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THE CONSEQUENCES OF RELATIONALISM ON PROFITABILITY AND GROWTH: DEVELOPING A THEORETICAL FRAMEWORK AND PROPOSITIONS

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Introduction

Relationalism as a marketing strategy has recently aroused a lot of interest among marketing researchers and practitioners. Generally, it has been stated that '21st century marketing' is poised for revolutionary changes in its organizational context as well as in its relationship with inter-organizational actors. The proposed changes are underpinned by the emergence of a network society, in which business success is argued to be increasingly dependent on alliance building and resource sharing (Castells, 1996). Achrol and Kotler (1999) argue that, driven by a dynamic and knowledge-rich environment, hierarchical organizations are disaggregating into a variety of network forms, applying increasingly cooperative marketing strategies.

Consequently, an extensive and heterogeneous global literature has emerged on the relationship and network point of view to marketing (e.g. Coviello, Brodie, Danaher & Johnston, 2002; Anderson, Håkansson & Johanson, 1994; Morgan & Hunt, 1994). A starting point for the relational approaches in marketing research is the proposition that business relationships may be situated in a 'marketing strategy continuum' (Grönroos, 1994) or a 'range of marketing relationships' (Webster, 1992). At one end of the continuum is the purely transactional market relationship, in which the customer and the seller focus on short-term economic exchange. At the other end, some authors place the mutually beneficial, long term -oriented business relationship with cooperative interaction strategies and a host of accrued relationship assets such as trust and commitment (Grönroos, 1994). Other researchers go even further and see strategic alliances and vertical integration as the ultimate, predominantly hierarchical modes of relational governance (Webster, 1992). The mentioned marketing strategy continuum can be related conceptually to the issue of how economic activities are organized through different modes of governance ranging from markets to hybrids to hierarchies (Williamson, 1996). In this paper, however, we limit our attention to relational marketing strategies and disregard the more transactional and hierarchical governance modes.

However, we argue that the nearly univocal relational approach to marketing should be approached with some caution. The key message in a host of relationship marketing (RM) literature is that regardless of the industry and the nature of their customer relationships, companies should strive towards the creation of close and bonded relationships with their key customers. Moreover, information and communications technology (ICT) -assisted, explicit customer relationship management (CRM) programs and systems should be created to manage the customer relationship base more systematically. We think that this basic assumption is problematic, since none of the governance modes has been proven to be superior *per se*. There is little empirical evidence that close relationships to key customers would eventually directly increase the profitability of a company. On the other hand, we also do not know much about the consequences of relationalism to growth. One might even assume that extreme relationalism suppresses growth since the scarce resources of the firm are tied to serving a few close customer relationships. In general, firm profitability and growth are the key outcomes investors essentially demand from a firm. However, there is little evidence as to how much relationalism manifested in a firm's marketing practices and its accrued relationship assets actually explains them (Shrivastava, Shervani & Fahey, 1999). Moreover, it is also unknown how much the marketing capability of the firm and environmental conditions influence the objectives of firm profitability and growth.

When it comes business-to-business marketing, it is easy to accept the basic postulate of much of business and industrial marketing research that relationships and networks act as the principal governance system within which most inter-organizational exchange takes place. A lot of empirical research in different industries has clearly validated this assumption (e.g. Turnbull, Ford & Cunningham, 1996; Håkansson and Snehota, 1995; Turnbull & Valla, 1986; Håkansson, 1982). On the other hand, the question about the relationship between relationalism and profitability and/or growth can also be raised in the business-to-business marketing context.

Consequently, we have set the research questions of the focal study as follows:

(1) In a population of business-to-business marketing firms, what is the extent of firms that apply relational marketing practices and have been able to accumulate a high level of relationship assets?
(2) What is the relationship between firm profitability and relationalism manifested in the marketing practices and accrued relationship assets of a firm? To be more specific, is there a positive relationship between the relational orientation in a firm's marketing practices, the high level of relationship assets, and the profitability of a firm?
(3) What is the relationship between firm growth and relationalism manifested in the marketing practices and accrued relationship assets of a firm? To be more specific, is there a negative relationship between the relational orientation in a firm's marketing practices, the high level of relationship assets, and the growth of the firm in terms of overlooked opportunities for scalable business?
(4) What is the intermediating role of marketing capability on the one hand and environmental conditions on the other in answering research questions (2) – (3)?

In our empirical study, we have limited our attention to business-to-business marketing firms in the Finnish metal and electrotechnical industry, represented by the almost 1500 member firms of the association of the Technology Industries of Finland, founded in 1903.

