FIT BETWEEN MARKET ORIENTATION AND BOARD STRUCTURE AS A CONTINGENCY REQUIREMENT FOR SUPERIOR FIRM PERFORMANCE

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ABSTRACT

Research into the effects of market orientation on firm performance has produced mixed results. Prior research in marketing has paid little attention to a legitimate governance issue such as "what is an optimal board structure to enhance the market orientation behavior of firms." We develop a contingency model that attempts to explain the mixed findings. We propose that fit between market orientation and board structure produces superior performance in market-oriented firms.

INTRODUCTION

Over the decade the concept of market orientation has occupied the center stage of the theory and practice of marketing strategy (Day 1994; Kohli and Jaworski 1990; Kotler 1977; Levitt 1960; Narver and Slater 1990; Shapiro 1988; Webster, Jr. 1988). In recent years, practitioners and academicians have shown increasing interest in the impact of market orientation on firm performance (Kohli and Jaworski 1990; Narver and Slater 1990; Greenley 1995; Atuahene-Gima 1996). A contingency perspective which conceptualizes the competitive environment as a key contextual construct moderating the market orientation-performance relationship has been examined both conceptually and empirically (Day and Wensley 1988; Kohli and Jaworski 1990; Slater and Narver 1994). The resulting research has made a contribution to a growing awareness of the need to understand how organizational activities are orchestrated to promote the effectiveness of market orientation and to augment firm performance.

Even though previous research has contributed to enhancing our understanding regarding the importance of market orientation and its impact on firm performance, a review of previous research reveals a lack of attention addressing a number of managerially important issues. In particular, little is known about the linkage between top management characteristics and market orientation behavior of firms. Kohli and Jaworski's (1990) article underscores the critical role of top managers in fostering market orientation, and emphasizes the importance of top managers' role in shaping an organization's values and strategic orientation (Hambrick and Mason 1984; Webster, Jr. 1988). This idea is not new. In 1959, Felton asserted that market orientation is attainable only if "the board of directors, chief executives, and top-echelon executives appreciate the need to develop this marketing state of mind" (1959, p. 55). Even though the influence of senior managers and boards of directors on market orientation has been recognized, little attention has been paid to the nature of the relationship. So, for example, we do not know what types of board leadership, composition, and size enhance the market orientation behavior of firms. The primary objective of this paper is to develop propositions linking board structure, market orientation, and performance.

LITERATURE REVIEW

Market Orientation and Firm Performance

Market orientation is considered the organizational culture that most effectively and efficiently creates the necessary behavior for the creation of superior value for buyers (Deshpande and Webster, Jr. 1989). The market orientation construct has been discussed as having three components; customer orientation, competitor orientation, and interfunctional coordination (Narver and Slater 1990). Customer and competitor orientations are defined as intelligence generation and dissemination activities (Kohli and Jaworski 1990; Narver and Slater 1990). These activities are considered essential to identify customers' value and understand capabilities and strategies of competitors. The final component incorporates an activity that involves coordinating across the firm's departmental activities. All three components are defined as activities conducive to delivering superior value to customers.

Empirical research on the relationship market orientation and firm performance has shown mixed results. One of the conceptual arguments by Kohli and Jaworski (1990) is that the greater the level of market orientation of organizations, the higher their performance. Narver and Slater's (1990) findings support strong relationship between market orientation and firm performance after controlling for important market-level and business-level influences. Market orientation is also found to have a significant impact on the job attitudes and customer orientation of the salesperson (Siguaw, Brown, and Widing, II 1994) and the effectiveness of innovation activities (Atuahene-Gima 1996). Ruekert's (1992) study on two SBUs suggests that the higher performing SBU is

found to have a higher level of market orientation than the lower performing SBU. However, Jaworski and Kohli's (1993) study provides somewhat mixed findings in which market orientation is related to overall judgmental business performance, but not market share. Greenley's (1995) study does not support a direct relationship between market orientation and firm performance.

