

**IS MARKET ORIENTATION DRIVING RELATIONAL CAPABILITIES DEVELOPMENT?
THE CASE OF RUSSIAN INDUSTRIAL FIRMS**

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Abstract

The paper investigates the role of market orientation as a driver of the development of relational capabilities in Russian firms. The study tests the role of market orientation not only as a driver of business performance, but mainly as a platform for the creation and enhancement of a firm's embeddedness in relational structures through developing organizational capabilities and adapting internal processes within a dynamically changing environment.

The results of the study demonstrate existing differences in the role of market orientation subcomponents – customer orientation, competitor orientation and interfunctional coordination – in determining the level of relational capabilities and firm performance of the firms in the sample. We confirm the positive and significant impact of the level of relational capabilities on firm performance indicators – growth, adaptability and customer satisfaction.

Keywords: market orientation; relational capabilities, Russia, industrial markets

1. Introduction

This study is about the impact of market orientation on the development of relational capabilities and performance outcomes. Our objective is to investigate existing attitudes of firms in Russia towards the systematic development of organizational capabilities, aimed to support and enhance customer relationships and interactions. Inter-firm cooperation has become a means for competing on both national as well as global levels. Cooperation and collaboration contributes to the evolution of business networks which have recently attracted increasing research interest (Achrol, 1997; Uzzi, 1997; Araujo & Mouzas, 1997; Achrol & Kotler, 1999). The advantages that a firm can gain from existing cooperation and network effects depends significantly on the tuning of that firm's ability to coordinate and manage within relationships (Ford et al., 2003). In business-to-business markets, relational capabilities not only serve as a guarantee of mutual understanding and satisfaction in customer relationships, but are also a source of relevant professional and market knowledge, strategic flexibility and effective process configuration. Research on relational capabilities of industrial companies has attracted serious attention (Dyer & Singh, 1998; Day & van den Bulte, 2002; Jacob, 2006; Paulraj et al, 2008), however, conceptually the field is still rather fragmented.

Developing relational capabilities requires an understanding of the market, the nature of customer needs and values, and also the customer's production process and value chain (Narver and Slater, 1990). This notion correlates closely with the concept of a market orientation of the firm, adding a relational perspective to the firm-market alignment. From the interaction and network perspective, market orientation can be seen as a pre-requisite for creation of a firm's ability to initiate, develop and maintain successful interactions with business partners (Zhao & Cavusgil, 2006). This issue is even more complex in relation to firms in developing or transitioning markets, such as Russia, where marketing is still a developing concept in the managerial practice, and managing interfirm relationships is also strongly influenced by the transition process, the existing business culture, and the interpersonal relationships that have traditionally been seen as important in the Russian context (Salmi, 2004, Jansson et al., 2007; Johanson, 2008). Problems of managing relationships in markets in transition have started to gain increased attention (Salmi, 2004; Jansson et al., 2007), while there are just a few examples of research on the comparison of relationship patterns in developed and developing markets (Hitt & Borza, 2000).

Specifically, our research aims to analyze whether organizational routines and practices exist which are underpinning the interpersonal relationships that are traditional for the Russian economy. Thus, the study aims to fill important gaps in the existing research literature. Firm's ability to manage inter-firm relationships has attracted considerable research attention over the last decade (Dyer & Singh, 1998; Sivadas & Dwyer, 2000; Day & Van den Bulte, 2002; Jacob, 2006; Möller & Törrönen, 2003). Notwithstanding this research attraction, there is still no integrated conceptualization of the relational capabilities construct as well as the underlying approaches to its operationalization. Existing research reflects particular facets of the construct and its importance, with some agreement that the common element is the implication that higher level of relational capabilities development should have a positive impact on firm performance and competitiveness (Dyer and Singh, 1998). Moreover, no research has been conducted on development of systematic relational capabilities of industrial firms in transitional economies and drivers of their development. Researchers often take as a starting point for analysis of transition economies is level of marketing integration in the business processes

and acceptance of market orientation (Hooley et al 2000). But no research evidence exists whether development of market orientation leads to further introduction of organization-wide capabilities aiming better market-sensing or customer-linking, as discussed by Foley and Fahy (2009). Our main research questions thus deal with the following aspects:

- 1) Does the level of market orientation have an impact on the performance of industrial firms in Russia?
- 2) Are market oriented industrial firms also more oriented towards the systematic development of relational capabilities?
- 3) Will systematic development of relational capabilities by Russian industrial firms have a positive impact on business performance?

The paper is structured as follows: firstly, we present a discussion of the most recent perspectives on the role of market orientation in transitional economies. Furthermore, we will elaborate on the nature and scope of relational capabilities. We will then introduce our research method and present empirical findings of a recent study on market orientation and relational capabilities in Russia. Finally, we discuss the role of market orientation as a facilitator of relationship development for business-to-business firms in transitional economies. A discussion of limitations and further research will conclude our argument.

2. Relational Capabilities and Market Orientation in Transition Economies

2.1 Understanding Relational Capabilities

In trying to define relational capabilities we adopt the classic definition of dynamic capabilities (Teece, 2000) as the firm's ability to sense and then to seize new opportunities, to reconfigure and protect knowledge assets, competences, and complementary assets and technologies, to achieve sustainable competitive advantages on the base of customer relationship management. In association with definition of marketing capabilities (Weerawardena & O'Cass, 2004) it is possible to propose a definition of relational capabilities as integrative processes designed to apply the collective knowledge, skills, and resources of the firm to the relationship-related needs of the business and towards better customer integration. Similarly, Dyer and Singh (1998) define relational capability as the competitive advantage from the ability to forge, develop, and govern partnerships. This is based on Day's (1994) understanding of customer-linking capability as a capability to create and manage close customer relationships, requiring a higher level of coordination, participation in joint activities and close communication between partners.

