

December 2002

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Recommended Citation

Jackson, Joyce; Chang, Kuo-chung; and Grover, Varun, "E-COMMERCE STRATEGY AND CORPORATE PERFORMANCE" (2002). *AMCIS 2002 Proceedings*. 101.
<http://aisel.aisnet.org/amcis2002/101>

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E-COMMERCE STRATEGY AND CORPORATE PERFORMANCE

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Abstract

This study proposes that e-commerce (EC) initiatives are important strategic initiatives and firms' with a stronger market orientation with respect to EC would be more successful. Content analysis of the CEO's letter to shareholders of 135 Fortune 500 firms was conducted in order to evaluate the importance of EC and strategic orientation. The results provide support to the study's propositions and indicate that EC must be pursued carefully as a strategic initiative, rather than an appendage to an existing organization.

Keywords: E-commerce, strategic orientation, market orientation, corporate performance, CEO letters, content analysis

Introduction

Over the year 2000-01 a plunge in the share prices of dot com companies sent the tech-heavy NASDAQ index into a free fall; down 67% of the record high achieved on March 10, 2000. True, an economic slowdown was on the horizon, yet one thing was painfully clear; the Internet "pure plays" could not find sustainable profitability in e-commerce simply by excelling in the management of technology, information and the consumer behavior. Hence, rather than viewing e-commerce as an appendage to the business or an afterthought, it is our contention that firms must clearly recognize their e-commerce initiatives as an integral part of their strategic objectives. In addition, we also propose that, particularly in the competitive e-commerce environment, deliberately following a strategy that reflects a market orientation would be critical to success.

Therefore, the overall goal of this study is to investigate the extent to which large successful companies adopt an e-commerce posture that is integrated with their corporate strategy, and to that end, we examine the qualitative portion of the company's Annual Report: the CEO's Letter to the Shareholder using content analysis. The Chairman's letter to the shareholders presents a unique observation deck for the researcher interested in examining corporate strategy (Ginsberg 1988). Bowman (1978) demonstrates that, "content analysis of annual reports can be of real usefulness for understanding issues of corporate strategy". Bettman and Weitz (1983) argue that the CEO's letter, which is a standardized component of the report, provides comparable, and more objective data on organizations than interviews. Pfeffer (1981), recognizing the utility of the CEO's letter as a source of "objective" data on organizations, has called for increased research use of annual report data.

Hypotheses

The Perceived Importance of E-Commerce

Despite the various arguments addressing the benefits provided by e-commerce, we hold that merely adopting e-commerce does not ensure competitive advantage because the technological architectures and tools on which it is based are increasingly open and

available to all competitors. It is increasingly being recognized that economic impacts do not emanate from IT investments directly, but through the value created by the interaction of these assets with the “complementary assets” of the firm (Clemons 1991).

Consistent with the resource-based view of the firm, Bharadwaj (2000) proposes that the ability to mobilize IT resources in conjunction with other organizational resources is critical to superior performance. Therefore, corporations that perceive the importance and potential of e-commerce as reflected in its integration with corporate strategy would be more likely to leverage the efficiency and effectiveness benefits inherent in the e-commerce marketplace.

Through such strategic recognition it is presumed that the unique resources and capabilities created by the interaction of technology with complementary assets of the firm would be mobilized to create inimitable and sustainable competitive advantage for the firm. In contrast, failure to recognize e-commerce as a part of corporate strategy is more likely to result in isolated initiatives or responses to competitive pressures that are less likely to leverage the full complement of organizational resources. Therefore, we propose the following hypothesis:

H₁: There is a positive relationship between a firm’s perception of the importance of e-commerce, as reflected in corporate strategy, and firm performance.

Market Orientation

Market orientation reflects a firm’s strategic direction to create the proper behaviors for the continuous superior performance of the business. While some research shows that the relationship between market orientation and performance could be contingent on industry characteristics, customer characteristics, or the type of performance measure used, the hypothesis that market-driven companies will outperform their competitors is generally supported (Day 1994; Gatignon and Xuereb 1997; Jaworski and Kohli 1993; Narver and Slater 1990, Kumar et al., 1998).

