

## Research Article

# Strategic Role of Customer Orientation in Differentiation Strategy and Organizational Performance Nexus: A Partial Least Square (PLS) Approach

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**Abstract:** The aim of this study is to investigate the nexus of differentiation strategy and organizational performance with customer orientation as a mediator in setting of the hotel industry in Malaysia. Data were gathered through a survey using mail and email questionnaire with a sample of 60 three to five star hotels. Smart PLS 2.0 (M3) was used to test the hypotheses. Findings suggest that customer orientation mediates the relationship of differentiation strategy and performance. This study is bridging the gap and presenting the importance of strategic role of customer orientation in facilitating differentiation strategy to produce better performance. It also provides several theoretical and practical implications for scholars and practitioners from perspective of this study.

**Keywords:** Customer orientation, differentiation strategy, organizational performance

## INTRODUCTION

The link between generic competitive strategy and organizational performance has been widely documented more than three decades (Parnell, 2011). Due to several arguments on the simple framework of Porter's generic strategies, the scholars tend to examine the roles of mediators and moderators in strategy and performance linkage (Campbell-Hunt, 2000; Allen and Helms, 2006). However, there were limited empirical studies examine the role of capabilities in business strategy and performance link especially in Malaysia hotel industry. Therefore, this study assessing the influence of competitor orientation (capability) on the differentiation strategy (business strategy) and organizational performance link among hotels in Malaysia. Specifically, does competitor orientation improve the performance of hotels that implementing differentiation strategy?

## LITERATURE REVIEW

**Differentiation strategy:** Differentiation strategy is relatively on offering superior, different and unique product or service to the customer and considers customers as their first priority (Hilman, 2009; Hlavacka *et al.*, 2001; Hyatt, 2001; Porter, 1980). The literatures showed that differentiation strategy emphasis more on creating value added products or services through the uniqueness which contrasting to the low cost strategy. Normally, hotel which is pursuing differentiation strategy charges higher price for the

products or services due to the uniqueness and quality features (Bordean *et al.*, 2010; Venu, 2001; Porter, 1980). Customer loyalty and difficult to imitate of uniqueness will create sustainable competitive advantage for the differentiators. In fact, differentiation strategy increases customers' interest in buying unique and quality products or services (Allen and Helms, 2006; Hlavacka *et al.*, 2001; Venu, 2001). For instance, currently hotels are utilising Wi-Fi as a tool of differentiation (Bordean *et al.*, 2010). Specifically, an organization which attempts to pursue a differentiation strategy tends to be more customer oriented (Frambach *et al.*, 2003).

**Customer orientation:** Zhou *et al.* (2009) stated customer orientation emphasized understanding of the target customers adequately in order to create superior value for them. Customer oriented organization makes more appealing offerings by adjusting the marketing mix with the knowledge of a customer's desire (Safarnia *et al.*, 2011; Porter, 1985). In addition, when an organization clearly recognizes the gap between customers' desire and market offerings, it can efficiently fill the gap with capabilities and resources (Slater and Narver, 1998).

Zhou *et al.* (2009) explained that customer orientation also enables organizations to develop a competitive advantage based on market differentiation. In addition, Slater and Narver (1998) and Day (1994) stated that customer orientation highly motivated to provide unique offerings to meet the needs of the target customers. Frambach *et al.* (2003) found that

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differentiation strategy clearly allied with customer orientation. The literatures showed that differentiation strategy and customer orientation have similarities in characteristic where both approaches emphasize on creating unique products or services in order to meet the customers' needs and wants as well as achieve customer satisfaction, superior performance and competitive advantage. The literatures clearly indicated similar characteristics between differentiation strategy and customer orientation, but very limited empirical evidence available relating to the association of above mentioned variables.

**Differentiation strategy, customer orientation and organizational performance:** Porter (1980) mentioned that generic strategies facilitate organization to achieve competitive advantage. Differentiation strategy enables organizations to concentrate more on customers' effectively and secure better performance (Hilman, 2009; Porter, 1980, 1985). Many studies were found significant association between differentiation strategy and organizational performance (Nandakumar *et al.*, 2011; Hilman, 2009; Seedee *et al.*, 2009; Allen and Helms, 2006).

The concept of customer orientation effects on business performance is a matter of extensive research and the association has been well established (Ellis, 2006; Kirca *et al.*, 2005). The relationship between differentiation strategy (business strategy) and customer orientation is built on consideration of market orientation as a functional level strategy (Frambach *et al.*, 2003). Prior literatures indicated that appropriate functional level strategies contributed to the effectiveness of business strategies (Slater and Olson, 2001; Porter, 1980, 1985). The extent of behavioral components of market orientation namely customer orientation depends on the business strategy implemented by the organization (Frambach *et al.*, 2003). Lukas (1999) revealed that market oriented behavior change systematically when organizations implemented various types of business strategies.

