



**Firm strategy impact
on performance of
SMALL AND MEDIUM
ENTERPRISES**

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Full Length Research

Firm strategy impact on performance of small and medium enterprises

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Managers of business firms employ various strategies to be more competitive and profitable. However, the question whether strategy positively impacts on performance abounds. Thus the paper was aimed at seeking answers to the question by providing a systematic review of various studies on the relationship between strategy and firm performance. Existing studies have used various strategy topologies to examine the relationship between strategy and firm performance. The most prominent ones include the typology of Chandler (1962), Miles and Snow (1978), Porter (1980) and Mintzberg (1990). There is almost unanimous agreement among studies that business organizations with a clear and consistent strategy will perform better than firms without such a strategy. It is clear from the studies that the trajectory to high levels of performance is partly based upon a strategy that would strengthen firm's dynamic strategic capabilities which are critical mechanism between the business activities and performance.

Key words: Entrepreneurship, firm performance, strategy, topologies, SMEs.

INTRODUCTION

The business environment is rapidly changing posing great challenges to firms as they struggle to survive and prosper. Dynamic environments are characterized by unpredictable and rapid change, which increases uncertainty for individuals and firms operating within them (Dess and Beard, 1984; Ensley *et al.*, 2006). In such state, firms have to consistently use strategies of various types and levels to become more competitive and profitable (Tsai and Yen, 2008). Consequently research has focused on strategies to help isolate out appropriate ones that would strengthen firms dynamic strategic capabilities which are critical mechanism between the business activities and performance (Blyer and Coff, 2003; Tsai and Yen, 2008).

Strategy has often been described differently in literature (for example, by Chandler, 1962; Leonard *et al.*, 1969; Porter, 1996). However, there is general consensus that strategy is the art and science of planning and marshalling resources for their most efficient and effective use. Chandler (1962) defined strategy as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out

the goals. Leonard *et al.* (1969) described strategy as the pattern of objectives, purposes, or goals and major policies and plans for achieving these goals, stated in such a way as to define what business the company is in, or is to be in and the kind of company it is or is to be. Porter (1996) on the other hand defined strategy as creating fit among a company's activities. Grant (1991) defines a strategy as the overall game plan for deploying resources to establish a favourable industry – market position. Oyedijo and Akewusola (2012) captured a strategy as a pattern of decisions that are selected and implemented to achieve a long-term goal and a sustainable competitive advantage. Maurer (1988) conceptualized strategy as the firm's competitive "game plan" that aligns a firm's resources and capabilities with its environmental opportunities, constraints, and threats in order to achieve some objectives. Grant (1991) defines a strategy as the overall game plan for deploying resources to establish a favourable industry – market position.

Several types of business strategies implemented in business environment exist. SMEs may use a number of business strategies, depending on the prevailing

situation. Often challenges faced by firms differ resulting in application of different strategies. However, common types of business strategies include the growth, product differentiation, price skimming, integration, intensification, diversification and defensive strategies. Porter (1980) advanced three generic strategies that a business can adopt characterized along two dimensions of competency and market scope. The three Porter's (Porter, 1980) generic strategies include the cost leadership, differentiation and market focus. The cost leadership strategy aims to have the lowest price in the target market. To achieve this, while remaining competitive, firms following this strategy must be able to operate at costs lower than their competitors. Low operating costs can be realized via high asset turnover, low operating costs and control over the supply chain. Low cost strategies are aimed at achieving high profit margins. Studies ((for example, Miles and Snow, 1978; Kand so onhen, *et. al.*, 1996; Slater and Olsen, 2000) have shown that the type of strategy that is used by a firm matters and makes a big difference to performance. Consequently, managers of business firms have to ensure that they have the right strategy in order to perform and be competitive. Despite this perceived stand by business managers, it is still not clear how strategy impacts on performance. Studies (for example, D'Amboise, 1993; Teach and Schwartz, 2000; Pelham, 2000; Verhoeven, 2002; Kemp and Verhoeven, 2002) suggest no relationship between strategy and performance. The paper, therefore, aims to provide a systematic review of the relationship between strategy and firm performance.

Theoretical orientation of strategy

Theories of different strategy types commonly referred to as strategy typologies exist (Gibcus and Kemp, 2003). The most prominent ones include the typology of Chandler (1962), Miles and Snow (1978), Porter (1980) and Mintzberg (1990). Chandler (1962) describes strategy in terms of growth and strategic decisions and distinguished the following types of strategy: volume expansion, geographic expansion, vertical integration and product diversification. Chandler (1962) views volume expansion as the first logical strategy to follow after introduction of a successful product and involved producing, selling and distributing products or services to existing customers. Chandler (1962) states the next logical step as geographic expansion and involves venturing in new geographical areas with new field units. Vertical integration is an attempt at increasing value added within a given business base reflected as forward, which leads the firm closer to its customers and backward, which moves it closer to its suppliers. Product diversification is the last step and concerns the firm getting involved in new industries either through merger,

acquisition or product development (Chandler, 1962).