We argue that the market orientation of a firm is particularly applicable to e-commerce. Market oriented firms engaging in e-commerce would be more inclined to obtain efficiency as well as effectiveness benefits. Further, many e-commerce technologies are particularly suited for supporting a market orientation by providing a responsive and interactive medium through which an organization can gain and respond to in-depth knowledge with respect to competitors’ and customers’ profiles (Peterson et al., 1997). Additionally, by leveraging e-commerce technologies (i.e. inter-organizational information systems such as internet EDI and EFT), a firm can reduce transaction costs (Gatignon and Xuereb 1997; Bailey and Bakos 1997) and realize the possibility of mass customization, a concept of strategic flexibility that enables an organization to provide customers with personalized products while retaining the economic advantages of mass production (Pine 1993; Kahn 1998). These benefits provide a firm with positional advantages in that it could impart superior customer value with diverse products and lower costs (Day and Wensley 1998).

In sum, market oriented firms that stress both customer and competitor orientation can leverage the benefits offered by e-commerce technologies. Thus, we propose that in the intensely competitive e-commerce marketplace, a market-oriented organization would outperform one that does not actively pursue such an orientation. This leads to our second hypotheses:

H₂: Companies that are market oriented will outperform those that are non-market oriented in the e-commerce marketplace.

Balanced vs. “Skewed” Market Orientation

Extant research has examined the holistic effect of market orientation on business performance. The research also posits that both customer and competitor orientation are equally important and that a company should keep a balanced mix (Narver and Slater 1990; Slater and Narver 1994; Day and Wensley 1988; Desphande et al. 1993; Kumar et al, 1998). However, some researchers indicate that keeping a balanced mix may not be possible since managers cope with vast amounts of rapidly changing and often conflicting market information through the processes of selective attention and simplification (Pfeffer and Salancik 1978).

Since a manager’s perception of the relative importance of customer or competitor analyses with respect to a business’s ability to create and sustain superior value for customers determines the firm’s primary orientation (Day and Wensley 1988), it is argued that managers normally take a skewed or slanted market orientation. Alternatively stated, due to the limited information

processing capability of humans, managers generally take an orientation that is geared towards either the customer or the competitor, rather than the ideal balanced orientation. However, and consistent with the previous literature, we argue that focusing primarily on either customers or competitors could lead to a partial and biased picture of reality and that a balanced mixture of the two perspectives is the most desirable.

Furthermore, the open and omniscient architectures on which e-commerce is based can reduce entry barriers, customer switching costs, and purportedly, the power of suppliers. This could lead to greater levels of competitiveness, requiring firms to be responsive to both customer and competitor information. The ability to sense problems or opportunities and respond to them would be instrumental to success. Therefore, we propose that a balanced posture with respect to customer and competitor orientation as opposed to a skewed posture, that's slanted towards either orientation, would better leverage the benefits provided by e-commerce. More formally stated:

H₃: Companies pursuing a balanced market orientation strategy would outperform those pursuing a skewed strategy in the e-commerce market space.

By testing these hypotheses, this research addresses the following questions:

1. How important is e-commerce to corporate strategy in large U.S. firms? Is that importance reflected in improved corporate performance?
2. Does a firm's strategic direction with respect to e-commerce have an impact on their performance?

Methodology

Industries were chosen to reflect a broad range of industry types as suggested by Narver and Slater (1990). The sample frame used for this study was corporations in the Standard & Poor's 500 index. A total of nine industries were selected so as to provide a wide diversity of the potential to use e-commerce: Banking, Non-Banking Financial, Electronics, Retailing, Manufacturing, Consumer Products, Fuel, Food, and Metals & Mining. Further, the industries were selected in order to coincide with the Standard & Poor (S&P) and Morgan Stanley Capital International (MSCI) Global Industry Classification Standard (GICS) system. The system was developed in response to the global financial community's need for one complete, consistent set of global sector and industry definitions that reflects today's economy. Using a stratified random sampling plan, companies were selected within each industry