Board Structure and Firm Performance

Board Leadership Structure. CEO duality refers to a board leadership in which one person wears two hats - one as CEO of the firm and the other as chairperson of the board of directors. Nonduality implies that different individuals serve as the CEO and the chairperson. Proponents of CEO duality argue that it enhances a clear focus on objectives and operations (Stoeberl and Sherony 1985). CEO duality establishes a unity of command at the top of the organization, with unambiguous leadership clarifying decision-making authority (Finkelstein and D'Aveni 1994). However, opponents of CEO duality argue that CEO duality reduces the board's ability to fulfill its proper governance function (Vance 1983). CEO duality entrenches the CEO at the top of the organization, challenging the board's ability to effectively monitor and discipline management (Mallette and Fowler 1992). Similarly, empirical studies investigating the relationship between board leadership and firm performance have yielded mixed results. In the study of the *Fortune* 500, Rechner and Dalton (1991) reported that CEO duality was negatively related to firm performance. CEO duality has been linked with signs of ineffective governance, such as hostile takeovers (Morck, Shleifer, and Vishny 1989) and the adoption of "poison pills" (Mallette and Fowler 1992). Several other studies have found CEO duality and firm performance to be unrelated (Berg and Smith 1978; Chaganti, Mahajan, and Sharma 1985; Daily and Dalton 1992). However, according to the supplemental analyses in Berg and Smith's study (1978), CEO duality had a positive effect on firm performance in some industries. Donaldson and Davis (1991) reported that CEO duality and firm performance were positively associated.

Board Composition. Research into the linkage between board composition and firm performance has produced conflicting opinions and mixed findings. Based on agency theory (Fama and Jensen 1983), the interests of insiders are theorized to be aligned with those of management, while those of outsiders are aligned with stockholders. Accordingly, it has been suggested that effective boards should be comprised of a higher proportion of outside directors (Zahra and Pearce 1989; Mizruchi 1983). The presence of outsiders is thought to be beneficial to the extent that their inclusion on the board provides access to valued resources and information, facilitates interfirm commitments, and aids in establishing legitimacy (Stearns and Mizruchi 1993). However, it has been recognized that it is hard for them to understand the complexities of the company and to monitor its operations since they usually serve on several boards (Patton and Baker 1987). They may not have access to information that is relevant to assessing managerial competence and the strategic desirability of initiatives (Baysinger and Hoskisson 1990). In addition, little empirical agreement exists regarding the relationship between board composition and firm performance; a higher proportion of outside directors is positively associated with performance (Stearns and Mizruchi 1993), is not an important factor in performance (Daily and Dalton 1992), and is negatively associated with performance (Goodstein and Boeker 1991).

Board Size. Previous research into the effects of board size on firm performance shows opposing opinions and mixed findings. Increasing the board size is thought to provide an increased pool of expertise and resources for the firm (Pfeffer 1972). A larger board is viewed as being essential to co-opt multiple aspects of the firm's environments. In contrast, a larger board inhibits the board's ability to initiate strategic actions and faces a number of barriers in reaching a broad consensus on critical strategic decisions (Goodstein, Gautam, and Boeker 1994). A larger board is presumed to be less knowledgeable about the CEO's activities since they typically have an external focus (Beekun, Stedham, and Young 1998). At the empirical level, Zahra and Stanton (1988) reported that a larger board was conducive to effective performance of the firm. In addition, Chaganti, Mahajan, and Sharma (1985) found that a smaller board was associated with a higher rate of corporate bankruptcy. In contrast, Yermack (1996) found the inverse relationship between firm market value and board size in a sample of 452 large U.S. industrial corporations between 1984 and 1991. Goodstein, Gautam, and Boeker (1994) found that larger hospital boards tended to initiate fewer service reorganizations. The study by Holthausen and Larcker (1993) failed to find consistent evidence of an association between board size and firm performance.

A THEORETICAL FRAMEWORK AND PROPOSITIONS

One of the primary purposes of marketing and strategic management is improving firm performance (Venkatraman and Ramanujam 1986). A key premise in the strategy literature on organizational change and adaptation is that an optimal strategy-structure fit yields superior firm performance (Chakravarthy 1982). It seems reasonable to assume that the ideal board structure for a firm pursuing one strategic orientation may be very different from a firm pursuing a different strategic orientation. Contingent upon the strategic orientation, the firm would be confronted by a competitive arena which will vary considerably and that a distinct competitive situa-

tion it faces will call for a unique type of strategic behavior as the base for exploiting opportunities and overcoming obstacles. In addition, recent thinking suggests that boards should be structured to meet the strategic requirements of the firm. The importance of the board's strategic function has been emphasized by advocates (Zahra and Pearce 1989). There is also a growing recognition of the importance of directors' professional expertise in developing, implementing, and refining strategies in firms.