Relational capabilities are the result of a gradual process by which the firm decides to broaden its vision of relationships in order to obtain additional benefits from extremely close, long-term relationships between companies and improve their competitive position in the market (Webster, 1992). In this case interfirm cooperation is supported by the creation of specific capabilities, which contribute to the development of inter-organizational teams and integrated-operating routines, as well as facilitation of information and knowledge exchange (Rodríguez-Díaz & Espino-Rodríguez (2006). This approach to conceptualizing relational capabilities relies strongly on the cooperation culture developed among partners to leveraging their ability to manage interaction, and creating positive impact on relationship success (Kale et al., 2000).

One of the main distinctive features of relational capabilities is that by going outside of the marketing function and belonging to cross-functional firm capabilities, they require alignment of the whole organization and thereby influence firm performance (Grant, 2004).

Sivadas and Dwyer (2000) develop a construct of "cooperative competency, derived from related concepts of mutual adjustment, absorptive capacity, and relational capability is posited as the key factor affecting new product development success, regardless of whether it is an intra- or interfirm endeavor" (p. 33). Cooperative competency is used by the authors to refer to the midrange variable composed of three interrelated facets: trust, communication, and coordination, and represents the ability "of interacting units to adjust mutually" (p. 33). Contrasting with this, Lorenzoni and Lipparini (1999) focus on the organizational ability to interact with other companies (relational capability in the narrow sense) that accelerate the lead firm's knowledge access and transfer with positive effects on company growth and innovativeness. Development of relational capability is seen as a reaction of the firm to increased uncertainty, leading not to absorption of uncertainty within the organization but rather to an increase in the reliance on external partners (Lorenzoni and Lipparini, 1999). As Ma, Yao and Xi (2008) argue, a network in which a firm is embedded is a critical resource for the firm's competitive capabilities. The firm's ability to integrate these resources in the form of knowledge acquisition is one of the most crucial relational capabilities (Lorenzoni and Lipparini, 1999). Development of relational capabilities thus leads not only to the creation of superior relationship benefits, but also to some relational sacrifices in form of specific investments and adaptations. These investments and adaptations can substantially increase fit between partners in relationships and facilitate cooperation (Hallén et al., 1991). As perceived from the customer's side, the development of relational capability by suppliers will result in an improved ability to run individually-tuned projects and create customized solutions (Jacob, 2006). Thus

Möller and Törrönen (2003) stress the fact that only core values can be created on the basis of production capabilities. The more future-oriented and innovative the firm's strategy (i.e. less core value-oriented), the more complex become necessary capabilities, underlying the value creation that would be a basis for long-term customer relationships.

Relational capability is also the central construct for the study of Day and Van den Bulte (2002). It is defined as a bundle of three interrelated components: orientation, information and configuration. Communication, joint problem solving and coordinating activities were already mentioned in the work of Day (1994) on market-driven organizations. The study of Day and Van den Bulte (2002) is based on the same framework of competitive advantage and shares Leonard- Barton's (1995) view of a capability as a knowledge acquisition and application process. The configuration school of strategy (Black and Boal, 1994; Miller, 1996; Day and Van den Bulte, 2002) has expanded the capability construct thus to incorporate interactions, implying that when firm interactions are dysfunctional due to poor alignment or conflict, the capability is degraded and contributes to a competitive disadvantage.

Investigating the nature of customer integration in industrial markets, Jacob (2006) has developed a customer integration competency approach quite similar to the approach of Day and Van den Bulte (2002). The measurement tool was developed and validated on a sample of German firms and contains three key dimensions – process configuration capability, customer communication capability, and control capability. These dimensions were measuring a firm's ability to provide customized solutions for industrial customers. This approach is supported by Rodríguez-Díaz and Espino-Rodríguez, (2006) who state that the development of relational capabilities leads to “integration of processes by related companies in such a way that greater integration means greater cooperation, higher commitment and trust, greater transfer of knowledge, greater innovation capability and a simplification or elimination of activities” (p.489).

Generally, the communication component is most common among the approaches to conceptualization of relational capabilities (Day, 1994; Day & van den Bulte, 2002; Jacob, 2006). Consequently, Paulraj et al. (2008) have developed a conceptual model of relational competency, defined mainly as inter-organizational communication.

Applied to firms in Russian economy, the concept of relational capabilities must be critically examined. We argue that we should differentiate on the one hand between the ability to interact with the partners due to knowledge and experience at the *interpersonal level* (Salmi, 2004; Mikhailitchenko & Lundstrom, 2006), and an *organization-wide capability*, based on the adaptation of organization routines, creation of adjusted process configuration, communication systems and control mechanisms to analyze and assess interaction on the other hand (Jacob, 2006). As Day (1994) states, “capabilities and organizational processes are closely entwined, because it is the capability that enables the activities in a business process to be carried out” (38). The nature of a firm's ability to manage relationships in the Russian economy is subject to critical revision through the lenses of existing research on the Russian management style. Multiple studies during the last years of post-Soviet development have focused on understanding the cultural features of differences in firm's behaviors and the role of business culture in forming relationship practices (Salmi, 2004; Ayios, 2004). A further factor is the role of interpersonal relationships which remain equally important now as in the Soviet time. At the same time a unique feature of the Russian economy exists: there is often insufficient trust among the firms, while high levels of trust on interpersonal level (Butler and Purchase, 2008). Thus, business relationships are often managed on the interfirm level of relational capabilities.