Theoretical Framework and Propositions

The relational approaches in marketing research can be categorized into at least three, partly overlapping conceptual perspectives: Anglo-American Relationship Marketing (e.g. Dwyer, Schurr & Oh, 1987; Webster, 1992; Morgan & Hunt, 1994), the Nordic School of Services and Relationship Marketing (e.g. Grönroos, 1994; Gummesson, 1999) and the work of the International Industrial Marketing and Purchasing (IMP) Group (e.g. Håkansson, 1982; Håkansson & Snehota, 1995). Despite differences in conceptual language and methodological orientation, central viewpoints in all of the three perspectives focus on the creation of cooperative and trust-based relationships with customers and other stakeholders, on a broad conceptualization of the notion of (both 'external' and 'internal') marketing backed by inter-unit collaboration within the company, and on building and leveraging firms' and networks' key resources and capabilities through inter-organizational cooperation and joint technological development.

As stated, a lot of business and industrial marketing literature has put long-term oriented, cooperative and bonded business relationships into research focus. Empirical field research - mainly in-depth case studies - has identified them as the dominating governance structure in most industrial business settings (Håkansson, 1982; Turnbull & Valla, 1986). At least implicitly, it seems to be assumed that a relational orientation in the key business relationships of a firm also has a positive effect on firm performance. On the other hand, studies that examine the explanatory factors of profitability at the level of individual business relationships are scarce (cf. Storbacka, 1994). The dynamics and interrelationships between the profitablity of individual business relationships and the profitability of the entire customer relationship portfolio of the firm also remain ambiguous. Existing customer relationship portfolio management models give only modest indications to this issue (Fiocca, 1982; Turnbull & Zolkiewski, 1996). Consequently, no large-scale empirical studies have aimed at establishing a link between relationalism as a marketing strategy and the financial performance of an industrial firm.

When the concept of firm performance is extended beyond financial considerations to issues such as firm or market share growth, studies on the marketing strategy – performance relationship have primarily been conducted outside the relational paradigm of marketing research. The link between the central characteristics of the marketing strategy of a firm and its performance has been investigated in the stream of research concentrating on market orientation (Han, Kim & Shrivastava, 1998). The market orientation literature has primarily focused on the strength of the market orientation–performance relationship (Kohli & Jaworski, 1990). Potential environmental moderators such as competitive intensity, market turbulence, and technological turbulence have also received a lot of attention (Slater & Narver, 1994a). More recent studies have identified knowledge and innovation as central value-creating capabilities that underpin the market orientation–performance relationship (Day, 1994; Hurley & Hult, 1998).

The primary contribution of our study is to aim at establishing a relationship between relationalism as a marketing strategy of an industrial business-to-business firm and its aggregate performance manifested in its profitability on the one hand and turnover growth on the other. The marketing capability of the firm and environmental conditions are identified as the central moderating factors underpinning the proposed setting. Our theoretical model on the relationship between relationalism in a firm’s marketing strategies and profitability and growth is illustrated in Figure 1. In general, we define the relationalism of a marketing strategy in terms of the cooperativeness of marketing practices and the level of accrued relationship assets within key business relationships in a specific business-to-business marketing context.

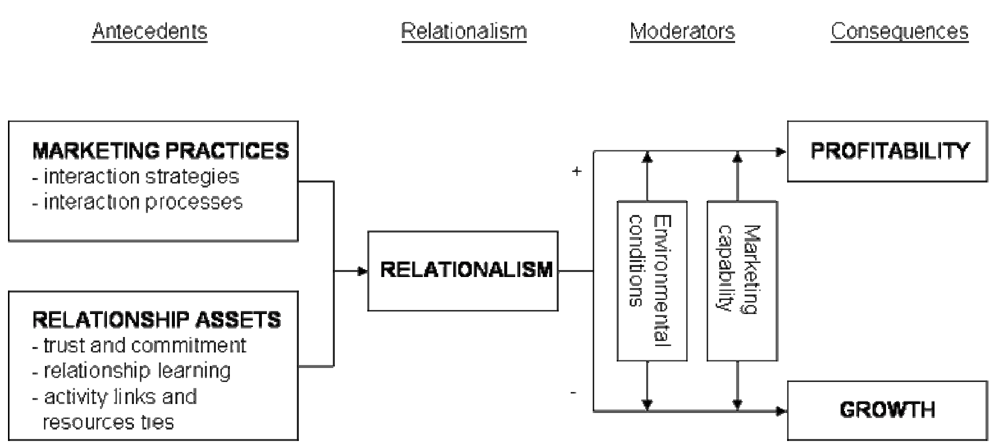

Figure 1. The Consequences of Relationalism on Profitability and Growth.