In Figure 1, we suggest a theoretical framework that attempts to link board structure and market orientation. In our framework, we conceptualize market orientation as the balanced external focus on customers and competitors or simply strategic breath. We argue that the board should be constructed in response to the strategic requirements of market orientation (strategic breadth). Thus, we suggest a proper fit between market orientation and board structure (leadership, composition, and size) is a key contingency factor influencing the relationship between market orientation and firm performance.

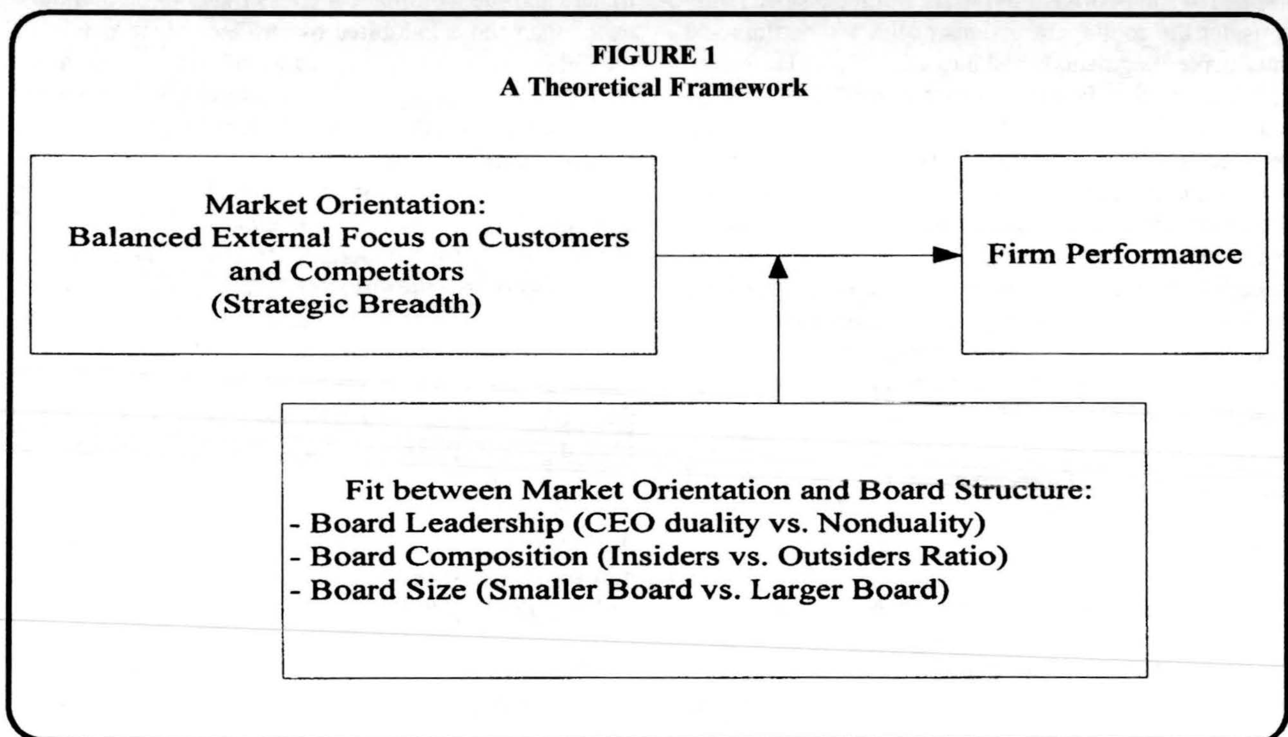
Market Orientation Behavior

One view of market orientation focuses on three components; customer orientation, competitor orientation, and interfunctional cooperation (Slater and Narver 1994). Customer orientation is a relative emphasis on collecting, processing, and responding to customer-oriented intelligence. Organizations pursuing customer orientation rely on detailed analyses of customer benefits and satisfaction, and their strategies are defined by close attention to customer needs (Day and Nedungadi 1994). Similarly, competitor orientation is a relative emphasis on collecting, processing, and responding to competitor-oriented intelligence. Organizations pursuing competitor orientation depend on direct management comparisons of salient attributes to a few larger peer competitors, and their strategies are formulated to defend or counter competitive actions (Day and Nedungadi 1994). Market orientation, on the other hand, is a balanced external emphasis on both customers and competitors (Day and Nedungadi 1994). Organizations pursuing market orientation devote themselves to achieving a balance between customer and competitor perspectives and work to avoid the oversimplifications inherent in orientations that are overly biased toward either market player. Market orientation is broad enough that it appreciates the value of a variety of intelligence and perspectives. As a result, organizations in this group search for and rely on all types of information when they act and respond in a competitive market. Firms pursuing either customer orientation or competitor orientation can be defined as those who pay selective attention to their environment and rely on strategic simplicity. Strategic simplicity is an preoccupation with a single goal, strategic activity, department, or worldview – one that increasingly precludes consideration of others (Miller 1993). On the other hand, market-oriented firms define reality in relatively boarder terms and concentrate on broader ranges of strategic behavior by keeping a balanced perspective between customers and competitors.

