Market Orientation and Business Performance: The Point of Diminishing Returns in Community Banks

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These are interesting days for bankers and their banks. Customers are demanding ever more at lesser cost. Competition is coming from all points on the financial services compass. Shareholders are seeking increased returns on their investment in bank equities. In addition, the financial regulators are demanding that capital be increased thus putting pressure to increase earnings. It is into this fray that the authors of this article journeyed to determine at what point customer orientation and being influenced by competitors detracted from the ability of a bank to maximize its profitability and thus meet the requirements and demands of the shareholders and the financial regulators.

Prior studies have shown an inconsistent relationship between market orientation and enhanced business performance. Numerous researchers have addressed this issue with mixed results. Research has shown an inconsistent relationship between market orientation and enhanced business performance. (Kohli & Jaworski, (1990, 1993); Narver & Slater, (1990, 1994; Desphande et al., 1993; Avlonitis & Gounaris, 1999, Chang & Chen, 1998; McNaughton et al., 2002) Some studies showed a slightly positive relationship between the two factors and levels of profitability, while other studies concluded there was no relationship. This has led the authors to conclude that perhaps

there was a point of diminishing returns when it came to customer orientation and concerns over competitive factors. To the knowledge of the authors, no research has been conducted to investigate at what point, if any, there is a diminishing return on an investment in market orientation. In the attempt to better understand the relationships between the factors of a customer and competitive orientations and profitability, the authors conducted a study of the community banking industry.

Problem and its Background

For the purposes of this study market orientation is defined by Narver and Slater (1990). From an extensive review of the literature, Narver and Slater (1990) inferred that there are three behavioral components and two decision criteria that comprise market orientation. The three behavioral components are customer orientation, competitor orientation and inter-functional discipline. The two decision criteria are long term focus and profitability. The authors define customer orientation as "the sufficient understanding of one's target buyers to be able to create superior value for them continuously" (Narver& Slater, 1990, p. 21). Competitor orientation is defined as the "seller's understanding of the short-term strengths and weaknesses and long-term capabilities and strategies of both the key current and key potential competitors" (Narver & Slater, 1990, p. 21). Inter-functional discipline is defined as "the coordinated utilization of company resources in creating superior value for target customers" (Narver & Slater, 1990, p. 22). This study examines the relationship between market orientation, its three behavioral components and enhanced business performance, as measured by return on assets in the community banking segment of the commercial banking industry.

The investigators looked at three behavioral components of customer orientation. These are; customer orientation, competitor orientation and inter-functional coordination. Based on these components of customer orientation four hypotheses were develop.

H1 There is a positive and significant relationship between market orientation and return on assets.

H2 There is a positive and significant relationship between customer orientation and the return on assets.

H3 There is a positive and significant relationship between competitor orientation and the return on assets.

H4 There is a positive and significant relationship between inter-functional coordination and return on assets.

Population

The surveyed population consisted of CEOs of community banks in several southeastern states. The homogeneity of the sample was a plus in reducing the impact of extraneous factors. Also, the time frame selected for study precluded the current economic turmoil and was considered by the authors to be a period of normal economic activity.

Community banks and savings associations in Florida, Georgia, Tennessee, North Carolina and Virginia comprised the study population. A total of 926 institutions were selected from the directories published by the various state bankers' associations. There

were three selection criteria: 1) that the bank is not part of a super-regional or nation-wide bank holding company, 2) the bank is at least three years old, and 3) the bank needs to be profitable.

Questionnaire Design and Scaling

A self-administered twenty question survey instrument was utilized for the study. The questions used a scale of 1 to 7, where 1 represented "not at all" and 7 reprresented “to an extreme extent”. Interviewees were asked a matrix of open ended questions about their respective banks total assets, total capital, and profit after taxes for a three year period. These figures were obtained or derived from audited financial reports filed with each of the bank’s appropriate governmental regulators.

A total of 926 survey questionnaires were sent via US Postal Service first class mail with a cover letter and a stamped self-addressed return envelope. No compensation or inducement was offered to the survey participants. A total of 221 survey questionnaires were returned. Of the 221 questionnaires returned 40 lacked data and 19 were from banks that suffered financial losses during the time frame studied, which eliminated these questionnaires from the study. The remaining 162 usable questionnaires resulted in 17.5% response rate.

Analysis

Descriptive statistics and other statistics were analyzed, which comprised several steps. Strong linear correlations were found between market orientation and return on assets in the scale range surrounding 4.7.

Results

The results indicated that beyond a certain point, the investment in market orientation, and its three components yielded a negative return. This point was approximately 4.7 on a 7 point scale, which equated to a “more than moderate (4.0)”, but “less than considerable (5.0)” In summary, an investment beyond a "more than moderate level" yielded a negative return.

Analysis of Findings

The possible causes of decline in profitability as market orientation is enhanced are as follows:

Customer Orientation:

1. Excessive staffing levels required to provide an enhanced level of customer service.
2. Positive responses to customer’s request to waive fees for services provided or the charging of lower interest rates on extensions of credit.
3. Excessive advertising or hours of operation with their accompanying expense.

Competitor Orientation:

1. Heavy investment in branch and ATM networks in order to compete with large or less profit oriented institutions.

2. Responding to meet the competition from lower cost providers such as credit unions or banks that are market share oriented.
3. Inclusion of products in the bank's product line in which the bank has limited expertise and thus subjects itself to operational inefficiencies or credit losses.

Inter-functional Discipline:

1. Duplication of staff efforts as decisions are made between departments rather than granting the original customer contact point authority to address the issue in question in a more timely and cost efficient manner.
2. Excessive investment in technology and communication systems.

Conclusion and Managerial Implications

Bank management should understand the costs involved in its marketing orientation, which should lead toward improved financial performance. Utilizing the results of this study may assist in determining actions that will improve the return on assets while continuing to provide services to the customer and competing effectively.

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