Within the centrally planned economy, as long as a firm accepted ‘the’ plan, there was no need for firms to pay attention to planning their interaction with business partners (Johanson, 2008). After the dissolution of the planned economy, the development of interfirm relationships has required thus not only the capability to understand the market as well as customers and competitors, but also to serve industrial customers by providing them with customized solutions and being able to organize all the customer-related processes (Jacob, 2006). The changes which occurred have led to a re-balancing of the system. Farley and Deshpandé (2005) point to the fact that firms in business-to-business market in the Soviet time had to face “supplier orientation” with the “customer absorbing almost all risk as well as tolerating poor quality and irregular delivery” (p.7). One of the critical factors of the Soviet-style economy was that firms had to deal with constant shortages that made the buyer depend fully on an often unfriendly and impolite seller (Farley and Deshpandé, 2005). Thus suppliers did not have to undertake any steps to decrease the uncertainty for the customer, or adapt their own processes to create higher value and integrate customer in the value creation processes, making relationships truly asymmetric.

After the collapse of the planned economy and the dissolution of existing economic ties between companies and whole value-creating systems, Russian firms had to adapt to newly formed business relationships. As Johanson (2007) points out, such new relationship building required significant time and resource investments, and was based on the development of decentralized and mutual planning capabilities by

individual firms. This initial period was a time of highly unstable networks, which were gradually replaced by more stable ones through the creation of actors' new identities and positions within these networks and also the development of capabilities to match mutual activities through exchanges and interactions ("plan matching") (Johanson, 2007).

These transformation processes required the development of a market orientation, and in particular a customer orientation as a turning point towards new interaction rules. Based on analyzing the development of a market orientation in transition economies, Singh (2003) states that it was the customer orientation dimension that received the most rapid acceptance. Facing the dissolution of existing economic links, firms had to find a new system of coordinates – and the role of customers was the focus of business development (Appiah-Adu, 1998). These arguments support provide our study with the premise about the important role of a market orientation in developing relational capabilities in Russian companies.

2.2. *The Role of Market Orientation in Russia*

Market orientation is one of the most central concepts in research literature on marketing, starting from the 1990s (Narver and Slater, 1990; Kohli and Jaworski, 1990). Our study follows Narver and Slater (1990) in defining three major components of a market orientation: customer orientation, competitor orientation and interfunctional coordination. All of these have to be long-term oriented and profit-driven. Since "the heart of the market orientation is its customer focus" (Slater and Narver, 1994, p. 22), this requires understanding not only of the current needs of the customer, but also the whole value chain of the customer. Competitor orientation provides the firm with an opportunity of benchmark and comparison with alternative suppliers, looking at them with customers' eyes. Finally, interfunctional coordination implies involvement of personnel and other firm resources across the company in creating value for the buyer.

Empirical studies have confirmed the role that market orientation plays in improving firm performance, fostering innovativeness and contributing to the creation of market-driven organizations (Day, 1994). While some research exists which showed weak link between the constructs (Greenley, 1995), this was explained by the inappropriateness of additional investments in the creation of a market orientation under certain economic conditions. Thus, for small industrial firms a market orientation may require less substantial investments than for larger ones (Singh, 2003). The role of market orientation though was also confirmed in some work undertaken in transitional economies (Hooley et al., 2000; Farley and Deshpandé, 2005; Bathgate et al., 2006). Despite more than 15 years of being in transition, the impact of the centrally planned economy in Russia, in particular in terms of institutions and social networks, is still visible (Toppinen et al., 2007). An analysis of existing supply chains revealed substantial problems (Lorentz and Ghauri, 2008). Thus, the development of the processes supporting a market orientation and its integration along the whole supply chain will be a challenging task for most firms. It is likely that only those able to overcome the transition process and change from a supplier orientation to a market-driven thinking will be able to have higher performance outcomes (Farley and Deshpandé, 2005). Thus, we propose the following hypotheses:

H_{1a}: The level of customer orientation of a firm is positively related with firm performance.

H_{1b}: The level of competitor orientation of a firm is positively related with firm performance.

H_{1c}: The level of interfunctional coordination a the firm is positively related with firm performance.

2.3. *The Role of Relational Capabilities in Russia*

The level of complexity and dynamism of the new international economic environment makes the firms face the challenges of transforming competition rules (often dysfunctional), causing 'collapsing capabilities' (Atuahene-Gima, 2005). Thus, market orientation can contribute to a heterogeneous collection of customer and competitor related information which can help firms in transitional economies to analyze, process, and integrate environmental trends (Ma et al., 2006). Another feature of the transitional economy is the role of interaction and networks as compensating for the lack of market-supporting institutions. Teece et al. (1997) state that in rapidly changing environments "there is obviously value in the ability to sense the need to reconfigure the firm's asset structure and to accomplish the necessary internal and external transformation" (p.520). This relational perspective leads to the requirement to understand whether the key emphasis in firms' development is transactional or relational (Coviello et al, 2002). For many Russian firms, development by creating a market orientation and identifying superior market positions through relationships and interaction has become a vital source of understanding their own potential and moving from anonymity to identity (Johanson, 2007)

The role of market orientation in market sensing and linking customer developing capabilities has been discussed widely in the literature (Day, 1994; Gonzalez-Benito &Gonzalez-Benito, 2005). Hooley et al. (2005) consider a number of marketing-related capabilities, including market sensing and market innovation capabilities, as outcome variables of the level of market orientation of the firm. Gonzalez-Benito and Gonzalez-Benito (2005) discuss market orientation as one of the cultural orientations of the firm which

determines differentiation strategies as well adaptive and proactive innovation and organizational competences. Foley and Fahy (2009) stress the importance to understand the role of market orientation within a capabilities framework. The key idea of their conceptual paper is that understanding capabilities related to market orientation could substantially contribute to marketing theory. In particular, market sensing capabilities or customer linking capabilities could facilitate further development of a market orientation construct, and vice versa.