Coding Scheme

Based on a review of the associated literature (Bailey and Bakos 1997; Day and Wensley 1988; Deshpande et al. 1993; Gatignon and Xuereb 1997; Jaworski and Kohli 1993; Kahn 1998; Kohli and Jaworski 1990; Kumar et al., 1998; Narver and Slater 1990; Pine 1993; Robert 2000; Rust and Zahorik 1993; Slater and Narver 1994, 1995), three sets of coding schemes associated with e-commerce, a customer-centered strategy and a competitor-driven strategy were developed (see Table 1). E-commerce terms or phrases would refer to the e-commerce applications and those value-added processes that enhance a firm's performance. Terms such as Internet, EDI, EFT, on-line, B2B, B2C, e-strategy etc, were thus identified as being representative of the concept of e-commerce.

In terms of a customer-focused strategy, since this orientation aims at gauging and satisfying customer's needs along the entire value chain, firms adopting a customer-led strategy tend to emphasize activities that could establish a close relationship with the customer which often leads to enhanced customer satisfaction, trust and loyalty. Therefore, terms such as customer, customization, service, trust, relationship, satisfaction, loyalty, etc., were seen to be representative of a customer-oriented strategy.

Competitor orientation is most similar to Porter's overall cost leadership and differentiation strategies (Porter 1980, 1985). Porter's strategy of cost leadership is characterized by cost control efforts. The differentiation strategy focuses on product diversity in terms of design, style, and quality and tends to optimize the marketing mix so as to increase market share or expand the customer base. Thus, terms such as product differentiation, market niche, customization, cost reduction, product refinement, efficiency, market share, etc., were included as competitor-related terms.

Table 1. Coding Schema for Content Analysis

E-Commerce		Strategy			
		Customer-Orientation		Competitor-Orientation	
Internet	B2B	customer (service)	collaboration	differentiation	cost reduction
dot com	B2C	relation	cooperation	brand	product refinement
e-business	www	service quality	interaction	image	product quality
e-commerce	URL	trust	satisfaction	product diversity	efficiency
e-strategy	EDI	customization	reliability	new product	market share
(e-)	EFT	communication	loyalty	R&D	economies of scale
Virtual	electronic (marketplace)	customer retention		unique market	competitive pricing
(web) site	digital			market niche	price control
on line				specialized market	

The terms initially identified from literature sources were not exhaustive. Therefore, two additional steps were followed. First, a panel of six doctoral students and faculty were asked to classify these terms based on definitions of customer and competitor orientation. Second, an iterative procedure was adopted whereby the letters were randomly scrutinized for additional terms before final data collection ensued. Supplementary terms were subsequently added. Table 1 reflects the terms used for conducting the content analysis.

Content Analysis

Annual reports were obtained for each of the firms for the 1999 fiscal year. The year 1999 was selected because it was such a dramatic year in the emergence of e-commerce. During 1999, it appeared that the financial markets had suspended—at least, temporarily—traditional methods of investment valuation resulting in the stock prices of companies with no earnings greatly exceeding those who had real earnings. Then, in the year 2000, the stock prices of those companies began to come more into line with their valuations. While these events and the resulting perceptions were dramatic, the change in the perceptions of the Internet and e-commerce as an opportunity to fuel innovation, to open up alternate distribution channels, to create new cost structures and to in general, transform an organization’s competitiveness, underwent a less dramatic change in perception. Thus, the impact of the Internet and e-commerce, and what had been happening in stock markets around the world, were two very distinct phenomena. For each annual report, each CEO’s letter was copied, read, and all words related to e-commerce were underlined. The analysis proceeded following the general principles put forth by Krippendorff (1980) for the content analysis method. An e-commerce related phrase was the unit of analysis and was defined as an instance of a word or a set of words that “embodied the concept of using network information technology in order to engage in a wide range of activities up and down the value-added chain both within and outside the organization” (Applegate et al, 1996). Each e-commerce related phrase referred to only one instance of an e-commerce related event, opportunity, or problem. Two judges received extensive training in the three sets of coding schemes that were developed based on a review of the associated literature. An initial test with 30 letters that were similar to, but not included in the actual sample, revealed that the two judges were in near 90% agreement concerning the identification of e-commerce related phrases. Next, each judge worked independently and then collectively, in the coding of each letter in terms of identifying the e-commerce related phrases, isolating those paragraphs containing those phrases, then coding the phrases based on the three sets of coding schemes. Each of the coding schemes formed the basis from which the numeric counts of the variables were obtained. Since the letters were of varying lengths, the e-commerce word count as well as the count associated with the two components of the market orientation, were each divided by the total word count of the associated letter, forming ratios indicating the extent to which a company is e-commerce oriented, marketing oriented and customer vs. competitor oriented. These ratios were later used for analysis to test the three hypotheses.

