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# The effect of customer orientation on financial performance in service firms: The mediating role of service innovation

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**ABSTRACT**

In service firms, customer orientation and service innovativeness are the important strategic features to pledge sustainable wealth and growth for financial performance. Focusing on customer means, companies must have rigorous knowledge and understanding of customer needs, expectations, and demands. To satisfy those demands and expectations, new products and/or services need to be carefully designed. Customer orientation involves the introduction of something new or different in response to market conditions and can be perceived as an important driver for innovation. The literature on innovation in services demonstrates that this territory is still under-investigated. Our study is an attempt to slightly complement this shortcoming by empirically solving several issues related to service firms. In particular, we propose the service innovativeness as a mediating effect in the relationship between customer orientation and financial performance. A theoretical research model was investigated via structural equation modeling (SEM) using 686 survey responses from the service industry. The findings of the structural equation model indicated that customer orientation is positively related to financial performance and service innovativeness respectively. And service innovativeness was found as a partial mediating effect, which means that the service innovativeness intervenes for some part but not all of the relationships between customer orientation and financial performance.



## 1. Introduction

The service sector is a labor-intensive sector. It is extremely important to preserve the highest quality of relations between clients and staff. Researchers determined that a modern service industry that provides success in highly complex competitive local and international industries should offer distinctive services (Simpson, 1995a). The importance of the service sector is growing in all economies. GNP in developed countries over the past two decades has grown significantly from the contribution of the service industry. Business activity has passed the highest levels of development and growth due to the introduction of innovations in the service sector and increased customer focus. Currently, the term "customer orientation" is becoming increasingly popular in various business areas, especially for enterprises engaged in customer service. Many service companies call themselves "customer-oriented". But, unfortunately, not every company meets the stated requirements. Customer orientation can be observed to improve an appreciation of customers so that they can obtain a superior value (Evans, 2007); (Maydeu-Olivares & Lado, 2003). Customer attention means that businesses must know and consider the desires, aspirations, and demands of customers carefully. For these demands and desires to be met by goods and services, those require careful planning.

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The concept of customer orientation is comparable in its importance to the concept of competitiveness, with the difference that competitiveness implies the organization's compliance with the market situation in general, and customer-centeredness reflects the degree of compliance of an enterprise with consumers' expectations. In this regard, strategic management of customer-oriented approach comes to the fore, since a service company that is guided by the interests of the client in its activities, makes a choice in favor of long-term relationships with the client, often rejecting short-term benefits. The principle of customer orientation is firmly established in the theories of service management. The potential of the client-oriented approach is not limited to the operational level. With the complete implementation of this approach, customer focus should be a characteristic, image, characteristic of the company's activities, among whose priorities the place of the client's interests should be clearly defined. The definition of customer focus, formulated by the scholar "Ryzhkovsky" (*Collection of scientific papers*, 2013), largely corresponds to the principles of accuracy and completeness. Nevertheless, it is necessary to take into account that there is another unaccounted relationship between the enterprise of the service industry and the consumer of its services, which consists of the existence of a mutual adjustment between the needs of clients and the key competencies of the organization. On the one hand, by formulating the characteristic needs of a specific target group, a service company can improve its key competencies. On the other hand, the client does not suspect many of their needs until their implementation is proposed by the market. This interrelation of needs and key competencies is realized through communications, which must be taken into account when determining customer orientation. According to frequent studies by different researchers (Day, 1994); (Ulin, 1954), it is known that firms that follow customer-oriented strategies are more likely to guarantee the quality, promote customer satisfaction, and achieve organizational goals more effectively and efficiently than competitors. Besides, it argued that the orientation in service organizations plays a more critical role than in other companies (Kelley, 1992; Kim & Cha, 2002).

Currently, service firms are considered as the most competitive companies in the world. As the specialized literature shows, productivity fluctuations in various service industries are significantly higher than in all other sectors of the economy. This discrepancy can be explained by a different focus on innovation in the service sector. This casts doubt on the role of traditional innovative practices in the service sector and necessitates the need for new strategic paradigms. In the recent work of scholars (Martin-Rios & Pasamar, 2018), considerable attention was paid to the introduction of innovative practices. Nevertheless, in the works of different scholars (Karlsson & Tavassoli, 2016) in the service sector, attention is hardly paid to the development of more and less complex innovative strategies - a combination of technological and non-technological forms of innovation.

The leading economists in the field of economic analysis and financial management devote a large place in their research to the study of the financial results of the company's business, but they approach the definition of the economic content of a given concept in various aspects and with varying degrees of detail. Efimova (2006), understanding the profit as the financial result of the company, at the same time notes that "the final result is the one that the owners have the right to dispose of," and in world practice, it means "growth of net assets".

Research has found that "the financial results of the company's operations are characterized by the sum of the profits received and the level of profitability": "profits are part of the income that business entities directly receive after selling the products" (Ferrando et al., 2015). A different study has analyzed the financial mechanisms of managing the formation of operating profit, characterizing the balance sheet profit as "one of the most important financial results of the company" (Ferrando et al., 2015). The financial performance of the company serves as a kind of indicator of the significance of this organization in the national economy. In the market economy, any organization is interested in obtaining a positive indicator of its activities, since, thanks to the value of this indicator, it can expand its capacity, financially interested personnel working in this company, pay dividends to shareholders, etc.