This study drew upon the framework based on dynamic capabilities perspectives that illustrated link of differentiation strategy (business strategy), customer orientation (capability) and organizational performance. Teece *et al.* (1997) referred dynamic as ability to renovate competences to attain consistency. Meanwhile, capabilities referred as proper adaptation, integration and reconfiguration of internal or external organizational skills, resources and functional competencies to match the necessity against the changing environment (Teece *et al.*, 1997). The theoretical framework of present study illustrated in Fig. 1.

The primary research question of this study was to determine the extent to customer orientation mediates the differentiation strategy in its relationship with organizational performance. Based on the gap in the literature, this study proposed several hypotheses.

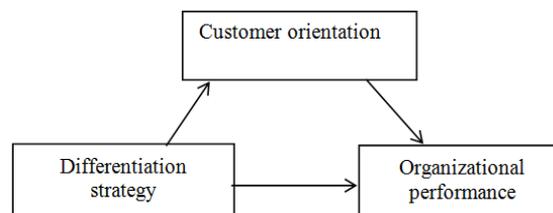


Fig. 1: Theoretical framework

- H1:** Differentiation strategy positively linked to customer orientation.
- H2:** Customer orientation positively linked to organizational performance.
- H3:** Differentiation strategy positively linked to organizational performance.
- H4:** Hotels pursuing a differentiation strategy mediates by customer orientation produce better organizational performance.

## MATERIALS AND METHODS

The data for this study have been collected from July 2013 to September 2013. The sample for this was chosen from the Directory of Ministry of Tourism and Culture, Malaysia.

A total of 475 surveys were distributed through mail and email to three to five star hotels and only 24% of, which was 114 returned. Of these, 114 respondents only 60 hotels opted for differentiation strategy and customer orientation. This study adapted instrument of Auzair (2011) which consist of seven questions. For customer orientation, instrument adapted from Grawe *et al.* (2009) which consist of five questions. While, organizational performance measured through balanced scorecard setting which consist of six items adapted from Kaplan and Norton (1996) and Hilman (2009). The items were measured through seven point scale. Table 1 indicates profile of respondents.

This study used SmartPLS 2.0 (M3) approach to assess the measurement model and structural model

Table 1: Profile of respondents (N = 60)

Variables	Frequency	(%)
Respondents' position		
Top management	31	52
Middle management	29	48
Hotel rating		
3 star	10	17
4 star	32	53
5 star	18	30
Hotel location		
City/town	44	73
Beach/island	16	27
Average occupancy rate		
51-60%	6	10
61-70%	18	30
71-80%	16	27
More than 80%	20	33
Years of operation		
Under 5 years	3	5
5-9 years	17	28
10-15 years	22	37
More than 15 years	18	30

