link between corporate objectives and

the tactical processes needed to operate the business. The focus is usually on a limited, manageable set of operational tasks that meet the order winning criteria of customer segments. Any change in the way a company does business will radically alter its cost base, distribution network and ultimately its position on the supply chain. It may move downstream and address consumers, directly cutting out its traditional wholesaler/retailer distribution network, or may migrate upstream providing new services and possibly outsourcing its direct sales force.

Innovative supply chain strategies, policies and procedures are key drivers in increasing shareholder value through profitable growth, cost minimisation, working capital efficiency, fixed capital efficiency, and tax minimisation. BT's experience suggests that improvements in SCM can reduce external costs by 5-15%, purchasing costs by 90%, and the cost of sales by 50%.

Organisational Effectiveness

The primary focus of Organisational Effectiveness (OE) is to enable organisational flexibility and agility, leading to greater shareholder value. This covers a large area of the customers' business. The two prime areas are the management assets and work processes (the applications and functions that deliver value for BT customers) work styles (how an organisation operates in a "people and places" sense). OE is about getting the best value from support processes, functions and assets and hence the best value services to and from employees. Customers who respond to OE value propositions develop an advantage over time by managing strategies, particularly at the operating level to ensure that they are created, funded, resourced, targeted and tracked.

Knowledge Management.

Knowledge Management (KM) is about making people and organisations smarter through new ways of working supported by new technology. Knowledge Management positions a company to respond to the fast emerging opportunities and threats of the knowledge economy. Its intention is to make people and organisations more efficient and enterprising by linking people with technology in ways that generate distinctive competencies and capabilities. The result is to mobilise new and better ways of thinking, working and competing.

KM is strategically important to any organisation wishing to succeed in the knowledge economy, as knowledge underpins the ability to compete. At an economic level this is due to the fundamental shift in the traditional basis of wealth creation from land, labour and capital - towards learning, innovation, collaboration, integration and the leverage of intellectual assets.

BT-MB's approach, developed into a KM framework, takes these needs into account. Ultimately, KM addresses the most important business issue facing organisations - the need to reconfigure internal capabilities faster than the pace of change in the external world.