In our theoretical model, the marketing strategy of a firm is divided into marketing practices and relationship assets. On the basis of our analysis of these variables, we are able to define the extent to which a firm's marketing strategy can be characterized as relational. By examining interaction strategies and processes, we are able to define how relational a firm's marketing practices are on a continuum from purely transactional, market-based marketing strategies towards increasing cooperativeness and inter-organizational bonding (Webster, 1992; Grönroos, 1994). Moreover, the level of accrued relationships assets also manifests the extent to which a firm's marketing strategy can be assessed as relational. By the means of the model, we examine the extent to which relationalism as defined above explains firm profitability and/or growth. The marketing capability of the firm and environmental conditions are seen as the moderating factors to the relationship between relationalism and the mentioned consequences. In the following, the components of our theoretical model and the linked propositions are explained in detail.

Main Propositions Related to the Theoretical Framework

When it comes to relationships between the relationalism of marketing strategy, profitability and growth it is proposed as follows.

- **A high degree of relationalism in the marketing strategy of a firm is positively related to firm profitability. Therefore, there is a positive relationship between the relational orientation in a firm's marketing practices, the high level of relationship assets, and the profitability of a firm.**
- **A high degree of relationalism in the marketing strategy of a firm is negatively related to firm growth. Therefore, there is a negative relationship between the relational orientation in a firm's marketing practices, the high level of relationship assets, and the growth of the firm in terms of overlooked opportunities for scalable business.**

Marketing Practices and the Related Propositions

The marketing practices of the firm have received research interest in recent marketing research (Coviello et al., 2002; Coviello, Brodie & Munro, 2000). Coviello et al. (2002) offer a fourfold categorization of a firm's marketing practices into transaction marketing, database marketing, interaction marketing and network marketing. Furthermore, they argue that their conceptualization focuses on marketing practice and allows for a better understanding of how firms relate to their markets and their relative emphasis on transactional and/or relational exchange. More specifically, they measure marketing practices through a framework focusing on the purpose of exchange, nature of communication, type of contact, duration of exchange, formality of exchange, managerial intent, managerial focus, managerial investment, and managerial level.

In our study, however, we operationalize the marketing practices of a firm through the adopted interaction strategies and the nature and state of the key interaction processes between the buyer and the seller. In studying interaction strategies, we adopt the threefold classification by Campbell (1985) of a firm's interaction strategies into competitive, cooperative and command postures, representing the traditional continuum from market to hybrid to hierarchy (Williamson, 1996). According to Campbell, the nature of a buyer-seller relationship result from the interplay of the seller's and the buyer's interaction strategies which are themselves determined by a variety of other factors (such as industry, company, individual and product –related factors). In consequence, the interaction strategy of a selling firm in a clearly dominant position over the buyers (pure seller's market or captive market) can be most often assumed to be a command strategy. On the other hand, in a situation where selling and buying companies are dependent on each other (domesticated market), the interaction strategy of a marketer is often cooperative in its nature (Arndt, 1979). Sometimes the seller's interaction strategy can also be cooperative when it sells to few dominating buyers (subcontract market). However, in a situation of a dominating buyer, the seller's interaction strategy can also be competitive (buyer's market) (Campbell, 1985). In our study, we exclude the transactional market relationships (with competitive interaction strategies) and hierarchical relationships (with command interaction strategies) from the relationalism construct. **Thus, we propose that marketing strategy is considered to be relational only if a company has developed long-term oriented relationships with its key customers, in which both parties conduct primarily cooperative interaction strategies.**

Interaction strategies as defined above can be seen as relationship structures steering the interaction process between the seller and the buyer. The interaction process can be divided into three basic processes of exchange, coordination and adaptation (Möller & Wilson, 1995). Exchange processes refer to episodes comprising the transfer of some value between two parties. In more enduring relationships, the actors do not usually focus on just one single deal (discrete transaction). Instead, they look for potential ways to develop the relationship on a long-term basis. The term relational exchange refers to interlinked exchange episodes embedded into interactive relationships that are characterized by economic, social, legal, technical, informational and procedural bonds (Håkansson & Snehota, 1995). In other words, relational exchange is mostly governed by the structural elements of a business relationship rather than, for instance, by open market forces. **Hence, if exchange between two interacting parties is reciprocal in its nature and if it occurs repeatedly and relatively regularly between the parties, the seller's marketing strategy is proposed to be relational.**