Board Leadership for Market Orientation Behavior

CEO duality establishes a unity of command at the top of the firm, with clear and unambiguous leadership

FIGURE 1
A Theoretical Framework



clarifying decision-making authority. In contrast, nonduality, as a result of the existence of two public spokespersons, can create potential rivalry and conflict between the chairperson and the CEO and promote confusion among top managers as to who is the boss. The confusion will increase the probability that actions of management and the board are at odds with each other. Mintzberg, Raisinghani, and Theoret (1976) found that disagreements created decision interruptions, which in turn delayed the decision process in a study of 25 major decisions. Miller and Friesen (1977) suggested that firms without unified leadership face difficulties of taking decisive actions. On the other hand, CEO duality helps avoid confusion among top managers as to who is boss, facilitating effective decision-making (Finkelstein and D'Aveni 1994). By serving as the chairman, the CEO will acquire a wider power base and locus of control (Patton and Baker 1987). Strong CEO leadership can make rapid, unilateral choices when firms need to manage competitive environment and adapt to competitive environmental demands.

However, while CEO duality may lead to faster decision processes, it might sacrifice consensus and evenness of participation. A CEO-chairperson can dominate both the agenda and content of board meetings (Finkelstein and D'Aveni 1994). The perpetration of power, although providing continuity and stability, constrains the flexibility with which an organization can act and respond to new competitive contingencies and increases commitments to previous courses of action. It may be that relatively powerful CEOs serving simultaneously as board chairpersons use their influence not to effect to change, but to maintain a course (Daily and Dalton 1994). Thus, a powerful CEO is more likely to get trapped in competitive blind spots, failing to sufficiently consider the contingent actions of the competitors and thus make judgmental mistakes (Zajac and Bazerman 1991). If the firm faces a downward trend, CEO duality will exacerbate tendencies toward threat-rigidity responses (Daily and Dalton 1994). This is because a powerful CEO may have an incentive to concentrate on the competitive strategies that have rewarded him/her, and to reinforce the goals that the CEO believes in, even though those goals and strategies are less likely to address the complexity of changing competitive environment. Consequently, the presence of a single leader may not allow a broader range of strategic action and response to a changing competitive environment.

Proposition 1: Firms adopting market orientation will perform better with a CEO nonduality leadership structure than with a duality structure.

Board Composition for Market Orientation Behavior

Having been influenced by the culture of the organization, insiders are assumed to be more susceptible to hazardous "groupthink" narrowness (Janis 1982). Inside directors often do not have the power to discipline the CEO because they may be beholden to the CEO for their careers (Patton and Baker 1987). Thus, they may be reluctant to propose changes when in conflict with the CEO's plan. Since insiders are day-to-day participants in the firm's decision processes, positive reinforcements of their experiences in strategic decision processes over time induce them to search strategic behavior more narrowly. They can accomplish the strategic tasks at hand, but they do not understand why strategic behavior is performed in such a specific way. The search for comprehension is replaced by the quest for refinement (March 1991). They are likely to be mired in a single way of seeing and doing things. Moreover, the greater the representation of inside management on the board, the greater the degree of managerial discretion (Williamson 1975) and the possibility that management will act opportunistically. Opportunistic behavior may include management's persistence in an existing course of strategic behavior and direction. It has been shown that higher representation of insiders is associated with lower board involvement in strategic decision- making (Judge and Zeithmal 1992). Compared to groups whose members have diverse backgrounds and specialties, homogeneous groups tend to produce less creative, lower quality decisions, to be more cohesive, to experience strong pressures toward conformity and consensus, and to be more susceptible to narrow "groupthink" biases (Janis 1982).