For hypothesis 1, the firm’s e-commerce ratio was used as the independent variable and was regressed on the performance measurements (the performance measurements are discussed in the next section). In order to test hypothesis 2, companies with a non-zero ratio of market orientation (i.e. customer or competitor) were classified as being market-oriented while those whose both market-oriented components ratio (i.e. customer and competitor) were zero, were classified as being non-market oriented.

For hypothesis 3, firms in the market-oriented group were further sorted into two levels (high or low) based on their ratios regarding customer and competitor orientation. Firms with a customer-orientation ratio above the ratio's statistical mean were labeled as high customer-oriented companies and those below the ratio's statistical mean were labeled as low customer-oriented companies. The same procedure was repeated for competitor orientation. Regarding the determination of a balanced versus skewed strategy, a firm was perceived as pursuing a balanced strategy if it had a high customer orientation and a high competitor orientation. A firm was considered having a skewed strategy if it had either a high-competitor and low-customer orientation or vice versa.

Note that hypothesis 1 argues that the CEO's perception of the importance of e-commerce could lead to better performance. Therefore, a firm's past performance could encroach on the CEOs' prospect of the importance of e-commerce. However, it is also possible that well-performing firms, having more resources available, could conceivably lead to a greater perception of the importance of e-commerce. To address this concern, a test was conducted for what is known as a financial performance halo effect. A halo effect refers to circumstances where researchers are using secondary proxies to capture constructs of interest, and as a result, may introduce measurement error; and if that error is pervasive--a halo is said to exist. A financial performance halo effect occurs when financial performance variables may affect the validity of research results that use secondary proxies, as may be the case in this situation. Following the procedures in Brown and Perry (1994), a financial performance halo effect was identified and removed.

Performance Measurements

It is widely believed that performance is multi-dimensional in nature and that it is advantageous to integrate different dimensions of performance in empirical studies (Cameron 1978; Lumpkin and Dess 1996). Wiklund (1999) regards profitability and growth as different aspects of performance and holds that when combined, they give a richer description of the actual performance of the firm than each does separately. Company profit growth (CPG) was selected because in the knowledge economy, strategy must focus on expanding existing markets or creating new ones – not only on beating the competition. However, as is more recently being recognized, growth without profitability is not sustainable. Many e-commerce companies had high valuations based on an excessive focus on high growth by attracting new customers. However, their inability to generate profit margins proved detrimental. Therefore, Gross Profit Margin (GPM) is a measure of an organization's operating efficiency and in the new economy is included as a second measure. The data regarding these performance measurements were collected from the COMPUSTAT database for the 1999 fiscal year.

Control Variables

In terms of the control variables, we selected industry type and firm size to be included in our model. These variables are included because of their recognized influence on performance. Extant literature has identified a number of situational variables that moderate an organization's performance (Kumar et al., 1998; Slate and Narver 1994; Dess et al., 1997; Hitt and Tyler 1991). These variables include: market growth, market turbulence, competitive intensity, and technological turbulence. These situational variables unveil the complexities existing in various industries, which should be controlled in order to avoid the potential effect on performance. Therefore, industry type in this study was used as a blocking variable to control potential moderators of firm performance.

In addition to industry type, firm size is another important factor that could affect a firm's performance (Barrett et al. 2000, Slater and Narver 1994). Total assets, total number of employees, and total sales were collected from COMPUSTAT for each participant firm based on the fiscal year-end data. This data was divided into three groups of equal size to distinguish very large, large and medium sized firms.