Adaptation processes relate to how interactants modify resources or ways of operating in order to benefit more from a business relationship. Consequently, adaptations may be made in either the elements exchanged or in the process of exchange, for example in products or services, in financial arrangements, and in information routines or social relations (Håkansson, 1982; Johanson & Mattsson, 1987). **Thus, if the state of adaptation is high (participants are willing to make different kinds of adaptations), the seller's marketing strategy is proposed to be relational.**

Coordination processes are those by which the interacting organizations harmonize their actions and decisions in order to achieve the expected benefits from the business relationship. Such processes include decisions on the terms of exchange between participant organizations, norms and procedures concerning how the exchange processes are to be carried out, and ad hoc responses to conflicts and relevant environmental changes (Möller & Wilson, 1995). Consequently, coordination refers to the development and use of mechanisms that facilitate the conduct and control of exchange processes. **Consequently, if the coordination of activities between two business parties is well developed, the marketing strategy is proposed to be relational.**

Relationship Assets the Related Propositions

Relationship assets are conceptualized here in terms of actor bonds, activity links, resource ties, inter-organizational trust, commitment, and climate for relationship learning. A well-performing relationship exists if both the customer and the supplier are satisfied with the relationship's effectiveness (i.e., doing the right things) and efficiency (i.e., doing things the right way). The effectiveness of a relationship can be determined by whether the personnel who interact perceive the relationship as worthwhile, equitable, productive, and satisfying (Ruekert & Walker, 1987; Selnes & Sallis, 2003). Thus, the purpose of relationship assets is to enhance the effectiveness and efficiency of the business relationship and in the end, the overall performance of the interacting companies as a whole.

According to Håkansson and Snehota (1995), the primary purpose of a business relationship is to connect a customer's buying activities with a supplier's selling activities and services. A relationship can expand in scope and include other activities as well, such as joint R&D, joint marketing, joint quality control, and so forth. This means that different kinds of bonds may develop between the parties to the relationship. As interorganizational relationships evolve, they tend to become more complex in terms of interlinked operational activities across organizational boundaries and operational units. Activity links refer to administrative, commercial and other activities of an organization that can be connected in different ways to those of another organization. Activity links form wider activity chains where activities performed by a company build on activities performed by others and enter into those of yet others (Håkansson & Snehota, 1995). Within a relationship, different heterogeneous resource elements of the business parties can be tied together. Thus, complex and heterogeneous resource ties may emerge between organizations (Håkansson & Snehota, 1995). **Hence, it is proposed that the scope and tightness of actor bonds, activity links and resource ties between the two business parties reflect the relationalism of their marketing and purchasing strategies.**

The above-mentioned complexity of interorganizational relationships is also expected to drive the emergence of different kinds of formal (e.g. contracts) and informal relationship assets (e.g. trust and commitment). It is quite obvious that formal and informal assets are not mutually exclusive, but complement each other. However, the significance and importance of different kind of informal relationship assets has been widely acknowledged in the interorganizational relationship literature. In our study, the concepts of trust, commitment and climate for learning are the main elements of relational assets. The concept of trust is defined here as the "perceived ability and willingness of the other party to behave in ways that consider the interests of both parties in the relationship". Trust exists in a relationship if parties have mutual confidence in each other's reliability and integrity. (Morgan & Hunt, 1994) It is often stated that trust is a central facilitator of effective cooperative behavior in supplier-buyer relationships (e.g., Dwyer, Schurr & Oh, 1987; Selnes & Sallis, 2003). It is often argued that high level of trust reduces reliance on formal control mechanisms, thus reducing transaction costs (Williamson, 1996). It has been suggested that trust is the strongest governance mechanism in developing collaborative relationships (MacNeil, 1980; Dyer & Singh, 1998; Selnes & Sallis, 2003). Commitment is the other central element in our construct of relationship assets. Following Moorman, Deshpande & Zaltman (1993), we define commitment as an enduring desire to maintain a valued relationship. **Hence, we propose that the high level of trust and commitment between two business parties reflects the relationalism of the marketing and purchasing strategies.**

Through interaction process, the two business parties are expected to gradually develop trust and dependence, which again fosters a commitment to collaborate and share information. The desire to collaborate and share information creates a climate for relationship-learning activities, which is expected to affect relationship performance positively (Selnes & Sallis, 2003; also Dwyer, Schurr & Oh, 1987; Morgan & Hunt, 1994). **If the business parties perceive the relationship as a**

platform for organizational learning, their marketing and purchasing strategies can be proposed to be relational.