On the other hand, outsiders also might simplify their mental models and their attention toward salient competitive attributes. A critical difference is, however, that perceptions of outsiders about competitors and customers and the workplace are less likely to be homogeneous than those exhibited by insiders, since outsiders are heterogeneous with regard to culture, occupational backgrounds, and experience. Therefore, new perspectives may be introduced by outsiders into the strategic decision making process, thereby facilitating an increased awareness of changing competitive environment and resulting in enhancing managers' knowledge of alternative ways of competing. Moreover, outside directors may promote the airing of diverse perspectives and reduce narrow mindedness in the board's evaluations of competitive situations. The promotion of diverse perspectives can produce wider ranges of solutions and decision criteria for strategic decisions. Thus, a board with a higher proportion of outsiders is capable of broader ranges of responses to competitive environmental changes (Goodstein and Boeker 1991). Consequently, the increasing the presence of outsiders on a board may allow a broader range of strategic action and response to a changing competitive environment.

Proposition 2: Firms adopting market orientation will perform better if they have a higher proportion of

outside directors than if they have a higher proportion of inside directors.

Board Size for Market Orientation Behavior

From the CEO's point of view, a larger board is potentially difficult to manage. A larger board might face a number of barriers in reaching a consensus on important decisions since large groups are more likely to develop factions and coalitions that can increase group conflicts. Large groups are more difficult to coordinate due to the large number of potential interactions among group members. Accordingly, large decision making groups are less cohesive and experience decreased levels of motivation and satisfaction due to the lack of participation (Jawell and Reitz 1981). Judge and Zeithmal (1992) find that a larger board is less likely to become involved in the strategic decision making process. On the other hand, a larger board is recognized as valuable for the breadth of its services by providing an increased pool of expertise and resources (Pfeffer 1972). A larger board also can permit the inclusion of a variety of perspectives on corporate strategy (Pearce and Zahra 1992). Singh and Harianto (1989) argue that a larger board enhances the governance function by reducing CEO domination and making it more difficult for the CEO to build a broad consensus within the board to take actions that might not be in shareholder's interests. A larger board is assumed to have directors with diverse industrial experiences, skills, and knowledge that can improve the quality of decision-making (Zahra and Pearce 1989).

Thus, a larger board seems to be more effective than a smaller board. While a larger board can cause slower decision-making due to the coordination and process problems, a larger board can improve the strategic actions of the firm by providing multiple perspectives, linking the firm to its environment, and buffering the firm from environmental disturbances. A larger board is presumed to be more conducive to debate and discussion of the firm's strategy resulting in the consideration of wider ranges of strategic options (Zahra and Pearce 1989). Consequently, the presence of a larger board should encourage consideration of a wider range of strategic action and response to a changing competitive environment, and should promote greater strategic breadth and a balanced external orientation of the firm.

Proposition 3: Firms adopting market orientation will perform better with a larger board than with a smaller board.

CONCLUSION

In this paper, we develop a contingency perspective that may help explain the mixed findings of previous research on the relationship between market orientation and firm performance. We propose an optimal board structure that can produce broader ranges of strategic behavior for market orientation. We propose nonduality leadership, a higher proportion of outside directors, and a larger board as the key structural characteristics of an optimal board for market-oriented firms. We then illustrate that fit between market orientation and board structure is a key contingency requirement to achieve superior firm performance. The identification of an optimal board structure for market orientation will help in understanding the importance of board structure and its effects on the market orientation-performance relationship. In addition, the introduction of a contingency perspective highlights the importance of board construction in response to the strategic requirements of market-oriented firms. The optimal board structure will allow market-oriented firms to develop broader ranges of strategic actions and responses or take a balanced external orientation between customer and competitor perspectives which are the critical requirements for market orientation (Day and Nedungadi 1994; Miller and Chen 1996; Slater and Narver 1994). It seems clear from previous research that a strong correspondence should exist between the strategic orientation practiced at the firm and the board structure set by the firm (Baysinger and Hoskisson 1990). The underlying assumption is that, when properly designed, board structure of a corporation can be a key factor contributing to the accomplishment of the market orientation objectives. The normative implication flowing from this argument is that unless board structure reinforces the firm's market orientation behavior, market orientation may not lead to superior performance. Therefore, market-oriented firms should have an optimal board structure to support and motivate the market orientation behavior.

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