Innovation plays a crucial role in companies operating in a progressively competitive environment. Investigators discovered how businesses evolve and how creativity grows for other businesses and personalities (DAMANPOUR, 1991). The center of service innovation is less than product innovation in the existing literature. Service innovation has been little studied empirically and discussed from a conceptual point of view. Service innovation allows businesses to gain a strategic edge according to various researchers (R. Agarwal et al., 2015). Benefits derived from launching new services include increasing profitability, increasing customer satisfaction and loyalty of current customers, and the possibility of opening new markets (Sampson & Spring, 2012). Innovation includes the use of innovative technologies to address innovative or current company and customer needs. Scholars have defined innovation as an idea, object, or practice, which human or organization received as new (Orr, 2003). The study concluded that the key goal of innovation is to find potential ways to create new goods, services, or work practices (Axtell et al., 2000). The distinction between service innovation and product innovation is that: first, the service delivery of employees is part of innovation. Second, the physical presence of customers' needs is service production capacity. One of the main aspects of many service outputs is the high degree of cooperation with clients, consumers, and users in the development of the final service. Service providers must also create a suitable type of service product and an acceptable way of communicating with customers because the development of digital technology is much more difficult than the development of a new tangible product. (Oke, 2007). Third, service innovations are not marked by brand names (Berry et al., 2006). Researchers have characterized innovation as the improvement and use of new thoughts (new administration/procedure of article or task) or practices in companies (Damanpour & Daniel Wischnevsky, 2006). Specifically, an inventive approach suggests the ability to embrace new thoughts for the business, even though the thoughts may have been elsewhere (Garud et al., 2013). In the authorized dimension, it is common for innovation to be considered as a culture that embraces new thoughts, demonstrating receptiveness to innovation (Part, 2010). At the moment that authorized people are anxious to think about innovation, they feel that innovation will improve the capacity of the company or that they might suspect it. In this sense, Researchers have expressed that some hierarchical societies are against innovation, although other researchers see the need to deal with an authorized culture if the workforce perceives the estimation of new thoughts within the company(Hult et al., 2004); (Ven, 1986). Scholars have described 'service innovativeness' as a term that covers macro level business innovation with customer relationships, which is more fitting to explain innovation success (Senbabaoglu, 2017). Service innovativeness has a huge effect on the behaviors of consumers and on the behaviors of competing companies (Berry et al., 2006) In addition, service innovativeness was seen as a significant success factor in separating a new company from its existing offerings (Model & Innovativeness, 2014).

Several scholars (Maurya et al., 2015);(Shin & Lee, 2016);(Leisen et al., 2002) (Deshpandé et al., 2012a); etc. analyzed the relationship between business innovation and company financial efficiency. A study among Japanese firms showed that innovation is positively linked to organizational success in terms of relative productivity, scale, market share, and rate of growth (Deshpandé et al., 2012a). Other scholars in their analysis among Australian firms found that firms have the highest percentage of potential new products in their technological offensive strategy and have achieved the highest level of performance in achieving their performance targets, the profitability of their new product ventures and perceived overall success (Dwyer & Mellor, 1993). In their analysis of Canadian companies, some other scholars have demonstrated the significant impact of innovation on a wide range of business performance indicators, including market share gain and return on investment. (Baldwin & Johnson, 1996). Several studies have explored the impact of innovation on financial performance in service companies (Cainelli et al., 2004). Innovative firms perform better than non-innovative firms, they find. The service companies can achieve superior financial efficiency by providing differential positional benefits, creative technologies, and higher product quality (Day, 1994). Focusing on customers means companies need to have a comprehensive knowledge and understanding of consumer desires, preferences, and demands. Those need to be carefully charted to fulfill these demands and standards of products and services. Scholars have concluded that effective companies need a client-focused corporate culture (Deshpandé et al., 2012a); (Athanassopoulos, 2000);(Houston, 1986); (Parasuraman, 1994). Research has shown that customer orientation is a source of organizational learning that contributes to the higher credit rating and greater customer satisfaction. (Slater & Narver, 1995); (Sinkula et al., 1997). Consumer orientation helps companies to incorporate and receive the knowledge they need to plan and execute marketing campaigns that result in more favorable customer results. Scholars and managers have recognized that service firms that do not innovate may not be able to survive in the competitive market place. Thereby, in recent years' service firms pay more attention to innovation. Some scholars have argued that innovation is one of the main factors of creating value and determining the relationship between customer orientation and financial performance (Slater & Narver, 1995).

The purpose of this study is to examine the relationship between customer orientation and financial performance with the mediating role of service innovativeness.

## 2. Theoretical background and hypothesis development

### *2.1 Customer orientation*

Customer-orientation is based on an "external approach" and is profoundly embedded in the cultural conviction of putting consumer needs first. The success of an organization depends on creating customer loyalty and concentrating on positive customer service. Many studies have concluded that customer-oriented business culture is important for successful companies (Deshpandé et al., 2012a; Simpson, 1995b). Other scholars have pointed out that, since the introduction of the marketing philosophy and over the four phases, customer orientation has been established as the basis for the theory and practice of marketing management (Jaworski & Kohli, 1993). Customer orientation is the basis of organizational learning, which contributes to higher value credit and greater customer satisfaction (Slater & Narver, 1995; Sinkula et al., 1997). Consumer orientation helps companies to incorporate and receive the knowledge they need to plan and execute marketing campaigns that result in more favorable customer results. Some authors say that one aspect of market orientation is customer orientation. For example, researchers have hypothesized customer orientation as part of market orientation, a term that consists of three behavioral components: customer orientation, competitiveness between rivals, and inter-functional coordination. (Slater & Narver, 1995). As a result of numerous interviews with managers, they came to the exception that market orientation ensures the pooling of efforts and individual projects, leading to excellent results. Some empirical studies show a close relationship between market orientation and several business performance indicators, including customer focus, profitability, customer retention, innovation, customer satisfaction, sales growth, and the success of a new product. As a company strategy that contributes to higher efficiency and productivity, customer orientation for a very long time was promoted. Studies have shown that consumer orientation has a positive impact on business and sales department performance (Slater & Narver, 1995; Singh & Ranchhod, 2004). In several studies, the direct effect of customer orientation on firm results was investigated (Deshpandé et al., 2012a; Kirca et al., 2005; Slater & Narver, 1995). Another research found a positive trend in the direct relationship between customer orientation and firm performance (Thoumrungroje & Racela, 2013). The indirect effects of customer orientation on business performance have been examined in recent studies through other organizational processes such as innovation and suggested innovation as a "missing link" between customer orientation and business efficiency (Han et al., 1998; Agarwal et al., 2003; Maydeu-Olivares & Lado, 2003). Literature has mediated a “market orientation- innovation performance” chain and used banking industry data to empirically test the connecting role of innovation in the market orientation-corporate performance relationship (Han et al., 1998). Researchers have proposed that orientation to a market has a double role: a direct performance contribution and as an indirect innovation contribution (Matear et al., 2002). Scholars examined customer orientation in the field of innovation through a sample of 193 sales departments in Japanese companies in three types of conflict (Matsuo, 2006). As a result, customer focus was found to be impacting innovation by intensifying positive conflict and reducing negative conflict. Customer orientation may lead to certain variables related to new service or product development activities which lead to innovation performance in turn.