Narver and Slater (1990) point to the fact that every department and function can create higher value for customers. Indeed, the contribution of other functions should be incorporated into the firm's marketing strategy (Wind and Robertson, 1983; Narver and Slater, 1990). Customer orientation and competitor orientation both provide the firm with relevant market information, contributing to creation of better value for the customer (Narver and Slater, 1990). As Golden et al. (1995) state, market oriented firms put more emphasis on customer service and customer satisfaction. Optimization of processes and organizational competences, leading to an increase in customer satisfaction, should be even more important for industrial firms with higher levels of market orientation. The results by Daugherty et al., (2006) found that collaborative relationships have contributed to developing better customer satisfaction results as well superior levels of service and increased flexibility. Day (1994) states that market-driven firms have superior market sensing, customer linking and channel bonding capabilities. We argue therefore that superior understanding of customers and their value chains will have a positive effect on supplier's relational capabilities.

H_{2a}: The level of customer orientation of a firm is positively related with the level of relational capabilities of a firm.

Similarly, the role of competitor orientation becomes more important the higher the competitive intensity in the marketplace. Understanding competitors can help the firm to re-organize and improve their own business processes. This will depend on the firm's competitiveness and ability to compete with the other market players. As long-term relationships require investments and commitment (Morgan, Hunt, 1994; Ganesan, 1994), in case a firm's competitiveness is low, it may be unreasonable to expect substantial investments and adaptations to improve customer relationships. The firm may decide to identify existing market niches and adapt to better serving these customers. Hooley et al. (2000) argue that firms with higher market orientation will follow a more aggressive, externally focused approach, and will strongly aim to differentiate their offer from that of competitors. We conclude that such closer attention to competition will enable the firm to develop better processes to serve target markets, and thus develop relational capabilities.

H_{2b}: The level of competitor orientation of a firm is positively related with the level of relational capabilities of a firm.

The construct of interfunctional coordination refers to the degree to which the functions and departments within the firm communicate and interact with each other (Narver and Slater, 1990; Jaworski and Kohli, 1990). The focus of the construct is related to gathering and dissemination of market information within the firm that should enable its long-term orientation. The danger of low internal alignment has been addressed by Atuahene-Gima (2005), who stresses the phenomenon of 'internal stickiness', which occurs when market knowledge accumulated in a firm stays within the specific department. One of the key aspects of interfunctional coordination is the sharing and exchange of knowledge and ideas (Day, 1994). Most relational capabilities concepts include process re-configuration in order to achieve better information and knowledge exchange, integrate customers in the customer-related processes to improve customer value creation, and consequently increase customer satisfaction. Lai et al. (2009) have found customer and supplier market orientation to significantly affect relationship learning. We conclude that coordination between functions can stimulate not only learning through relationships, but also the incorporation of this knowledge into processes and organizational capabilities. Thus relational capability as an internal capability to reconfigure customer integration processes will also be positively influenced by higher levels of interfunctional coordination.

H_{2c}: The level of interfunctional coordination of a firm is positively related with the level of relational capabilities of a firm.

2.4. Linking Relational Capabilities and Firm Performance in Russia

Lorenzoni and Lipparini (1999) state that despite the growing literature on interfirm relationships, there is insufficient empirical evidence regarding the link between relational capability and firm performance. However, most existing studies stress the creation of superior benefits for firms with high relational capabilities. Rodríguez-Díaz and Espino-Rodríguez (2006) consider the creation of a particular competitive advantages, i.e. associative advantages, which is created in interaction with particular partners and can only be retained when the firms continue their relationships and develop dynamic capabilities in the face of environmental changes (Teece et al., 1997). This means that in case of relationship dissolution, relational capabilities cannot immediately be rebuilt and are lost. Similarly, Dyer and Singh (1998) state that a relational rent is created through the development of such capabilities, and define it as "a supernormal profit jointly

generated in an exchange relationship that cannot be generated by either firm in isolation and can only be created through the joint idiosyncratic contributions of the specific alliance partners” (p. 662). Furthermore, Jacob (2006) considers market success as a direct outcome of the firm’s ability to integrate customer interaction in its organizational routines.

Following the logic of Johanson (2007), the role of plan matching requires firms in Russia to develop superior capabilities in coordinating and integrating customer interactions. We hypothesize that those firms having created superior organizational relational capabilities, aimed at a better customer integration and coordination of interfirm relationships, will also have superior business results.

H₃: The level of relational capabilities is positively related with firm performance.

Thus, the nomological model of linking customer orientation with relational capabilities and ultimately firm performance is based on seven hypotheses (see Figure 1). The different component of a market orientation are hypothesized to be drivers of both relational capabilities as well as firm performance (direct impact). Furthermore, market orientation also positively impacts on firm performance via the mediating variable of relational capabilities (indirect impact).