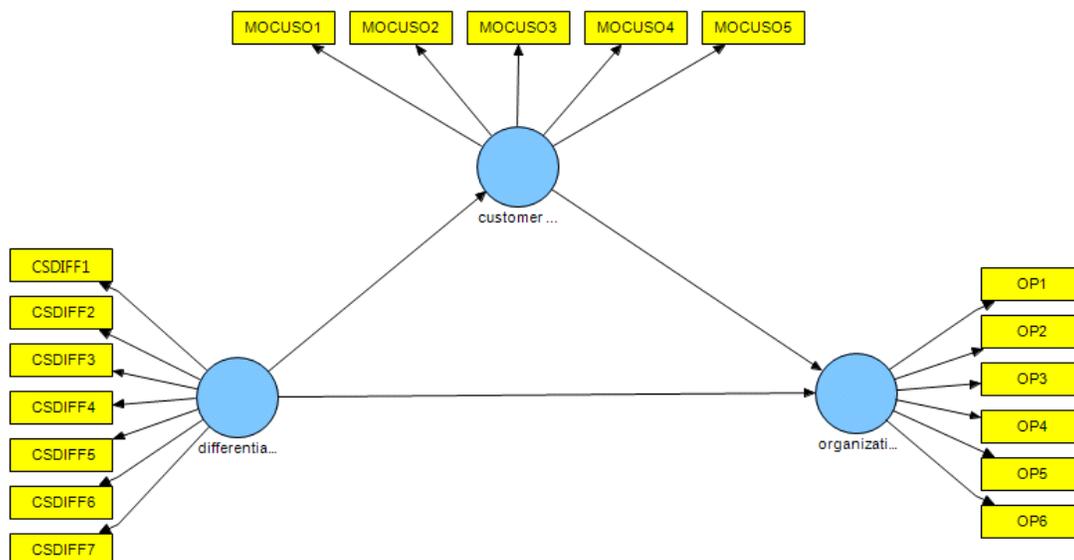


Fig. 2: Research model

Table 2: Loadings and cross loadings

	Differentiation strategy	Customer orientation	Organizational performance
CSDIFF1	<b>0.952</b>	0.928	0.942
CSDIFF2	<b>0.947</b>	0.932	0.929
CSDIFF3	<b>0.963</b>	0.936	0.935
CSDIFF4	<b>0.955</b>	0.944	0.936
CSDIFF5	<b>0.951</b>	0.924	0.935
CSDIFF6	<b>0.955</b>	0.922	0.925
CSDIFF7	<b>0.954</b>	0.924	0.940
MOCUSO1	0.899	<b>0.941</b>	0.893
MOCUSO2	0.943	<b>0.966</b>	0.951
MOCUSO3	0.949	<b>0.977</b>	0.940
MOCUSO4	0.944	<b>0.953</b>	0.943
MOCUSO5	0.949	<b>0.967</b>	0.935
OP1	0.965	0.972	<b>0.990</b>
OP2	0.966	0.977	<b>0.995</b>
OP3	0.964	0.976	<b>0.993</b>
OP4	0.962	0.969	<b>0.994</b>
OP5	0.962	0.968	<b>0.993</b>
OP6	0.967	0.976	<b>0.995</b>

Values in bold indicate items loadings

Table 3: Measurement model

Model construct	Items	Loadings	AVE	CR	$\alpha$
Differentiation strategy	CSDIFF1	0.952	0.909	0.986	0.983
	CSDIFF2	0.947			
	CSDIFF3	0.963			
	CSDIFF4	0.955			
	CSDIFF5	0.951			
	CSDIFF6	0.955			
	CSDIFF7	0.954			
Customer orientation	MOCUSO1	0.941	0.923	0.984	0.979
	MOCUSO2	0.966			
	MOCUSO3	0.977			
	MOCUSO4	0.953			
	MOCUSO5	0.967			
Organizational performance	OP1	0.990	0.986	0.998	0.997
	OP2	0.995			
	OP3	0.993			
	OP4	0.994			
	OP5	0.993			
	OP6	0.995			

Table 4: Discriminant validity

	Differentiation strategy	Customer orientation	Organizational performance
Differentiation strategy	0.953		
Customer orientation	0.950	0.961	
Organizational performance	0.952	0.960	0.993

Values in the diagonal signify the square root of the AVE whereas the off diagonal represents the correlations

(Chin, 1998; Ringle *et al.*, 2005). Figure 2 illustrated the research model of this study.

## RESULTS AND DISCUSSION

Confirmatory Factor Analysis (CFA) was verified the convergent validity, reliability and discriminant validity. Table 2 and 3 show all the items loading exceeded the minimum point of 0.50 (Gefen and Straub, 2000). The Composite Reliability (CR) values were above 0.70 (Requelme and Rios, 2010) and Average Variance Extracted (AVE) values meet the minimum criteria of 0.50 (Henseler *et al.*, 2009). All the values of Cronbach alpha were exceeding minimum of 0.70, which shows the measurement was valid, reliable and achieved goodness of measures. The following tables presented the findings of this study.

Table 4 shows the discriminant validity, the values of AVE was square rooted and testified with the inter-correlations of the constructs (Chin, 2010). All the values were greater than inter-correlations of each construct. So, the measurement model provides sufficient evidence in terms of convergent validity and discriminant validity.

Table 5 indicates findings of predictive power of the model, the R<sup>2</sup> showed that 96.5% of the organizational performance explained by the differentiation strategy and customer orientation. Furthermore, 95.1% of the customer orientation was

Table 5: Prediction relevance of model

Endogenous	R <sup>2</sup>	Cross validated redundancy	Cross validated communality
Customer orientation	0.951	0.872	0.869
Organizational performance	0.965	0.913	0.971