A study has argued that many large companies that listen too closely to their customers fail because customers impose severe restrictions on strategies that firms may not use (Christensen, 2011). This is because customers are unaware of how their needs evolve or how other innovations will affect their meetings. As a result, managers are motivated by designing new, similar programs to current ones, based on customer reaction. Researchers have pointed out that, because of service characteristics, customer-oriented service firms can pay particular attention to current customers and unconsciously ignore the potential needs of new customers (Ramani & Kumar, 2008). This creates an impetus for customer-orientated service providers to further build creative services. Students have shown that incremental innovation in service is linked with customer-led tactics that focus on obvious needs (Slater & Narver, 1998; Faché, 2000). Companies run by customers depend on identifying customers' unique needs and designing programs to meet those requirements. Researchers have argued that customer-oriented employees have satisfaction from pleasing external and internal customers (Donavan & Hocutt, 2001). Additionally, other researchers said that improving the understanding and use of customer learning to produce better products or services should directly influence customer satisfaction (Gustafsson et al., 2005). Moreover, it has been highlighted that the world economy has created compression on competition and managing customer satisfaction which becomes an essential strategy in attaining a competitive advantage (Navickas et al., 2015). Successful firms believed to enjoy a high level of customer satisfaction if they have a high level of revenue. Scholars who researched customer satisfaction topic agreed that satisfied customers became loyal customers. Most scholars have reported that customer satisfaction and financial performance have a clear correlation within an organization (Anderson et al., 2004; Gupta & Lehmann, 2006; Li et al., 2005; Kumar, 2005). If financial performance and customer satisfaction were associated, reduced customer satisfaction may bring a reduction of repurchases, preferences, and recommendations, based on unsatisfying customer experiences.

### *2.2 Service-dominant Logic theory:*

This paper builds on theoretical and empirical literature on the Service-Dominant Logic theory (SDL) (Lusch & Vargo, 2006). In this article, we focus on customer orientation to study how it affects financial performance with the mediating role of service innovativeness in the service firms. Modern studies emphasize the need to consider the client as a service provider and creator of the personalized experience. The essence of customer-oriented service lies in the consumer’s making a significant contribution to the process of designing and producing final products. The contribution may be the consumer himself, his property, or the information that he has. Researchers stated in their theory of “non-ownership” clarified the concept of “service” and noted that economic interactions accompanied (or not accompanied) can be characterized by “obtaining material benefits for temporary use”; “Obtaining qualified assistance from other people”; “Access to network resources (using information and communication networks, as well as banking, utilities, and other services)” (Lovelock & Gummesson, 2004; Ehret & Wirtz, 2010). The studies of Vargo and Lusch have shown the most customer-oriented service approach (Lusch & Vargo, 2006). The authors claimed that marketing is evolving from goods-dominant logic (GD) to service-dominant logic (SD) in the direction of a new logic. The client and the company in the process of value creation interact online, and the cost of the product or service does not exist by itself but depends on the consumer perception of the contextual experience invested in the customer-oriented service. Moreover, the co-creation of values, accompanied by the exchange of services, is the fundamental basis in service-dominant logic. In other words, in service-dominant logic in the exchange of service-for-service, material goods are only a mechanism for the distribution (delivery) of a service, as an alternative to the direct provision of a service. Thus, firms are an element of the service system along with clients, suppliers, partners of an inter-company network. SDL is realized through the transition of organizations from the competitive space of goods to the solution space, forming global value chains. The studies of the researchers most accurately determine future trends in the development of the theory of relationship marketing (Lusch & Vargo, 2006). The customer-oriented service acts as a set of competencies and resources of clients, solutions of products of personalized suppliers, employees, and partners of the service ecosystem. Through new information technologies, consumers enter into a dialogue with manufacturers of product offerings. Customers change the dynamics of the market by taking a direct part in creating value. A distinctive characteristic of the modern market is that customers are turned into a new source of experience for businesses and that the idea of personal knowledge as an organization's competitive advantage is implemented. In a customer-oriented service, the main principle of relationship marketing is cooperation. That is, all members or parties involved in the process of creating a product offer are considered as an equal partner. Many scholars proposed the study, in which they examined the decisive competitive advantage of an adequately developed relationship network within and outside their companies and leading to success (Creelman, 1991). Relationship management is not based on an individual unit in implementing a customer-oriented strategy, but rather on the conception of business processes and an integral part of a company's corporate culture. It is not just the integration of customer relationship management (CRM), supplier relationship management (SRM), and enterprise resource management (ERM) systems that create a customer-oriented customer value creation network. A consumer value network is a system that expands a company's core competencies, engaging suppliers and other partners with unique capabilities to provide additional products and services to significantly increase the benefits offered by the company and support the brand. Building client-side processes create new opportunities to ensure the flexibility of the organization in a competitive environment and to respond quickly to emerging market opportunities for the development of customer-oriented services. Changes take place as consumer information accumulation and processing progressively become a corporate system of knowledge in the company and this becomes, in turn, a source of progressive changes, which is the important "know-how" that distinguishes a company from its competitors. Customer orientation is a characteristic that represents the key place of customer interest in the system of priorities of management and business owners. Customer focus is a marketing tool that enhances customer loyalty to the company. Therefore, it is a means to use additional resources of the company to defeat competitors.