Please insert Figure 1

3. Research Design

In the following we describe our data collection process, our construct measures and quality tests.

3.1. Data Collection

Data collection for the study occurred during the period February 2007 – March 2008 and included both qualitative and quantitative stages. The first stage of the study included in-depth interviews conducted with CEOs and marketing and purchasing directors of three different firms (packaging materials distribution, and production of metal constructs), which were conducted during February – July 2007. The aim was to understand relational capabilities in these firms, as well as verifying the initial structural model of hypotheses. In the next step of the qualitative research, the role of market orientation was discussed in a seminar with 40 marketing and purchasing top managers from four large metallurgical companies in December 2007. Seminar participants were divided into groups according to their firm affiliation, and had to envisage the role of market orientation and of relational capabilities. The main finding was that a strong emphasis was put on the role of customers and competitors, while the coordination of internal processes was not prevalent. It was the lack of understanding between departments and insufficient information exchange that were claimed as the most serious barriers in improving performance. The managers involved also acted as an initial pre-test for the empirical questionnaire.

Following on we prepared a quantitative survey with industrial firms from multiple regions of Russia. Data was collected via a stratified by region, industry and size sample of Russian firms operating in industrial markets. The quantitative data collection was conducted in the period between December 2007 and March 2008. Data collection occurred with key respondents (top management or head of marketing) who were contacted to conduct two interviews with each respondent. We separated the questionnaire into two equal parts to minimize common method bias (Podsakoff et al., 2003). We contacted 479 industrial firms from 34 regions in Russia. 32.9 per cent (158 companies) agreed to participate in the study. Data collection was done via personal face-to-face interviews, thus 316 interviews were conducted in total. It is important to notice that data collection in Russia still is a difficult task due to low openness of the firms and a generally low readiness to disclose information. The average age of respondents was 40.9 years, with an average working experience in their current firm of 9.6 years (5.5 years in their current position). The respondents were mostly men (73.4 percent). The functions of most of respondents were specified as “strategic management” (51.9 per cent) and “marketing” (32.9 per cent). The level of respondent competence regarding the questions was high (4.7 on a 5-point Likert scale). Main industries included in the survey were machinery (26.1 per cent), production of construction materials (14.0), chemical industry (9.6), packaging (7.0), appliance manufacturing (7.6), telecommunications (6.4), woodworking (5.1), food (5.1). The relationship between products and services in the survey firms was 75.9 per cent products and 24.1 per cent services. The level of annual sales (2006 numbers) varied between less than \$1.5m (30.4 per cent); \$1.5 – 3m (20.3); \$3-15m (24.6); more than \$15m (26.8). The firm size also varied: 10.4 per cent of the sample had less than 50 employees, 13.0 per cent between 50 and 100 employees, 33.8 per cent with 100 to 500 employees, 19.0 per cent between 500 to 1000 employees, and 23.3 per cent had more than 1000 employees.

3.2 Construct Measures

The scales applied in this study were mostly taken from existing research. All scales were initially verified as relevant for the Russian context by a pool of academic experts. The questionnaire was a subject to several revisions on the basis of experts’ suggestions. The scales were pretested with the sample of 40 CEOs and marketing and purchasing managers. Most of the constructs were measured using multi-item scales (five-point Likert-type scales, ranging from “strongly agree” to “strongly disagree”) and are based on reflective

measurement models.. The scales' properties were evaluated using traditional psychometric approaches. Reliability and uni-dimensionality of the scales was assessed. Item-to-total correlations were assessed for all the scale items (Anderson and Gerbing, 1988). Some items were dropped as a result of confirmatory factor analysis due to cross-loading. To check for uni-dimensionality of constructs each of the scales was tested separately and a joint factor analysis was conducted.

Customer orientation, competitor orientation, and interfunctional coordination were measured using the original Narver and Slater (1990) scale for market orientation. The scales were successfully tested previously for transition economies (Hooley et al., 2000). A CFA confirmed the three factor solution for market orientation, establishing the independence of the three different components. The relational capabilities construct was measured by applying the integrated measurement scales developed by Jacob (2006) and tested on a sample of German industrial firms. The construct included four items. The construct was tested for uni-dimensionality, and a single factor structure was confirmed. The business performance construct was measured via three aspects proposed by Venkatraman (1989) and applied in the study of Vorhies and Harker (2000), namely growth, adaptability, and customer satisfaction. The first measured the firm's relative market share growth and sales growth in comparison to the main competitors. The second component measured the number of new products, the introduction of the new products to the market, and the time-to-market. Customer satisfaction was measured by two items – customer satisfaction itself, and delivering value to customers. The respondents were asked to compare the performance of the firm over the last three years in comparison to their main competitors. These items were measured on a five-point Likert-type scale (ranging from -2 to +2 and anchored in “much worse” and “much better”). Confirmatory factor analysis was applied to test the three-factor structure of the business performance construct. The measurement model provided good fit in case of three-factor structure: CMIN = 1,729 ($p = 0,110$), RMR = 0,009, GFI = 0,985, AGFI = 0,948, CFI = 0,995, RMSEA = 0,057 ($p = 0,357$). After confirmation of the measurement model's goodness-of-fit, the final structural model included the construct as a second factor construct with three items, built as item parcels on the base of three subdimensions – growth, adaptability and customer satisfaction.