Table 6: Summary result of model constructs

Model construct	Items	S.E.	t-value
Differentiation strategy	CSDIFF1	0.001	105.455
	CSDIFF2	0.001	101.200
	CSDIFF3	0.001	110.550
	CSDIFF4	0.002	96.689
	CSDIFF5	0.002	99.427
	CSDIFF6	0.001	107.600
	CSDIFF7	0.001	106.920
Customer orientation	MOCUSO1	0.003	79.529
	MOCUSO2	0.002	102.719
	MOCUSO3	0.002	101.198
	MOCUSO4	0.002	85.263
	MOCUSO5	0.002	92.472
Organizational performance	OP1	0.000	366.499
	OP2	0.000	415.098
	OP3	0.000	447.019
	OP4	0.000	417.431
	OP5	0.000	352.705
	OP6	0.000	430.481

described by the differentiation strategy. So, both R<sup>2</sup> values considered substantially showing the power of variables (Cohen, 1988).

In addition, the result of cross validated redundancy and cross validated communality obtained through blindfolding procedure. Present model has the predictive quality due to the values of cross validated redundancy were greater than zero (Fornell and Cha, 1994). The result shows that the cross validated redundancy values were 0.872 and 0.913. The result supported that the model has adequate prediction value.

In Table 6, all the t-values exceeded 1.96, significance level; hence all the measurement items were significantly clarifying the research construct.

The study tested Global Fit measure (GoF) result was 0.949 (average of R<sup>2</sup> = 0.958 and average of AVE = 0.939) exceeded the least large value of 0.36 and specified that the GoF value large sufficient to backing the justification of the model (Aker *et al.*, 2011; Tenenhaus *et al.*, 2005):

$$GoF = \sqrt{AVE \times R^2}$$

After the assessment of measurement model, the study test the hypotheses through PLS Algorithm and Bootstrapping. The outcomes were stated in Fig. 3 and 4, Table 7 and 8.

As showed in Fig. 3 and 4 and Table 7 differentiation strategy has positive and significant effect on customer orientation ( $\beta = 0.975$ ,  $t = 191.439$ ,  $p < 0.01$ ). The result also show that customer orientation has positive and significant effect on organizational performance ( $\beta = 0.314$ ,  $t = 2.984$ ,  $p < 0.01$ ).

Likewise, differentiation strategy positively related to organizational performance ( $\beta = 0.674$ ,  $t = 6.509$ ,  $p < 0.01$ ). As a result, these outcomes supported the propositions of this study.

The researchers used bootstrapping to assess the mediating effect of customer orientation of differentiation strategy and organizational performance. The findings in Table 8 display that differentiation strategy directly and indirectly affects the organizational performance ( $\beta = 0.980$ ,  $t = 252.064$ ,  $p < 0.01$ ) and ( $\beta = 0.306$ ,  $t = 2.782$ ,  $p < 0.01$ ). Additionally, this study tested the Variance Accounted for (VAF) through formula of Shrout and Bolger (2002):