### *2.3 Customer orientation and financial performance*

The effect of customer-oriented programs and innovation on the financial performance of the hotel sector in Iran was examined in studies (Jalilvand, 2017). For the study, the authors used a survey of 226 respondents from Isfahan's 3 * and 4 * hotel managers and staff, and the findings of Structural Equation Modeling indicate that customer orientation and innovativeness have a major effect on the financial performance of the hotel. Besides, customer orientation has influenced hotel employees' innovativeness. Scholars have argued that customer orientation can create a competitive advantage by making an uncommon, difficult to imitate, and high-quality product value (Slater & Narver, 1998); (Slater & Narver, 1995). Value creation comes at the cost of increasing customer welfare through reducing costs (Nwokah & Maclayton, 2006). Another study has explored that customer orientation can be evaluated as a strategy for obtaining critical info about customer needs (Management, 2003). Scholars recommended that customer orientation be the basis of business achievement and that all firms should understand and be aware of its importance (Br, 2015). Researchers have measured customer orientation across 140 strategic business units (SBUs) within a large, western corporation (Slater & Narver, 1995). According to Top manager's rating of firm performance, they found that SBUs with the greater customer orientation had expressively higher return on assets (ROA) than SBUs ranked with medium and low customer orientation. Studies also have shown that businesses will make financially competitive deals if they understand their customer needs better (Dawes, 2000). Researchers have concluded that customer orientation has a reasonable financial results outcome (Deshpandé et al., 2012a). During many studies, the positive impact on company efficiency has been demonstrated by customer orientation. Researchers have examined the association among corporate culture and business performance in 50 Japanese firms and found that firms rated as better performers were highly customer-oriented (Deshpandé et al., 2012a). In this analysis, the clients evaluated the degree of orientation of the organization towards the client by themselves, so the final results of the study are important. Hence, we put forward the first hypothesis:

**$H_1$:** *Customer orientation is positively related to financial performance.*

### *2.4 Customer orientation and service innovativeness*

Customer orientation is a culture where consumer desires and expectations are formally communicated between departments and managers within an organization and informally between all employees of a company. It has been established that the exchange of knowledge facilitates organizational capacity creation (Bergman et al., 2004; Teece & Teece, 1998). To foresee changes to wishes and create new goods and services these businesses should be finely positioned (S.Day, 1994). In particular, the study argued that service innovation could result from a firm's ability to focus on thinking on behalf of the customer to achieve an outcome beyond the expectations of the customer (Kandampully, 2002). The author also notes that service industry leaders are implementing new technologies, meeting consumer standards, and setting the pace on the market. Many scholars have been exploring the unresolved debate about the effects of customer orientation on innovation outcomes (Christensen et al., 2005); (Narver, J.C., & Slater, 1990). In marketing, customer orientation is widely believed to increase innovation, as it affects the creation of something new or different in response to market conditions (Jaworski & Kohli, 1993). Customer-oriented companies prioritize and define latent client requirements, thereby enhancing innovativeness knowledge usage and learning (Narver et al., 2004). Management analysts tend to argue that customer-oriented behavior is a source of marginal innovation because customers find it difficult to express their latent desires that go beyond current consumption. (Christensen et al., 2005; Christensen, 2011). This creates competition for creative service companies. Besides, several programs are designed to suit the unique needs of the service provider to distinguish better through creativity (Cadogan et al., 2002). Some researchers have established that customer orientation is an organizational strategy (or culture) of changes and improvements in response to changing wants and requirements of customers which, thus promotes innovation (Narver, J.C., & Slater, 1990); (Jaworski & Kohli, 1993). Customer orientation makes it possible to use data, train, and identify external customer needs and therefore, affect activities to promote new products and performance. Customer orientation greatly increased the efficiency of innovation programs, both in product innovation and in-service innovation experiments (Atuahene-Gima, 1995). Study on the Top 500 Taiwanese Service Firms in terms of total revenue examines how the market orientation of the company has an impact on service innovation and, consequently, on the market and financial performance of the company (Cheng &

Krumwiede, 2010). The results show that the business is more likely to pursue an increased service innovation if a company uses its customer orientation, while the companies are likely to take a stronger stand for service innovation when a company uses competitor orientation. Studies have shown the independent effects of market orientation components such as customer orientation, competitor orientation, inter-functional coordination on innovation success and found the market orientation components have a positive impact on innovation, but the effect of competitor orientation depends on a minimum level of customer orientation (Grinstein, 2008). Findings also indicated that, despite the high competition, the relationship between market orientation components and developments is stronger but weaker in the face of technology turbulence. In conclusion, results indicate the relationship is stronger in big firms and service firms. According to the literature, we put forward the second hypothesis:

**H$_2$:** *Customer orientation is positively related to the service innovativeness.*

### *2.5 Service innovativeness in the relationship between customer orientation and financial performance*

Innovations introduced within the company can deliver excellent performance in almost all business areas. Because of the considerable financial resources and uncertainties associated with innovation, there is a large amount of work that examines the innovation outcomes. There is ample empirical proof of innovation and market success that supports important positive ties. Out of 159 types of research analyses, which tested the association between innovation, efficiency, the positive and strong relationship between innovation and the value of the company (e.g., stock market efficiency, market capitalization), market position (e.g., sales growth, market share) and financial position (profitability, return on investment) were discovered after the event (Rubera & Kirca, 2012). Nevertheless, the effect of innovation on a company's work in different strategic areas is still little understood. Some other scholars have argued that innovativeness is the first building block of innovation and the concept of openness to new ideas is a key aspect of a company's culture (Hult et al., 2004). Innovativeness is one of the most important strategic guidelines for organizations to achieve long-term success (Martínez-Ros & Orfila-Sintes, 2009). Earlier research has shown that innovativeness has a positive impact on the performance of ventures in the hospitality industry (Tajeddini, 2010). Researchers have found that non-owner hotel managers in the Balearic Islands are more innovative than owners-managers and that managers have the strongest impact on innovative behavior. (Martínez-Ros & Orfila-Sintes, 2009). It is also found that successful innovation is customer-oriented in a hospitality study in Germany (Ottenbacher, 2007). Another scientist demonstrates that catering companies, hotels, and retailers offer new products to customers less often than other sectors (De Jong, 2003). It means the hospitality industry could not respond quickly regardless of the benefits of innovativeness as a valuable tool for businesses, and there is limited empirical research on how to increase the performance of the hospitality firm. Several studies show that service innovation has a positive impact on the performance of a company (Grawe et al., 2009; Nijssen et al., 2006). According to other researchers, global market companies compete based on services rather than goods, since service innovation is a value-creating operation that drives customer orientation and firm market performance (Slater & Narver, 1995). Companies facing environmental problems and uncertainty can achieve good results by incorporating social and technical control into their innovation structure. The ability to innovate is the most important factor determining the efficiency of the company, said (Mone et al., 1998). Innovation and market orientation are different concepts but are interrelated. Market orientation in response to market conditions implies the realization of something new and can be perceived as innovative behavior. That is, market-oriented firms increase innovation and thus enjoy success in marketing new products (Jaworski & Kohli, 1993; Slater & Narver, 1995). Scholars also argued that the success of innovation on the road to productivity is an important manifestation of market orientation (Deshpandé et al., 2012a; Slater & Narver, 1995). Thus, other researchers argued that although market orientation and innovation have an important impact on business performance, much of the difference in business performance is explained by the intermediary role of innovation concerning market orientation and productivity (Agarwal et al., 2003). Innovation is less likely to be seen by less market-oriented companies, so these companies could be less successful if not shielded from the competition (S. Agarwal et al., 2003). As a result, companies that demonstrate a significant capacity to innovate will respond more successfully to environmental changes and develop skills that will enable them to gain a competitive advantage, which will ultimately lead to increased efficiency (Hult et al., 2004). The progress of innovation in the field of insurance and banking services depends on the company's market orientation, in particular its customer orientation suggested by numerous scholars (Atuahene-Gima, 1995). Market orientation is, therefore "the key to innovative success in the service sector." As imitating service inventions is simpler and quicker and therefore harder to shield them through patenting and copyright means, researchers have argued that a strong link is incontrovertible between consumer orientation, innovation, and business performance (Lado & Maydeu-Olivares, 2001). Hence, according to the arguments above the following hypothesis is formulated:

**H$_3$:** *Service innovativeness mediates in the relationship between customer orientation and financial performance.*

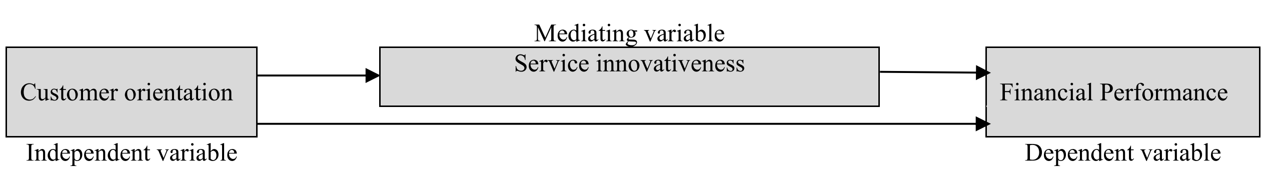


**Fig. 1.** Conceptual Model

## 3. Methodology

### *3.1 Data and sample:*

Data was collected through a nationwide survey in 14 provinces of China by sending a questionnaire to top managers and general managers of service firms. A selective combination of firms in China consisted of members of the Chinese Quality Association (CAQ). CAQ is a national nonprofit organization, managed by a central government that is responsible for economic development and quality and has more than 3000 members in the service industry and manufacturing. Emails were sent to all members of CAQ. Then, this resulted in 686 usable questionnaires. Table 1 represent the profiles of the respondent firms. Respondents, as we mentioned above, were mostly from the top and general managers of different types of service industries. Service firms consist of industries, including business services (20%), retail and wholesale trade (15.7%), transport and logistics (9.3%), and other types of services.

**Table 1**
Company profiles

| Industry (Dataset N=686) | Number of firms | Percent (%) |
|---|---|---|
| Business services | 137 | 20 |
| Retail and wholesale trade | 108 | 15.7 |
| Transportation and logistics | 64 | 9.3 |
| Real estate and property management | 50 | 7.3 |
| Hotel and catering | 47 | 6.9 |
| IT and communication services | 33 | 4.8 |
| Public utilities and services | 25 | 3.6 |
| Construction Finance and Insurance | 22 | 3.2 |
| Education and entertainment | 13 | 1.9 |
| Other | 170 | 24.8 |

### *3.2 Measures*

#### *3.2.1 Customer orientation*

Since customer orientation is an important component of service firms, with the development of theoretical approaches to the analysis of customer orientation, researchers have proposed a measurement tool based on psychographic scales, which made it possible to measure the relationship between customer orientation and business performance indicators. The first developments in this direction (Narver & Slater, 1990; Jaworski & Kohli, 1993) included a customer orientation unit in the market orientation assessment scale. In this study, with some trivial adaptations in wording, five items scale was created to measure the independent variable (customer orientation), which were borrowed from (Narver & Slater, 1990; Deshpandé et al., 2012a). Five items were recorded on a six-point Likert scale with 1(one) indicating that the firm does not participate in the practice at all and a 6(six) indicating that it participates in the practice to a very great range and makes improvement continuously.

#### *3.2.2 Service innovativeness*

Service innovativeness (mediating variable) was measured from four aspects as newness to the market, impact on the industry, adoption of new techniques, and creativeness (R. G. Cooper & Kleinschmidt, 1993); (Robert G. Cooper & Kleinschmidt, 1993). As indicators were commonly used impact on the industry and newness to the market and the technical characteristic of innovativeness has also been proposed as important (Swink, 2000); (Danneels & Kleinschmidt, 2001). Four items were measured on a six-point Likert scale with a 1 indicating strong disagreement and a 6 indicating a strong agreement.

#### *3.2.3 Firm performance*

The firm performance was measured as the financial performance of the company (dependent variable) of the main services compared to its main competitors to minimize the impact of the industry. Overall profitability, sales growth, market share growth, return on investment (ROI), ROI growth, return on sales (ROS), and ROS growth are key indicators. Respondents were asked to score the performance of their firm in these areas on a six-point scale compared to their main competitors with a 1 indicating significantly worse than the competitor and 6 indicating significantly better than the competitor. To confirm the reliability of the statement based questionnaire, the English version questionnaire was developed.