3.3. *Quality Tests*

To avoid common method variance, we used data from two sequential interviews with the same respondent. Thus, data on market orientation and business performance were gathered during the first wave of interviews, and the data on relational capabilities was gathered during the second wave of interviews. We used AMOS 7.0 to test the measurement model of the proposed structural model. A confirmatory factor analysis was conducted. Fit indices suggested by Joerskog and Soerbom (1999) and Kline (2005) were used. The estimates of the CFA demonstrated a reasonable model fit:

CMIN = 1,253 ($p = 0,030$), RMR = 0,045, GFI = 0,905, AGFI = 0,869, CFI = 0,986, RMSEA = 0,040 ($p = 0,792$).

Please insert Table 1

Please insert Table 2

Table 2 contains the standardized maximum likelihood (ML) parameters for the measurement model, the proportions of average variance extracted (AVE), the composite reliability of the constructs and their Cronbach alphas. All the Cronbach alpha values exceed 0.7. In all cases the average variance extracted exceeds the critical level of 0.5 and the composite reliability exceeds the critical level of 0.7. Support for the discriminant validity has been confirmed applying the Fornell-Larcker (1981) criterion.

4. Analysis and Findings

4.1. *Initial Model Analysis*

The test of the different hypotheses of the structural model was performed using AMOS 7.0. While seven hypotheses were proposed originally on the base of existing literature, only three of them were supported by the Russian data set at the $p < 0.01$ level. One hypothesis can be supported at a $p < 0.1$ level, while the other three hypotheses were not supported by statistically significant path coefficients, moreover one of the hypothesis has demonstrated negative path coefficient whereas positive effect was assumed on the base of existing theory. The overall fit measures and significant levels of the paths coefficient show a reasonable fit of the model (CMIN = 1.151 ($p=0.119$), RMR = 0.044, GFI = 0.908, AGFI = 0.874, CFI = 0.991, RMSEA = 0.031 ($p=0.930$)).

Please insert Table 3

Our aim was to understand the role of different aspects of market orientation in creating relational capabilities and ultimately firm performance in industrial firms in Russia. The results confirm hypothesis H2a and H2c, thus both customer orientation and interfunctional coordination have a positive impact on the level of relational capabilities. However, it is important to notice that the impact of interfunctional coordination is only significant at the $p = 0,1$ level, therefore interpretation of this result needs to be tentative. This would confirm

the findings of the exploratory qualitative stage of research with interfunctional coordination being of secondary importance in driving relational capabilities. The impact of competitor orientation was not significant. Thus the level of the firm's orientation towards gathering information on competitors has no influence on the level of the firm's relational capabilities. This result maybe interpreted by assuming that competition in Russia does not always represents a benchmark for improving interfirm relationship practices, and comparison with competitors may not lead to learning how to improve customer relationships.

Hypothesis 3 tested the impact of relational orientation on business performance. This hypothesis was confirmed, and the path coefficient relatively strong with 0.256. Thus, firms, which have undertaken investments and adaptation to create customer-oriented processes and specific organization capabilities with support customer integration, do achieve better overall performance.

Finally, the third set of hypotheses (H1a – H1c) tested the direct relationship between the three aspects of market orientation on firm performance. Again, not all the hypotheses were confirmed. We found a significant positive impact from competitor orientation on business performance (H1a: 0.504). The pathway between interfunctional coordination and business performance was also significant, however, with a coefficient of -0.249 it was negative and therefore opposite to the hypothesized impact. The direct link between customer orientation and business performance was not insignificant. However, as the indirect path via relational capabilities is positive and significant, this confirms that relational capabilities do perform the role of a mediator of customer orientation at business performance.

4.2. Further Exploratory Analysis

Following the analysis shown above, further exploratory data analysis was conducted, aimed at identifying clusters of firms according to their level of relational capability development. On the basis of the relational capabilities scale, we were able to identify four distinct clusters of firms in our sample, based on a two-step cluster analysis using the Schwartz Bayesian criterion. Other variables of the study were applied to describe the cluster characteristics. The clusters do confirm the differentiation of the firms according to their level of relational capabilities and corresponding levels of market orientation and business performance.

The best performing cluster 3 contains 38 firms of the sample (24 per cent; see table 4). The firms in this cluster demonstrate very high levels of relational capabilities, supported by high customer orientation. The level of competitor orientation and interfunctional coordination is also significantly higher than in other clusters, but comparatively lower than levels of customer orientation. Business performance is also substantially higher than in other clusters. The firms in this cluster have also indicated the highest level of competitive pressure among all the firms in the sample.

Please insert Table 4

Cluster 1 demonstrates average business performance, and has significantly lower levels of relational capabilities development in comparison to cluster 3. The firms in this cluster (n=64, 40 per cent of the sample) demonstrate higher levels of customer orientation than relational capabilities; other aspects of market orientation are lower. The level of relational capabilities in this cluster is still higher than the overall average in the sample. Cluster 2 (n=40, 25.3 per cent of the sample) also has comparatively higher levels of customer orientation compared to other market orientation dimensions, and substantially lower than average levels of relational capabilities. Interestingly, firms from cluster 2 have much higher growth than adaptability performance indicators. Thus, low adaptability correlates with lower relational capabilities of the firms in this cluster. In line with this finding, higher level of relational capabilities in cluster 1 results in higher adaptability. Finally, cluster 4 (n=16, 10 per cent of the sample) demonstrate the worst performance among all clusters, while still having relatively high average customer orientation scores. It is important to notice that cluster 4 also has slightly higher results on competitor orientation and interfunctional coordination than cluster 2, but that the performance of cluster 4 is lower. This corresponds with the low average level of relational capabilities in this cluster which is the lowest

5. Discussion and Implications

Findings and Further Research

The key findings of our study contribute to a better understanding of the link between the level of market orientation, its sub-dimensions, and relational capabilities in industrial firms in Russia. Our results confirm the central role the creation of a customer orientation plays for the firm in order to achieve better customer integration and satisfaction by having direct positive impact on development of relational capabilities and through relational capabilities construct on firm performance outcomes, including the customer satisfaction subdimension. It seems that customer orientation was indeed one of the first facets that Russian firms have

developed as their economy emerges from the transition period. The level of customer orientation is reported to be relatively high overall in all the clusters identified. This trend, though, is not supported by other dimensions of the firms in the sample.