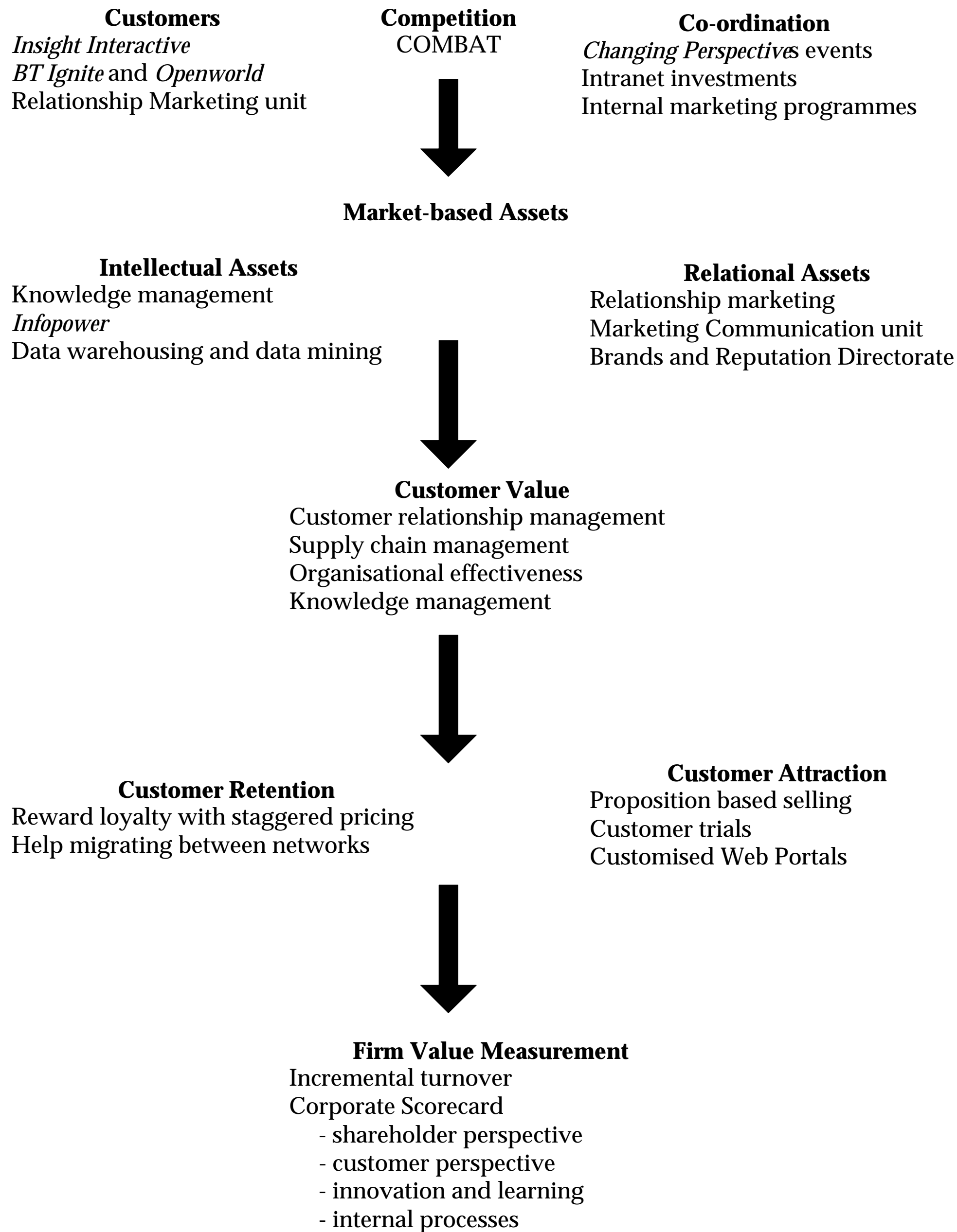

Figure 2. The Implementation of a Market-focused Organisation at

BT
Customer Retention and Customer Attraction

Retaining customers is key to BT-MB's strategy on loyalty. The company consistently designs propositions to reward customer loyalty, mostly in respect to migrating scalable networks. Examples of campaigns include the latest *From Legacy to Dotcom* campaign. This seeks to move companies away from proprietary networking to advanced concepts such as the creation of virtual businesses. BT-MB also tries to reduce switching to other telecommunication service providers for the same basic services. In the IT market, margins are tight and competition thrives on price, not technology. There are costs associated with retaining customers too: continuous maintenance of older style legacy technology, and customers who are not ready to migrate to newer networks and the associated marketing effort. Recruitment can sometimes be difficult in these areas and selling costs are high. Attracting new customers is also a focus of company efforts. BT-MB has financial engines in place to display what is incremental value based on technology and proposition selling. Customer trials are a feature and the vast scale of investments in Web portal design means that customers also have a unique experience in interacting with the company.

Firm Value

Firm value and market orientation are difficult to measure. What we are able to claim is that at BT-MB over US$225m has been attributed to incremental value since the implementation of the Central Marketing organisational structure. The value of total sales is approximately $US4.5 billion. Deductively this represents that Marketing is associated with 5% of the new total sales effort. But this does not capture the softer side of marketing such as the contributions of Relationship Marketing and Marketing Communications units. For this purpose, BT uses the Corporate Scorecard as a framework for analysis. This scorecard is divided into four value areas: shareholder perspective, customer perspective, innovation and learning and, the internal process perspective.

The shareholder perspective includes three measurable areas of success. The first is the revenue growth of traditional products and services. The second is revenue of "new wave" activity (including mobile and data applications, revenue obtained through third party alliances, Insight Interactive and Marketing propositions). Thirdly, marketing is measured by "contribution" to overall revenue, which is not necessarily direct as stipulated in the measures above. This includes contribution from various marketing programmes at both incremental and momentum level. Within this marketing measure cost comes into play. Managing cost involves

managing the Major Business marketing budget to effectively meet revenue and profit targets. Part of this is reducing the cost of sales through alternative routes and measuring return on investment, usually from direct response campaigns. The fourth area of activity, shareholder value, is closely associated with Marketing's virtual activity. This includes revenue driven from the online presence, the number of customers online and the proportion of sales made online.

The second part of the corporate scorecard measures the customer perspective. The first goal here for Marketing is to deliver excellent client relationship management. This is measured in three ways. Firstly customer loyalty, which measures the value of marketing communication as perceived by the customer. Secondly, the usage of Insight Interactive. Lastly the impact of Marketing's Thought Leadership Programmes. This is marketing activity designed to stimulate interest from senior decision-makers, via the *You Can* campaign, various public relations activities, Insight Executive programmes, Insight Magazine and Insight Interactive. The second goal is marketing's role in securing competitive advantage. This includes new case studies from the value propositions created and measuring the value of public relations activity.