### *3.3 Data analysis*

The Smart PLS3 software was used for the analysis in this study. Smart PLS3 is a variance-based structural equation modeling program (SEM) with a graphical user interface using the partial least squares (PLS) path modeling approach (Hamdollah &

Baghaei, 2016). SEM is a second-generation, multi-dimensional data analysis tool commonly used in marketing research since scholars say that it can check linear and additive causal models which are theoretically supported (Chin et al., 2008; Haenlein & Kaplan, 2004). Parameters in Smart PLS3 were estimated according to the suggestions of scholars: Researchers suggested to use maximum likelihood with a bias-corrected bootstrapping approach with 5000 bootstrap samples and the number of bootstrap cases, and with 300 maximum number of iterations (Hair et al., 2009; Hair et al., 2013). Since Smart PLS3 is not reading the data with missing values, we found out 192 missing values from our 686 sample size and then recoding them to (-99) marker and set up in parameters to the further "mean replacement". Replacing missing values is necessary to get a correct analysis. In this study, using PLS Algorithm firstly were calculated the reliability and validity, then using the Bootstrapping method the path coefficients (direct, indirect, total, and t-test) were calculated to determine the significance of indirect/ mediation effect in the hypothesis.

## 4. Results

### *4.1 Reliability, validity & factor analysis:*

Reliability and validity test are two technical properties which indicate the quality and usefulness of the test and they are the most important features of a test. After the data collection, reliability, and validity of the constructs were tested several times and have got the same results, that's mean that our data is good for further analysis. Composite reliability and convergent and discriminant validity testing process were supported by the previous studies of several authors. After calculating our data by PLS Algorithm, firstly, as suggested by the scholar, were checked the indicator reliability value, to find them each outer loading were squared. As reported in Table 2, it can be seen that all of the indicators have individual indicator reliability values that are much larger than the minimum acceptable level of 0.40 and higher from the preferred level of 0.70.

**Table 2**
Construct reliability and validity

| Constructs | Indicators | Loadings | Indicator Reliability | Cronbach's Alpha | Composite Reliability | AVE |
|---|---|---|---|---|---|---|
| Customer orientation (CO) | CO1 | 0.869 | 0.755 | 0.930 | 0.947 | 0.781 |
| | CO2 | 0.896 | 0.803 | | | |
| | CO3 | 0.887 | 0.787 | | | |
| | CO4 | 0.889 | 0.790 | | | |
| Service innovativeness (SI) | CO5 | 0.878 | 0.771 | | | |
| | SI1 | 0.888 | 0.789 | 0.920 | 0.944 | 0.807 |
| | SI2 | 0.909 | 0.826 | | | |
| Financial performance (FP) | SI3 | 0.915 | 0.837 | | | |
| | SI4 | 0.880 | 0.774 | | | |
| | FP1 | 0.856 | 0.733 | 0.957 | 0.965 | 0.797 |
| | FP2 | 0.882 | 0.778 | | | |
| | FP3 | 0.867 | 0.752 | | | |
| | FP4 | 0.898 | 0.806 | | | |
| | FP5 | 0.903 | 0.815 | | | |
| | FP6 | 0.924 | 0.854 | | | |
| | FP7 | 0.914 | 0.835 | | | |

Then, to measure construct reliability were computed composite reliability (CR) following (Bagozzi & Yi, 1988). Usually, in social science research scholars are using the "Cronbach's Alpha" to measure internal consistency reliability, but it tends to provide a conservative measurement in PLS-SEM. And previous literature has suggested using "Composite reliability" for "Cronbach's Alpha's" replacement (J. F. Hair et al., 2013); (Bagozzi & Yi, 1988). From Table 2, our values are shown to be larger than 0.70, so all our variables demonstrated high levels of internal consistency reliability.

### *4.2 Correlation analysis*

To test the convergent validity, the Average Variance Extracted (AVE) of each latent variable is assessed. In Table 2, the AVE values were shown to be greater than the acceptable 0.50 range, so convergent validity was achieved. Also, we followed studies of (Fornell & Larcker, 1981), which suggested the square root of AVE in each latent variable, where this value is greater than the other correlation values between the latent variables. AVE's determined square root is represented in Table 3.

**Table 3**
Correlation between the constructs

| | CO | SI | FP |
|---|---|---|---|
| CO | 0.610 | | |
| SI | 0.457 | 0.651 | |
| FP | 0.492 | 0.574 | 0.635 |

The result indicates that the squared AVE numbers are larger than the correlation values in each column and row. These results provided that discriminant validity is well established.

*4.3 Regression analysis*

Researchers have argued that PLS is a useful tool for hypothesis testing (Spencer et al., 1982; Chin, 2010). The bootstrapping method was used to test the hypothesis (Preacher & Hayes, 2008). Nowadays, the bootstrapping method for testing the indirect effect became increasingly popular. Bootstrapping is a non-parametric technique based on resampling with a replacement which is done 5000 times. From each of these samples, the indirect effect is calculated and a sampling delivery can be made empirically. To test the hypothesis with the mediating variable, we followed the causal-step guidelines proposed by (Baron & Kenny, 1986). Researchers have summarized these procedures as follow (Preacher & Hayes, 2008):

- *X* significantly effect for variability in *Y;*
- Variable *M* is a mediator if *X* significantly accounts for variability on *M;*
- *M* significantly accounts for variability *Y* when controlling for *X;*
- and the effect of *X* on *Y* decreases substantially when *M* is entered simultaneously with *X* as a predictor of *Y.*

The results of the hypothesis testing are summarized in Table 4. For the testing significance of the relationship between variables with the Bootstrapping method, a step-wise approach in different estimated path models was used. First, the model with only the total effect *c* was calculated (Fig. 2). Thereafter, the mediation variable was included to test the whole model (Fig. 2).