The Miles and Snow's (1978) model is the most widely used typology. Oyedijo and Akewusola (2012) in their review point out that the Miles and Snow's (1978) model is robust and adaptable, and pointed out its successful application in strategic based studies including examining changes in R and D intensity (Hambrick *et al.*, 1983), distinctive competence and performance (Snow and Hrebiniak, 1980); manufacturing and service strategies (Adam, 1983); strategic awareness (Hambrick, 1981); environmental scanning (Hambrick, 1982); strategic choice (Burgelman, 1983; Seger, 1989); and compensation strategies (Broderick, 1986; Gomez-Mejia, 1992). Miles and Snow (1978) divide organizations into prospectors, analysers, defenders and reactor types. Miles and Snow (1978) describes prospectors as organizations which continually search for market opportunities and regularly experiment with potential responses to emerging environmental trends. According to Miles and Snow (1978) anxious analyzers are organizations that are seldom first in with new products or services but monitor competitors and adjust their strategies as promising new ideas are seen. Defenders, as Miles and Snow (1978) argue, are organizations that prefer to maintain a secure position in a relatively stable product or service area. A reactor is characterized by an inability to respond effectively to pressures for change. According to Miles and Snow (1978), a reactor will seldom make adjustments of any sort until it is forced to do so by environmental pressure.

Porter (1980) distinguishes three generic strategies: cost-leadership strategy, differentiation strategy and a focus strategy. These strategies were described by Hambrick (1983) as efficiency, differentiation and scale/scope. The three strategies are better suited for determining successful strategies for SMEs to increase their participation (Gibcus and Kemp, 2003). In addition, Porter's (1980) typology better lends itself to implementation with game-theoretic models. Porter's generic business strategy results into five different groups of companies: cost leadership, service differentiators, innovation and marketing differentiator, process differentiators and stuck-in-the middle (Porter, 1996).

Mintzberg (1990) focuses on the process of strategy (deliberate versus emergent strategies) whereas the other three focus on the content of the strategy. Mintzberg (1990) sees strategy as a process and as pattern in a stream of decisions. Streams of behaviour could be isolated and strategies identified as patterns or consistencies in such streams. Position strategy relates to the context and external situation: the position in relation to competitors and the cooperative interrelations. The organization is matched against others and the demands of the environment. Mintzberg (1990) advances

that use of the term strategy as perspective emphasizes the group of strategy makers. Their views, whims, preferences and predilections are influential in the organization. The strategy makers have a personality and the organization does not have it.

Relationship between strategy and firm performance of SMEs

It is argued out that firms with a clear and consistent strategy outperform firms without such a strategy (Gibcus and Kemp, 2003). Zajac *et al.* (2000) observed that the pursuit of a strategy has desirable performance implications. Equally, Gilinsky *et al.* (2001) found a significant positive effect of a new product/market development strategy on firm size. However, empirical studies show mixed results on this claim. Furthermore, this claim is mostly based on studies conducted with large business firms. Peng *et al.* (2008) observed that firm specific differences drive strategy and performance. Generally, strategy is claimed to be positively related with the performance or success of a firm. Studies done (for example, Miles and Snow, 1978; Porter, 1991; Zajac *et al.*, 2000; Oyedijo and Akewusola, 2012) demonstrate that the type of strategy applied makes a big difference to performance.

Miles and Snow (1978) identified four types of viable strategies: prospectors, anxious analyzers, domain defenders and reluctant reactors. Miles and Snow (1978) observed that prospectors and anxious analyzers perform better than domain defenders and reluctant reactors. This has been supported by several studies (for example, Conant, *et al.*, 1990; Snow and Hrebiniak, 1990; Evans and Green, 2000). Conant, *et al.*, (1990) found that profitability is significantly greater for prospectors and defenders than for reactors. However, a reactor strategy is not always associated with poor performance. Snow and Hrebiniak's (1990) confirmed Miles and Snow's (1978) primary hypothesis except in the case of highly regulated industries where reactors outperformed prospectors and defenders. Evans and Green (2000) in their study on marketing strategy, constituent influence and resource allocation concluded that business turnaround is more likely to be achieved by prospectors than defenders. Slater and Olson (2001) concurred with Miles and Snow (1978) conclusion that there are no performance differences between prospectors and defenders.