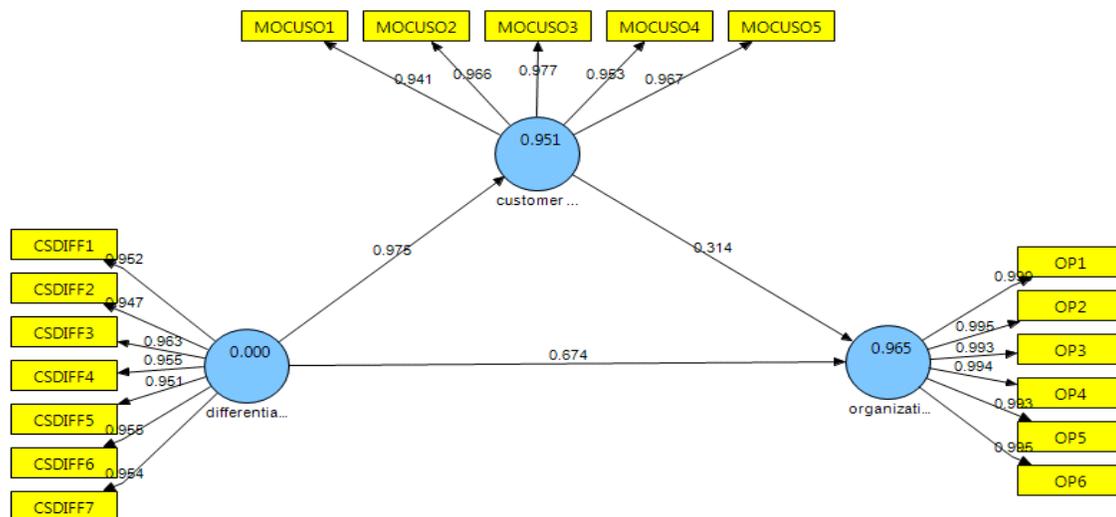


Fig. 3: Result of path coefficient

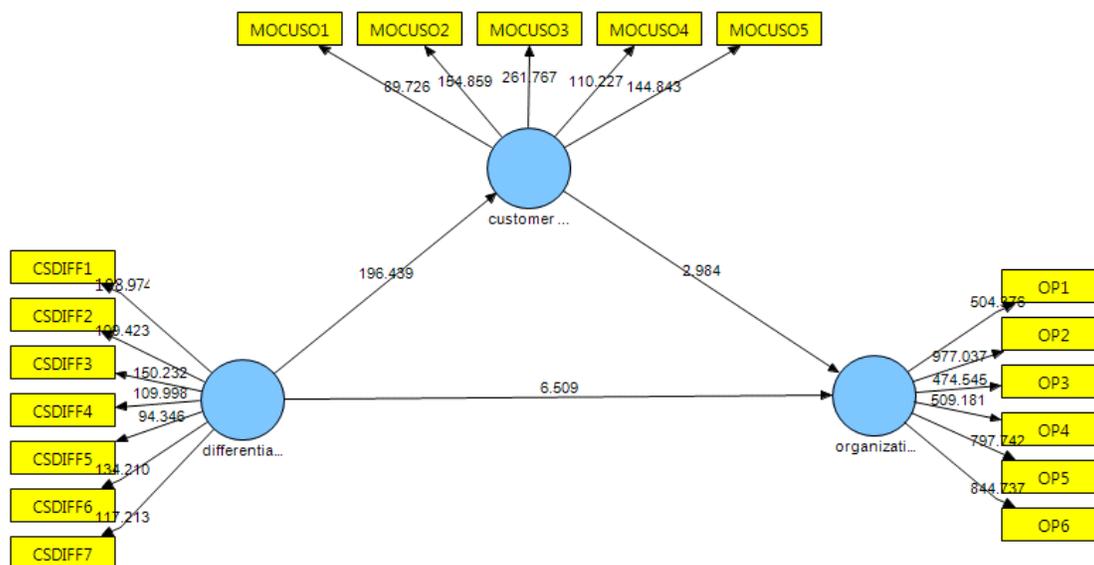


Fig. 4: Result of path analysis t value

Table 7: Result of hypothesis testing (1000 resamples)

Hypothesis	Relationship	$\beta$	S.E.	t-value	Decision
H1	Differentiation strategy is positively linked to customer orientation	0.975	0.005	191.439**	Supported
H2	Customer orientation positively linked to organizational performance	0.314	0.105	2.984**	Supported
H3	Differentiation strategy positively linked to organizational performance	0.674	0.104	6.509**	Supported

\*\* : p<0.01; \* : p<0.05

Table 8: Result of mediation analysis (1000 resamples)

No	Relationship	Path coefficient			S.E.	t-value	Decision
		axb	c	c'			
H4	Hotel pursuing differentiation strategy mediates by customer orientation produce better performance	0.306**	0.980**	0.674**	0.110	2.782**	Partial mediation

\*\* : p<0.01; t-value greater than 2.33

$$VAF = a.b/a.b + c$$

In a nutshell, customer orientation as a partial mediator between differentiation strategy and organizational performance with 31% of Variance Accounted for (VAF). Thus, this study also supported H4.

### IMPLICATIONS AND CONCLUSION

The main aim of this study was to test the effect of differentiation strategy on performance with customer orientation on hotel industry of Malaysia. The result established the influence of differentiation strategy on organizational performance and customer orientation. These outcomes were backing the propositions of this study by providing enough evidence on importance of implementing differentiation strategy and customer orientation in producing better performance.

Moreover, the results confirmed that the partial mediation of customer orientation in differentiation strategy and organizational performance nexus. This implies that implementation of differentiation strategy can directly affect the performance and indirectly affect through execution of customer orientation. In short, the findings have noted that differentiation strategy and

customer orientation is essentials in determining superior performance.

The present study has several theoretical and practical implications. This, study denoted the theoretical study about differentiation strategy (business strategy), customer orientation (capability) and organizational performance of hotel industry. There were very limited studies conducted on this perspective. Without doubt, the findings provide valuable information to hotel managers regarding the implementation of differentiation strategy and customer orientation. Knowledge that gained from this study could assist the managers to make strategic decisions regarding their organizational strategies and capabilities to shape better performance. Future research may perhaps integrate and investigate other potential mediators or moderators to expand the strategy and performance linkage.

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