1. First path model with only the total effect:

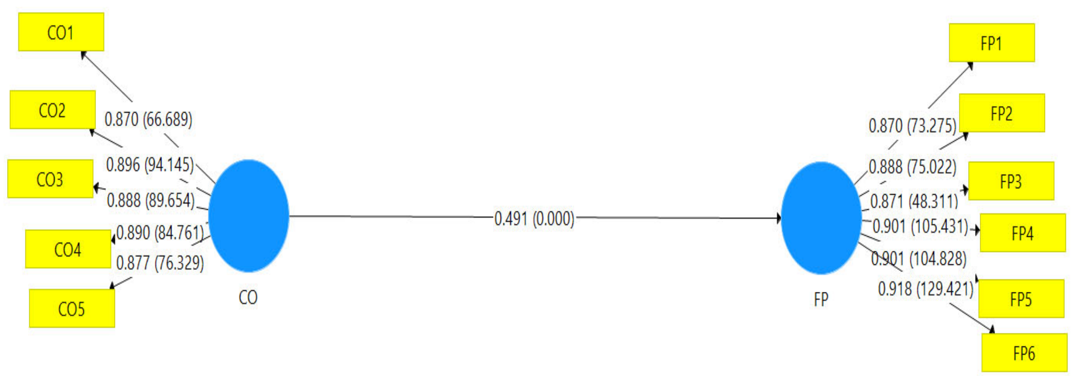


**Fig. 2.** Path model coefficients with only the total effect *c*

Fig. 2 represented that the total effect of customer orientation on financial performance was significantly positive with a coefficient of 0.491, with t=14.555, and p-value =0. Hence, our first hypothesis (H1) was supported.

2. Second path model of the full model:

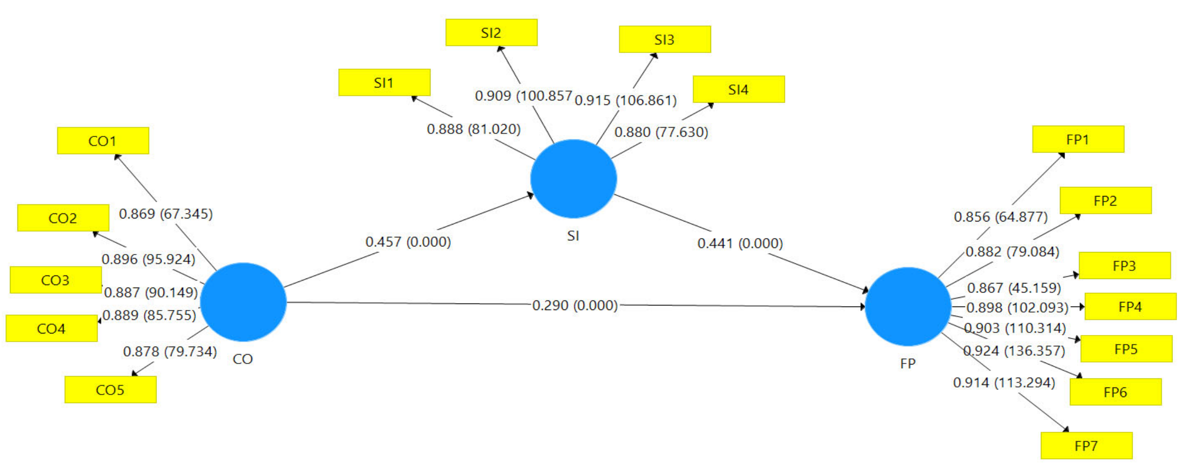


**Fig. 3.** Path model coefficients of the full model with the mediating variable

As reported in Fig. 3, customer orientation had the strongest positive effect on service innovativeness with the coefficient of 0.457, with t=14.405, and p-value=0, thus our second hypothesis (H2) was supported. According to the proposed steps of testing the mediating effect, Fig. 3 represented the significant effect of mediating variable *M* (service innovativeness) to dependent variable *Y* (financial performance) with the coefficient of 0.441, with t=12.5, and p-value=0.

**Table 4**
Results of hypothesis testing

| Path in the structural model | Path coefficient | | t-value | p-value | Outcome |
|---|---|---|---|---|---|
| | Simple model | Full model | | | |
| CO→FP | 0.491 | 0.290 | 14.555 | 0.000 | Supported |
| CO→SI | | 0.457 | 14.405 | 0.000 | Supported |
| CO→SI→FP | | 0.290 | 7.345 | 0.000 | Rejected |

The effect of *X* (independent variable) on *Y* (dependent variable) should decrease substantially when *M* (mediating variable) simultaneously entered to the model (Baron & Kenny, 1986). To test the mediating effect (H3), a full model was tested. From Figure 3 we saw that the effect of *X* to *Y* was still positive with the coefficient of 0.290, t=7.345, and p-value=0. Thus, the hypothesis (H3) of the mediating effect was rejected. In the further chapter, I was given the explanations.

## 5. Discussion

This study examines the relationship between customer orientation and financial performance and examines the mediating role of service innovativeness among them. Some of the scholars argued that the emphasis of every organization is on customer orientation and a central component of market orientation (Jaworski & Kohli, 1993); (Deshpandé et al., 2012b). However, researchers explored the questions about the positive effect of customer orientation on firm performance (Danneels, 2003); (Narver et al., 2004) and results of these studies show that increasing customer orientation can lead to firms focusing too much on their customers and, as a result, ignoring newly emerging customer needs.

Our first hypothesis supported by different researchers in their studies (Narver, J.C., & Slater, 1990); (Jaworski & Kohli, 1993); (Deshpandé et al., 2012b). Also, other studies have claimed that if organizations have a superior understanding of their customer needs, they can make financially profitable offerings (Dawes, 2000). Some of the scholars have argued that customer orientation has a satisfactory result on financial performance (Deshpandé et al., 2012b). He has examined the association among corporate culture and business performance in 50 Japanese firms and found that firms rated as better performers were highly customer-oriented. In this analysis, the clients evaluated the degree of orientation of the organization towards the client by themselves, so the final results of the study are important. Multiple studies have shown that customer orientation has a positive impact on business efficiency.