The third part of the scorecard includes the internal process perspective. There are five goals that must be fulfilled by Marketing. Firstly, measuring internal customer responsiveness by a Client Review Process (CRP) that looks at service to the customer. Secondly, internal processes capability and consultative selling. This involves looking at the CRP activity and examines the speed and professionalism of the company. Thirdly, Marketing as an organisation that *cares*; here a comprehensive CARE survey administered by Human Resources measures employee satisfaction, equal opportunities and culture within the job. Also included is the remit of Training, which considers the number of managers professionally qualified with chartered status and those pursuing similar marketing qualifications. The fourth area is sector liaison and product line support for marketing. This is measured via the number of senior managerial meetings, customer-competitor-market views, and prospects-portfolio reporting.

The last part of the scorecard deals with the innovation and learning perspective. There are four goals under this. Firstly, propositions that are measured by delivery of propositions to the sales account teams within BT–MB. Specifically this concerns creating and delivering propositions within the new wave areas (mobile and data). Closely related is the second goal of delivering compelling value propositions based on feedback from Insight Interactive. Thirdly, developing an e-channel that meets customer needs and provides information from a marketing portal environment. Lastly, the advent and practice of shared learning. An example is the *You Can Win Sales*

Zone (YCWSZ). Specific measures include the incremental case study contribution, number of YCWSZ registered users, increases in interaction on the YSWSZ Web site by registered users, use of the separate Major Business Web site, and training events for account managers.

Conclusions

This article presented a model that traces the theoretical effects of market orientation on firm value. The model furthers our understanding of the market orientation-performance relationship by making explicit the mechanisms whereby a customer value strategy can influence a firm's financial position. This addresses a gap in the stream of research that seeks to demonstrate a positive empirical relationship between market orientation and measures of financial performance (e.g., Narver and Slater 1990 and Ruekert 1992; Day and Wensley 1988; Diamantopoulos and Hart 1993; Greenley 1995, Jaworski and Kohli 1993).

The model postulates that a market-oriented firm is able to build market-based assets that can be deployed to create customer value. A customer value strategy results in more loyal and satisfied customers that are more receptive to marketing initiatives and cost less to service (Reichheld and Sasser 1990). Such favourable customer characteristics enhance and accelerate net cash flow, increase the residual value of cash, and decrease the volatility of the cash flow. These are key levers of firm value (Day and Fahey 1988). Market-based assets can also create value for the firm by establishing barriers for competitors, and can be directly leveraged through increased demand for stock, co-branding, and sales of data or expertise.

This model is illustrated by the Marketing structures and processes created by BT–MB in trying to move from a product-oriented to a market-oriented approach to business. The organisation of Marketing within BT-MB is summarised in Figure 2. The experience of BT provides an example of how the various components of our model can be operationalised. Our emphasis in this article is a description of the organisational structures BT created to support its stated goal of shifting to a more market-oriented culture. Further research will track and report on the functional linkages between the component, and the actual experience of how the structure creates value for customers and the firm.

Our model emphasises cash flow, which has two clear benefits. First it provides the ability to communicate the benefits of marketing expenditures across functional areas within a firm. The language of cash flow is universal. Second, it emphasises that marketing expenditures are investments whose net present value can be estimated. This provides a common framework for firms to compare the benefits of a market orientation with alternative

internally focused strategies (or indeed, the complementary effect of a market orientation on investment in tangible assets). As yet, BT-MB has not pursued a means of directly monitoring the effect of marketing activities on cash flow. However, they have implemented a sophisticated Corporate Scorecard to provide multiple measures of performance relative to different stakeholder groups.

Our model also emphasises that the benefits of a market orientation, like investments in tangible assets, are not realised in the same period as the investment. For example, many dot.com companies have a business model that articulates a customer value strategy, and an organisational culture that is strongly market oriented. However, in early accounting periods they have high cash burn rate as they invest externally raised equity in the creation of market-based assets. Studies that seek to correlate market orientation with traditional measures of financial performance would find a negative relationship for such firms. This model provides a framework for analysing the strategies that these firms pursue, and a way of understanding how they may eventually realise the value placed on them by their investors. This observation is also relevant to the massive investments BT-MB has made in its Internet presence The lag effect in realising the benefits of this are recognised within the Corporate Scorecard.

The full implementation of our model as a strategic framework would require an accounting method that is able to relate changes in cash position to specific marketing activities. Goebel, Marshall and Locander (1998) recently addressed this issue by describing how activity-based costing can assist analysis of the costs and benefits of a market orientation. The cost-per-customer and revenue-per-customer metrics that are being used to both value and track the performance of Internet-based firms are also relevant. These metrics make a direct link between the costs of marketing activities and the benefits derived in terms of customer retention, and the frequency and quality of sales (Whyman 1999).

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