Analyses

Due to large sample size, the normal distribution of the data in the study, and the random selection of the firms used, the parametric statistical methods, multiple regression analyses and ANOVA, were chosen to test the hypotheses. Ordinary least squares regression analysis was used to test the first hypothesis. Analysis of variance procedure was employed to test the remaining two hypotheses.

Table 2. Perceived Importance of EC and Performance

Dependent Variables	Parameter Estimates					
	E-commerce ^a	Std. Error	N	R ²	Adj. R ²	F
Gross Profit Margin	45.81****	4.09	135	0.31	0.3	20.01
Company Profit Growth	11.19***	3.93	132	0.06	0.04	2.75
^a	*p < .1 **p < .05 ***p < .01					

The first hypothesis posits a positive relationship between a firm's perception of the importance of e-commerce and the firm's performance. As can be seen in Table 2, there was significant support for the first hypothesis.¹ The regression coefficient for GPM is significant at 0.001 level and CPG at .01 level, suggesting that the more a firm perceives e-commerce as being important to strategy, the more likely it is that firm will have a higher level of operating efficiency as well as profitability, as compared to those firms with a lower degree of perception of importance.

Table 3 contains the results of the tests regarding the impact of a market-oriented strategy on firm performance. For Hypothesis 2, we anticipated that companies pursuing a market-oriented strategy would outperform those with a non-market orientation. The results in Table 3 support this hypothesis. The mean differences of the two performance measurements between market-oriented companies and non-market oriented companies are significant at the 0.05 level, suggesting that market-oriented firms perform better than non market-oriented firms.

Table 3. Market Orientation and Performance^a

Dependent Variables	Tukey Studentized Range Tests ^b		
	1-2 H2	3-4 H3	3-5 H3
Gross Profit Margin	**	**	n.s.
R ²	0.42 (127)	0.58 (63)	0.58 (63)
Company Profit Growth	**	***	**
R ²	0.26 (116)	0.57 (59)	0.57 (59)

^a Sample sizes are reported in parenthesis.

^b 1 represents companies pursuing market oriented strategy
2 represents companies pursuing non-market oriented strategy
3 represents companies having balanced market orientation strategy
4 represents companies that are skewed to customer oriented strategy
5 represents companies that are skewed to competitor oriented strategy

*p < .1
**p < .05
***p < .001

¹Based on Brown and Perry's model and suggestion (1994), we conducted a financial performance halo effect test and removed the halo effect. The result for halo-removed regression analysis remains statistically significant.

Hypothesis 3 contends that companies having a balanced market orientation posture will have a higher level of performance than firms that are more geared toward a particular component of market orientation. Table 3 shows a significant difference between balanced and (skewed) customer-focused companies ($p < 0.05$). However, performance differences are somewhat mixed between balanced and (skewed) competitor-focused companies. Although a substantial difference was found in terms of CPG ($p < 0.05$), no difference is present regarding GPM. The mixed results indicate a partial support for H_3 .

Discussion

The present study sought to investigate how the leaders of traditional companies view the rise of the e-commerce age. The first question examined was whether e-commerce, as reflected in corporate strategy, is positively related to performance. The next question focused on whether a market orientation for these companies is related to performance. Finally, two types of marketing strategies (balanced and skewed) were put to test regarding their impact on performance.

Support was found for the study's first two hypotheses and partially for the third hypothesis. From the findings, we conclude that the e-commerce marketplace is seen as promising and that it could generate positive performance implications if it is reflected in corporate strategy. This conclusion is interesting in light of numerous dot-com failures and suggests that e-commerce must be given priority in corporate strategy. Further, brick-and-mortar companies, which constituted a significant portion of our sample, that embrace e-commerce as an integrated part of what they are trying to accomplish, would be able to better leverage effectiveness and efficiency benefits. In contrast, if e-commerce is not adopted and integrated at the top, it would yield an imitable appendage to the business, that may not garner the appropriate resources in order to create unique capabilities instrumental to competitiveness in the virtual market.