Based on the analysis of the relationship between customer orientation and financial performance in Chinese service companies, it was concluded that customer orientation is one of the most important sources of competitive advantages for the company and has a significant impact on the company's main performance indicators. Our first hypothesis (H1) is thus verified by the results of the statistical study that customer orientation has a significantly positive impact on financial performance.

According to research, the only real goal of a business is to create customers, so the company has only two main functions: marketing and innovation (Ulin, 1954). Focusing on innovation, companies create new ideas of services/products to furthermore satisfaction of customer needs. Statistic results of this study supported a positive and significant relationship of customer orientation on service innovativeness (H2), which is consistent with the findings of previous studies (Atuahene-Gima, 1995), who argued that customer orientation makes it possible to use data, train and identify external customer needs and, therefore, affect to activities to promote new products and performance. Customer orientation greatly increased the efficiency of the innovation projects in both product innovation and service innovation samples. Studies have shown that the independent effects of market orientation components, such as customer orientation, competitor orientation, inter-functional coordination of innovation performance, have shown that market orientation components have a positive impact on innovation, but the impact of competitor orientation depends on a minimum level of customer orientation (Grinstein, 2008). Findings also indicated that, despite the high competition, the relationship between market orientation components and developments is stronger but weaker in the face of technology turbulence. In conclusion, findings suggest that the relationship is stronger in large firms and service companies.

## 6. Theoretical and practical implications

The first initial step of testing the mediating effect was to establish that such an effect of the independent variable (customer orientation) on the dependent variable (financial performance) exists. To prove this effect it requires that the analyses have sufficient power to find the total effect. As we mentioned above, we found out the strong and positive total effect in the relationship between independent to dependent variable with the path coefficient of 0.491. Nevertheless, in the last step of testing the indirect effect proposed by (Baron & Kenny, 1986), the mediating effect of service innovativeness in the relationship among customer orientation and financial performance statistically was rejected (H3). This result seems very surprising because it would seem that this is a clear model, where logically a customer-oriented firm, by improving its service innovativeness entails good financial results. But these findings went against the prior research proofs that found the strong effects of service innovativeness in the relationship between customer focus and financial performance. As our third hypothesis was supported, authors have argued that firms that are less customer-oriented are less likely to consider innovation, and such firms may experience deterioration in performance if they are not protected from competition (Hult et al., 2004); (Atuahene-Gima, 1995). As a result, companies that demonstrate a significant capacity to innovate will respond more successfully to environmental changes and develop skills that will enable them to gain a competitive advantage, which will ultimately lead to increased efficiency (Hult et al., 2004). The effectiveness of innovation in the field of insurance and banking services depends on the company's market orientation, in particular its customer orientation suggested by numerous authors (Atuahene-Gima, 1995). Market orientation is, therefore “the key to innovative success in the service industry”. Hence, after the calculation of our last mediated hypothesis, we found that we still had a positive direct effect, which meant the presence of partial mediation (Baron and Kenny, 1986). Supported by the proposed decision tree for establishing the type of mediation by different authors, we have determined the presence of partial complementary mediation. Partial mediation means that the mediating variable intervenes for some part but not all of the relationships between customer orientation (IV) and financial performance (DV) (Zhao et al., 2010).

## 7. Limitation and future research

There are some limitations on literature related to the presence of positive direct effects (partial mediation) that, more often than not, some authors do not hypothesize direct effects. They conclude them as a demonstration of partial mediation in the "Results" section, in which both the a*b path and the direct effect are significant. Some of the scholars have argued that the positive direct effect is a measurement error of mediation (M) and often it’s a result of skipping several mediators in the model which could be in it (Shrout & Bolger, 2002). In both developed and developing countries, prior research on the impact of market orientation with a customer emphasis on firm results has shown mixed findings. While some of the scholars in their studies have confirmed the direct relationship of customer orientation to firm performance (Sinkula et al., 1997; Dwyer & Mellor, 1993). Some scholars in their study indicated that marketing relationships contribute to positive business results through growing engagement and trust (Morgan & Hunt, 1994). But other researchers' meta-analysis showed the two-thirds of the total influence on business performance of relationship marketing, rather than mediated by commitment and trust (Palmatier et al., 2006). The direct effect was positive, leading them to look for substitute intermediaries with the same sign. And they found another key mediator as consumer appreciation. Our study provides evidence that customer orientation is positively related to service innovativeness because to satisfy their customers they always should try bringing new ideas and techniques to improve their product or services, which will differentiate them from their main competitors. Also, customer focus is a positive indicator by itself for the growth of financial performance, as we found from the analysis results. Hence, it’s important for every firm to monitor continuously their customer needs and simultaneously improve their technologies, service/product innovations and also take into account the other factors, which can influence the financial performance as a mediating effect. Therefore, according to our results of the mediating effect, further investigation is needed to understand the possible variables, mediating in the relationship between customer orientation and financial performance, since in this study we considered only one mediator. Also, as suggested by different researchers, consider and assess suppression effects (Rucker et al., 2011). They argued that this is important because the exploration of suppression effects gives a chance to gain a deeper understanding of the relationship between variables. Furthermore, while preparing a research study, it is better to consider not only mediating variables that link the IV to the DV, but also potential suppressors that might hide this relationship. We came to these results according to the analysis of data, which we collected from the Chinese service firms and in further research works related to this topic, however, it would certainly be interesting to see the results of data analysis, collected from companies of other countries.

## 8. Conclusion

Summarizing the existing research on the study of customer focus in the framework of the company’s innovative development would like to note that customer focus influences, varying degrees, the ability of companies to create different types of innovations. In the case when innovations are incremental improvements, customer orientation increases their efficiency and contributes to ideas for gradual improvements. When developing radical innovations, customer orientation reduces the risk of development failure, and also accelerates the adoption of innovations by the market; however, new product ideas, as a rule, come from developers and not from consumers. However, for any type of innovation, customer focus increases their effectiveness.

**Disclosure statement**

The authors have not reported any potential conflict of interest.

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