To able to establish a link between strategy and performance, Porter (1991) defined three sets of conditions that would result in a consistent strategy and eventually good firm performance. Firstly, Porter (1991) pointed out that need for development and implementation of an internally consistent set of goals and functional policies that collectively define a firm's

position in the market.

Secondly, the defined goals and policies should align the firm's strengths and weakness with the external (industry) opportunities and threats (Porter, 1991). Thirdly, the firm's strategy centrally be concerned with the creation and exploitation of its distinctive competences. These are unique strengths a firm possesses, which are seen as central to competitive success. Porter (1980) observed that entrepreneurial- type activities are linked much more closely with differentiation strategies than with low-cost leadership strategies. Such observation was strengthened by other studies (for example, Pelham, 1999; Gibcus and Kemp, 2003). Pelham (1999) argued that an emphasis on a differentiation strategy would have greater impact on the performance than an emphasis on a low-cost strategy for SMEs. Also Gibcus and Kemp (2003) noted that in order to be successful, there is need for differentiators to rely on strong marketing abilities, creative flair, product-engineering skills, and effective coordination across functional areas.

Oyedijo and Akewusola (2012) in their study on organizational strategy and firm performance in Nigeria observed that organizational strategy type was a key determinant of small and medium scale business performance. Oyedijo and Akewusola (2012) observed that small and medium scale business performance was positively associated with a prospector strategy and an anxious analyzer strategy. The result also showed that a domain defender strategy is associated with low performance while a negative performance is associated with a reluctant reactor strategy. This result suggests that the trajectory to high levels of organizational performance in the small and medium business sector is partly based upon a strategy of product and market innovation and continuous searching and monitoring of the external environment for new markets and competitor moves and responding to them quickly and proactively. By contrast, SMEs that adopt a domain defender strategy are likely to find it difficult to improve their performance while the performance of those that adopt a reluctant reactor strategy is likely to lag behind that of prospectors, analyzers and defenders and ultimately lead to failure.

Other studies (for example, D'Amboise, 1993; Campbell-Hunt, 2000; Pelham, 2000; Spanous and Lioukas, 2001; Kemp and Verhoeven, 2002) did not find a clear relationship between strategy and performance as well. D'Amboise (1993) concludes that there exists no link between strategy and performance. Campbell-Hunt (2000) analyzed several studies on strategy and performance and observed that consistent generic strategy does not outperform a mixed (or stuck-in-the-middle) strategy. Pelham (1999) observed that an emphasis on a low-cost strategy will have lower impact on the performance than an emphasis on a

growth/differentiation strategy. For instance, Spanous and Lioukas (2001), Pelham (2000) and Kemp and Verhoeven (2002) did not find a clear relationship between strategy and performance as well. Kemp and Verhoeven (2002) studied the relationship between the growth of a fast growing firm, the consistency of the selected generic strategy, the consistency of the resource bundles and the fit between the selected strategy and resources. The study observed that sales strategy did not influence the growth of the firm. The study of Kemp and Verhoeven (2002) showed that strategy does not seem to influence growth. Some studies found weak relationships between strategy and performance. Teach and Schwartz (2000) state that strategy and performance are at best weakly related.

CONCLUSION

Although several strategy typologies exist in literature, the most prominent and commonly applied ones are those of Chandler (1962), Miles and Snow (1978), Porter (1980) and Mintzberg (1990). Chandler (1962) distinguishes volume expansion, geographic expansion, vertical integration and product diversification. Miles and Snow (1978) divide organizations into prospectors, defenders, analyzers and reactor types. Porter (1980) distinguishes three generic strategies and introduces a cost-leadership strategy, differentiation strategy and a focus strategy. Finally Mintzberg (1990) focuses on the process of strategy (deliberate versus emergent strategies) whereas the other three focus on the content of the strategy.

There is almost unanimous agreement among studies that strategy impacts on firm performance. Firms with a clear and consistent strategy will outperform firms without such a strategy. Using Miles and Snow typologies, studies have demonstrated that prospectors and anxious analyzers perform better than domain defenders and reluctant reactors. Equally, studies applying Porter's typologies showed that entrepreneurial - type activities were linked much more closely with differentiation strategies than with low-cost leadership strategies. However, some studies have observed contrary results that strategy does not seem to influence growth. A weak relationship between strategy and performance has been observed by some studies. However, such observation of weak relationship is overwhelmed by proponents of a strong relationship between strategy and firm performance.

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