Thus the role of competitor orientation is evident and very strong in contributing to the firm performance, but our data shows that it does not contribute directly to the value creation for customers. Indeed, our results demonstrate a strong impact of competitor orientation of a firm on performance outcomes, while the impact of competitor orientation on relational capabilities has not been proved as significant. During the qualitative research stage the firms have revealed that market growth allowed the firms to follow competition and gain higher outcomes, being in fact not customer oriented, but competitor oriented. These firms thus, have changed a supplier orientation to a competitor orientation. This strategic orientation is based on imitation of successful tactics by competitors, but is possible just in industrial markets where the customer needs are rather standard and do not require adaptation.

Finally, the role of interfunctional collaboration is limited within the Russian dataset. The qualitative steps of the study clearly showed that there is lack of understanding of the importance of internal alignment to achieve better performance and higher customer satisfaction. As the firms admitted, this leads to internal conflict and does not have a positive impact on the value for customers. The role of interfunctional coordination in influencing relational capabilities and firm performance is significant on $p < 0.1$ level. While having a positive effect on relational capabilities, interfunctional coordination shows a negative direct impact on business results. This negative impact is one of the unexpected and counter-intuitive results of our study. On one hand, the results of our cluster analysis indicate that better performing firms (cluster 3 and cluster 1) still have on average higher level of interfunctional coordination. But comparison of clusters 2 and 4 reveals, that much worse performing firms in cluster 4 have higher level of interfunctional coordination than substantially better performing firms in cluster 2. Thus we assume that the negative impact in the structural model demonstrates a misperception of the role of interfunctional coordination. According to the results of the qualitative stage of research, there is usually a trend towards cross-functional meetings and discussions in Russian firms when the firm starts to face difficult times or particular competitive pressure. This forces top management to undertake organizational steps towards the improvement of communication and collaboration among the departments, as was also revealed by the qualitative stage of the study. We can also assume that relatively high level of interfunctional coordination of the firms in cluster 4 is forced by a need to improve their performance.

Two aspects should be considered here. Firstly, the results of such interfunctional coordination strategy can produce effects with some time delay. In the case of one of the firms, contacted during the qualitative stage, this delay was more than 2 years of successive efforts to build inter-functional coordination. The second aspect is the sporadic organization of internal communication. In those cases when inter-functional meetings and information exchange were not regular, this might produce no substantial affect on the firm's performance in the short term.

Our results pose a basis for further research on the role of sub-dimensions of market orientation in Russian industrial firms. While the role of customer orientation corresponds to results of previous studies, the role of competitor orientation needs further explanation. The role of interfunctional coordination also requires further investigation, and longitudinal case studies might be used to follow the development of inter-functional coordination mechanisms and their impact on firm performance in success of interfirm relationships with customers and other partners of the firm.

Our findings demonstrate a strong basis for a classification of firms according to their level of relational capabilities. Interpreting the findings, we conclude that investments in the development of customer interaction routines, better customer linking, and creating higher value for customers are indeed paying off for these firms. This commitment in implementing this approach indicates a long-term orientation and supports evidence of the changing nature of interfirm relationships in Russia's industrial markets (Salmi, 2004; Johanson, 2008). Future research in Russia needs to concentrate on the conceptualization and measurement of market orientation and relational capabilities aimed at interactions with multiple stakeholders, not just customers (Greenley et al., 2004). Such a research direction could provide a more comprehensive picture of organizational interactions in both developed and transition economies.

Figure 1 Model of Proposed Hypotheses

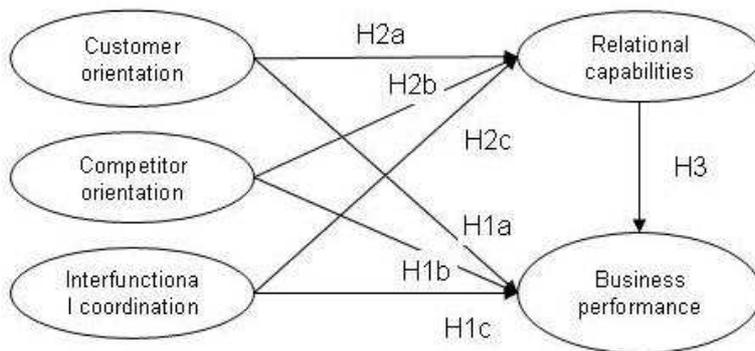


Table 1 Means, standard deviations and correlations of the constructs

Constructs	Mean	Standard deviation	1	2	3	4	5
1. Customer orientation	4,31	0,77	1				
2. Competitor orientation	3,55	0,95	0,464**	1			
3. Interfunctional coordination	3,73	0,95	0,527**	0,583**	1		
4. Relational capabilities	3,76	1,05	0,479**	0,479**	0,446**	1	
5. Business performance	0,56	0,69	0,358**	0,319**	0,240**	0,372**	1