Marketing Capability and the Related Propositions

A host of marketing research has recently focused on whether, when and how successful marketing-related activities (i.e. customer and market orientation) as a core capability of a firm or a group of firms lead to sustainable competitive advantage. Studies in this emerging research area that capitalize on earlier research on both marketing strategies (e.g . Jüttner & Wehrli 1994) and market orientation (Kohli & Jaworski, 1990; Slater & Narver, 1994b) have been labeled under the general notion of marketing capability (see e.g. Tuominen, Möller & Anttila 1999; Möller & Anttila, 1987).

In the related literature, a market orientation typically characterizes a company's disposition to deliver superior value to its customers. This requires an organization-wide commitment to continuous information gathering and coordination of customer needs, competitors' capabilities, and the provisions of other significant market agents and authorities (Slater & Narver, 1994b). The result is an integrated organizational effort, which gives rise to superior firm performance (Kohli & Jaworski, 1990).

Consequently, marketing capability refers to a nexus of market and customer-related resources in defining a firm's strategy and designing its intra- and inter-organizational business processes. It consists of teams of resources related to a firm's abilities in managing (1) customer linking and channel bonding, (2) market sensing, targeting, and positioning, (3) functional integration and coordination within the firm, and (4) the design of business processes and systems. The firm-internal and external elements of marketing capability are mutually intertwined (Tuominen et al. 1999).

Marketing capability can be expected to act as a strong moderator of the relationalism-business performance linkage. In our study, the concept of marketing capability refers to the capability of designing and operating relevant structures, processes, and systems by means of which a company can successfully accomplish its marketing tasks, or in this case, properly conduct the relational marketing strategy. Resources and capabilities that centrally underpin the marketing capability of a firm are divided into human (number and competence of marketing and sales personnel) and organizational (marketing-related organizational structures, processes and systems) component. **Thus, we propose that the high level of marketing capability increases the positive effect of relationalism on company profitability. On the other hand, the high level of marketing capability also decreases the negative effect of relationalism on company growth.**

Environmental Conditions and the Related Proposition

In addition to internal moderators presented above, it can be expected that certain external environmental contingencies moderate (i.e., increase or decrease) the strength of the relationship between relationalism and business performance. In the related literature, several environmental factors are mentioned. Campbell (1985) proposed six variables linked to the external environment of a company: industry concentration, the number of competitors, the intensity of competition, the rate of technical change, and industry traditions and norms. Kohli and Jaworski (1990) identified market turbulence, i.e. changes in the composition of customers and their preferences, technological change and the degree of competition in an industry as the key environmental factors influencing the relationship between the market orientation of a firm and its business performance.

The literature identifies environmental uncertainty as an important motivator for forming close collaborative relationships with customers. Environmental uncertainty, in turn, refers to the forces in the environment over which the parties to a business relationship have little or no control, for instance changes in end-user buying behavior, competition, and technology (Keysuk, 1999). According to resource dependence theory (Pfeffer & Salancik, 1978), an organization builds relationships in response to environmental uncertainty and organizes its resources accordingly. In line with the argument developed in the stream of research on organizational adaptation (e.g. Child, 1972), companies are motivated to engage in relational marketing strategies in order to cope with the consequences of environmental uncertainty (e.g. Mentzer, Min & Zacharia, 2000). Companies not only adapt passively to changing environments but through collaboration and joint learning, strategically develop competitive advantage (Selnes & Sallis, 2003; Dyer & Singh, 1998).

In our study, environmental conditions essentially moderating the relationship between relationalism and performance focus on uncertainty which stems from customer market turbulence, technological turbulence and the intensity of competition (Kohli & Jaworski, 1990). **Hence, it is proposed that the greater the uncertainty linked to environmental conditions, the stronger the relationship between relationalism and profitability.**

Performance

The performance of a firm is a multifaceted construct that can be approached from different perspectives such as financial outcomes (e.g. profit, ROI, cash flow), market-based outcomes (e.g. market share, customer retention), and effectiveness indicators (e.g. output/resources measures) (Venkatraman and Ramanujam, 1986; Varadarajan and Ramanujam, 1990). Concepts of business performance are generally centered on either efficiency or effectiveness. Since business enterprises must eventually be profitable to survive, financial efficiency in some form (e.g. gross margins, net margins, ROI, relative profitability, etc.) is typically used as an ultimate outcome when performance is included in research (Coviello et al., 2002). However, there are also definitions of firm performance that center on, or include, effectiveness. For instance, the value that is delivered to customers, the level of sales, the level of sales growth, market share, relative market share, capacity utilization of price premium are all effectiveness-oriented concepts that represent firm performance (Sandvik & Sandvik, 2003). In this research, business performance is divided into profitability and growth. In finance theory, profitability and growth are the key indicators of business performance, valued by investors. In our study, profitability refers to operating profit and growth to the sales (turnover) growth of a company.

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