Our findings are also consistent with the marketing literature (Narver and Slater 1990; Slater and Narver 1995) in that companies keeping abreast with market information could lead to better performance. While engaging in e-commerce undoubtedly has substantial benefits as we have argued, that marketplace is also quite competitive. This is due to the fact that e-commerce, especially the Internet, reduces customer search and switch costs (Bakos 1991). In addition, e-commerce has the ability to distribute information on new products, access new sales channels and reduce entry-level capital requirements. E-commerce also lowers barriers to entry enabling greater competition among companies. It is thus reasonable to expect that organizations leveraging e-commerce technologies to stress the evaluation and accumulation of market information regarding customer preference and competitor initiatives would enjoy superior performance. Over-emphasizing one dimension at the cost of the other would lead to sub-optimization in an environment that rewards the ability to sense and respond to a variety of informational cues.

As to the partial support for H_3 , it is possible that in the e-commerce market space, reductions in customer search costs and lower entry barriers indicate greater competition among companies and thus intensify price competition. This situation would be reinforced in the case where there is competition between companies that pursue a competitor-oriented strategy. In such a competitive environment, as suggested by Brynjolfsson (1993, 1996), firms may have increased their productivity, but they may also be compelled to pass on the subsequent benefits, in terms of profitability, to the consumer. As a result, Gross Profit Margin, the measurement of profitability performance, may not be able to detect this redistribution effect.

Limitations

Certain limitations to this research should be recognized when interpreting the study's findings. First, this study adopts a cross-sectional research methodology. Caution should be taken in interpreting causality. Second, since the companies included in this study are large firms, questions remain as to the generalizability of this study to medium and small companies. Third, the CEO's perception concerning the importance of e-commerce may be influenced by the firm's past performance. Though, the relationship between the CEO's view of e-commerce and firm performance is still positive and statistically significant after removing the financial performance halo effect from the data, we cannot rule out that there may be other potential variables that may influence the CEO's judgment. Fourth, the partial support for hypothesis 3 in this study suggests that high-level financial performance measures may not reveal the true value of e-commerce initiatives. Intermediate level performance measures, such as inventory turnover, time to market, and product and service quality may be more appropriate in establishing the relationship between e-commerce strategic initiatives and firm performance.

Implications for Research

For the academic reader, this study demonstrates that the CEO's letter to the shareholders presents a useful research tool for analyzing the relationship between strategy and e-commerce, and organizational performance. Unlike many methodologies used for IT research, the content analysis methodology is replicable and can readily be applied to other research questions. Moreover, it provides the means to obtain the perspective of the leaders of organizations in a format that is readily available, longitudinal, and relatively consistent across publicly held firms. However, a few notes of caution are in order. It has been observed that firms that are in financial trouble tend to focus their CEO letters on uncontrollable environmental factors. They also might avoid negative statements, lest they disorient the financial markets (Jarvenpaa and Ives, 1990). Therefore, while useful, it is fair to say that these letters represent strategic orientation, but are not equivalent to it. Therefore, complementing this approach with other sources of data, such as surveys and the study of corporate documents, could add richness to the representation of strategy.

There are other promising topics for future research. For example, financial statistics regarding a firm's online activity, such as a firm's online revenues, online sales, etc. could be used to add granularity to specific instances of performance. Also, the data for this study was gathered for one specific year, and e-commerce is a rapidly changing phenomenon, studies conducted using lagged analysis over two or more years, would be useful. Additional variables specifically demarcated such as bricks-and-mortar vs. pure plays, risk orientation, and type of product/service offered can shed further light on the performance implications of e-commerce initiatives.

Implications for Practice

CEOs seem to influence through their perceptions the strategic orientation of the organization. This study examined CEO views of e-commerce across a variety of industries and found that e-commerce coupled with a balanced marketing orientation, as reflected in these views is positively related to performance. With e-commerce going through a transitional phase, it is important to seek out relationships that can provide guidance on the future tenor of this phenomenon as it becomes increasingly imbibed into businesses. This study provides a modest step in this direction, alerting interested observers to the importance of tying e-commerce initiatives to corporate strategy and consequently other business resources in order to create distinctive capabilities for competitive advantage.

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