***Correlation is significant at the $p < 0.01$ level (2-tailed).*

Table 2 Scale Items for Theoretical Measures

Reflective scale names and items (Measured on 5-point scale indicating the extent to which respondent agrees with the following statements)	Standardized Factor Loading
<i>Customer Orientation (Cronbach's $\alpha = 0.919$, AVE = 0.75, CR = 0.92, Square root of AVE = 0.87)</i>	
• We closely monitor and assess our level of commitment in serving customer's needs.	0.88
• Business strategies are driven by the goal of increasing customer value.	0.93
• Our competitive advantage is based on understanding customer needs.	0.86
• Our business objectives are driven by customer satisfaction.	0.78
• We pay close attention to after-sales service.	---
• We frequently measure customer satisfaction.	---
<i>Competitor Orientation (Cronbach's $\alpha = 0.844$, AVE = 0.65, CR = 0.85, Square root of AVE = 0.81)</i>	
• Top management regularly discuss competitors' strength and weaknesses.	---
• We respond rapidly to competitive actions.	0.91
• Customers are targeted when we have an opportunity for competitive advantage.	0.76
• Our salespeople share information about competitors.	0.74
<i>Interfunctional Coordination (Cronbach's $\alpha = 0.889$, AVE = 0.68, CR = 0.89, Square root of AVE = 0.82)</i>	
• Top management regularly visits important customers	---
• Information about customers is freely communicated throughout our organization.	0.72
• Business functions within are integrated to serve the target market needs.	0.83
• Our managers understand how employees can contribute to value of customers.	0.87
• We share resources with other business units.	0.86
<i>Relational Capabilities (Cronbach's $\alpha = 0.954$, AVE = 0.84, CR = 0.95, Square root of AVE = 0.92)</i>	
• Our company has the competence required to create products and services for individual problem solutions.	0.93
• Our company has the competence required to communicate with customers about individual problem solutions.	0.91
• Our company has the competence required for the appropriate controlling of individual problem solutions.	0.91
• Our company has the competence required to successfully implement problem solutions for our customers.	0.91
<i>Business performance (2nd order factor) (Cronbach's $\alpha = 0.864$, AVE = 0.68, CR = 0.87, Square root of AVE = 0.82)</i>	
• Growth	0.85
• Adaptability	0.83
• Customer satisfaction	0.80
<i>Growth (Cronbach's $\alpha = 0.840$, AVE = 0.72, CR = 0.84, Square root of AVE = 0.84)</i>	
Relative to your competitors, how has your organization, over the last three years, performed with respect to...	
• Market share growth relative to our competition	0.83
• Growth in sales of our product and/or service	0.86
<i>Adaptability (Cronbach's $\alpha = 0.907$, AVE = 0.86, CR = 0.92, Square root of AVE = 0.93)</i>	
Relative to your competitors, how has your organization, over the last three years, performed with respect to...	
• Number of successful new products	0.92
• Introduction of new products/services	0.93
• Time to market for new products	---
<i>Customer satisfaction (Cronbach's $\alpha = 0.850$, AVE = 0.69, CR = 0.82, Square root of AVE = 0.83)</i>	
Relative to your competitors, how has your organization, over the last three years, performed with respect to...	
• Customer satisfaction	0.83
• Delivering value to your customers	0.83

(Note: AVE = Average variance extracted; CR = Construct reliability; --- = items deleted during the model estimation stage)

Table 3 Structural Model Results

Hypothesis	Proposed effect	Path coefficient	t-value	Results (p)
H1a	+	0.167	1.582	Not supported: non significant path coefficient ($p=0.144$)
H1b	+	0.355	2.792	Supported ($p=0.005$)
H1c	+	-0.188	-1.435	Not supported: non significant coefficient ($p=0.151$), the path coefficient is negative
H2a	+	0.291	3.137	Supported ($p=0.002$)
H2b	+	0.155	1.386	Not supported: non significant ($p=0.166$)
H2c	+	0.204	1.742	Supported ($p=0.082$)
H3	+	0.256	2.654	Supported ($p=0.008$)

*Table 4
Results of Cluster Analysis*

Variable (answer anchors)	F statistics (p)	Cluster 1 n=64	Cluster 2 n=40	Cluster 3 n=38	Cluster 4 n=16	Mean	Std. Deviation
Relational capabilities (1;5)	164.762 (p<0.001)	3.99	2.87	4.97	2.17	3.76	1.05
Market orientation (total) (1;5)	17.866 (p<0.001)	3.92	3.39	4.41	3.56	3.86	0.74
Customer orientation (1;5)	12.779 (p<0.001)	4.34	3.88	4.83	4.06	4.31	0.77
Competitor orientation (1;5)	10.913 (p < 0.001)	3.62	3.04	4.13	3.24	3.55	0.95
Interfunctional collaboration (1;5)	10.060 (p<0.001)	3.81	3.24	4.27	3.36	3.73	0.95
Business performance (total) (-2;+2)	8.996 (p<0.001)	0.53	0.41	0.97	0.06	0.56	0.69
Growth (-2;+2)	5.648 (p<0.001)	0.45	0.52	0.90	-0.04	0.53	0.83
Adaptability (-2;+2)	10.705 (p<0.001)	0.56	0.23	1.04	0.07	0.54	0.79
Customer satisfaction (-2;+2)	6.279 (p<0.001)	0.59	0.47	0.98	0.16	0.61	0.74

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