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Influence of Contextual Factors and Strategy on Performance of Firms

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Abstract: *The purpose of this study is to investigate whether business and marketing strategy has an influence on the business and marketing performance of firms. Another purpose is to find out whether contextual factors like ownership, size, age of the firm etc. has an influence on the strategy as well as performance of firms. As a corollary, the relationship between generic strategy and marketing mix decisions of the firms were explored. The variables for measuring generic strategy and marketing mix were obtained from literature. A questionnaire was prepared which was sent to top executives of about 50,000 firms. The response obtained was about 1% of the total sample. Analysis of the responses shows that there is no correlation between strategy and performance. Also contextual factors do not have any influence on strategy. However, there is a high degree of correlation between strategy and marketing mix decisions. Also, contextual factors have a moderate influence on performance of firms.*

Keywords: *Marketing Strategy, Porter's Generic Strategies, Marketing Mix, Contextual Factors, Performance of Firms.*

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I. Introduction

The success or failure of companies competing in a market is largely dependent on strategy they evolve and implement. The literature is full of references regarding comparisons between companies having strategy and winning and companies that do not have strategy and fail. One of the major reasons attributed to success or failure of companies is the presence or absence of a well formulated strategy (Nwielaghi & Ogwo, 2013). Jaakkola (2010) observes that the effects of strategic marketing on business performance are very relevant but has not been studied adequately. So, even after a lot of research, it is difficult to prove and reach a conclusion on the effect of strategic marketing on business performance (Hooley, Greenley, Cadogan, & Fahy, 2005).

Marketing strategies serve as the fundamental underpinning of marketing plans designed to fill market needs and reach marketing objectives (Marketing basics: Marketing strategy based on market needs, targets and goals). Quantifiable and measurable results prove the success of plans and objectives formulated by the organization. Careful formulation of marketing mix along with analysis of performance is very important for the success of marketing plans. The organization also has to consider the constraints it has in the process of implementing the chosen strategy. Also, careful analysis of customer, competitor, and target market are required for effective planning and implementation.

Research Objectives

This study aims to establish that distinct strategies are a result of different contextual factors, and these distinct strategies result in different business performance of firms. Distinct business strategies, however, may not influence performance directly. Business strategies influence marketing strategy, which, in turn, impacts performance of firms. Marketing strategy is manifested in organizations through marketing mix decisions, or as it is popularly known as the 4Ps – i.e. product, price, place, and promotion. So, strategy influences marketing mix decisions, which in turn affects the performance of firms.

So, this study aims to find out if contextual factors influence choice of strategy, as postulated by Porter (1980), and whether these strategies influence marketing strategy, which is manifested through marketing mix decisions. Finally, the study aims to ascertain whether strategy influences performance, and whether marketing mix decisions also have an impact on performance, both – business as well as market. Different firms follow different strategies depending on contextual factors like the size of the firm, the industry/market they are operating in, the number of years of operation, distinctive ownership patterns (domestic or foreign owned) and similar other factors. Porter (1980) has postulated generic strategies followed by firms across the world. These strategies, in conjunction with the contextual factors, have the capabilities to influence and impact firm-specific performance.

Literature Survey

Contextual factors are characteristics of the firm such as size (as measured by sales, or profit, or by the number of employees), the stage of its life-cycle (infancy, growth, maturity, or decline), number of years of existence in India, ownership (foreign-owned or domestic firm), and the nature of the industry it belongs to. Size of the firm and its performance (growth) are not necessarily correlated (Hall, Bronwyn H; 1987). However, more recent work has found mixed results. Generic strategy may be defined as the most basic decision made by an SBU in the hierarchy of its decision making (Tang, 1984, MIT Working Paper). It is also the highest decision which integrates and creates internal consistency among decisions.In Porter's Generic Strategies, Porter (1980) postulates that firms follow any of the three following strategies: 1) Differentiation, which isfollowed by firms who are capable of either manufacturing distinct products, or having a completely unique marketing strategy, or having a distinct positioning in the minds of the consumers;2) Cost leadership, which isfollowed by firms who are either leaders in the market place in terms of volumes, or have very low pricing of their products; and 3)Focus, which concentrates in a particular niche by satisfying the needs of that particular set of customer segment.

Marketing strategy provides concepts and processes for gaining a competitive advantage by delivering superior value to the business's customers. In order to deal with the current challenges, the businesses must have more distinctive and purposeful marketing strategies and they should be effectively implemented (Cravens et al., 2000).Marketing strategy has been viewed as any feasible combination of decisions relating to the components of the marketing mix (Cook, 1983). A marketing strategy requires decisions on the target market and the marketing mix (i.e. pricing, distribution, sales force, advertising and sales promotion, and product design) (Kotler 1980).Papers that have used marketing mix as a definition of marketing strategy includes Carpenter (1987), Shin (2012) and Azadi and Rahimzadeh (2012).

Though there is lack of evidence as to how the Mix contributes to the success of commercial organizations, several studies confirm that the 4Ps Mix is widely trusted as a concept by practitioners dealing with tactical/operational marketing issues (Sriram and Sapienza 1991; Romano and Ratnatunga 1995; Coviello et al. 2000).Alsem (1996) studied 550 Dutch companies and found that 70% of them used formal marketing planning for their operations. In a study (Shin 2012), pricing capability has shown a positive relationship with only customer satisfaction, while channel capability has shown a negative relationship with profitability. Mintz & Currim (2013) studied 1287 marketing mix activities with 439 US managers and found that use of metrics improves performance.Ataman et al (2010) concluded that high discounting, less advertising, lower distribution, & shorter product line led to decrease in sales.Consumer perceptions of quality are influenced by marketing mix variables (Boulding and Kirmani 1993, Gotlied and Sarel 1992, Zeithaml 1988, Martinez-Lorente, Angel R., et al 2008). Shoham (2003) had reported that the effect of product and distribution standardization on international performance was negative; while that of price and promotion was non-significant. In a study in Brazil (Brei et al, 2011), it was found that there does exist a relationshipof medium magnitude between marketing mix variables and performance of the firm.Leuschner, et al (2012) show that the relationship between constructs such as product and price and customer satisfaction was not statistically significant, whereas the promotion construct had significant impact on customer satisfaction. The link between place and customer satisfaction was statistically significant.Incase of B2B markets the highest influence is by sales representatives.

Hypothesis Development

The aim of this section is to develop the hypothesis which will be tested in the later part of this research study.

Contextual Factors and Porter's Generic Strategy

Given the previous discussions in literature review, contextual factors have an effect on strategy formulation as well as marketing mix decisions. For example, differentiation strategy is followed by firms/products in the initial stage of their life cycle (Mohan et al, 2006). According to another study (Hong, Fang 2013), in the maturity stage, firms tend to pursue cost leadership strategy. The authors also observed that in a competitive industry, domestic firms (in comparison to foreign owned firms) tend to follow cost leadership strategy. Baack and Boggs (2007) provide powerful evidence that there are substantial environmental obstacles to the successful implementation by developed-country MNCs of a cost-leadership strategy in emerging markets. According to Peng and Luo (2000), in these markets – focus, differentiation, or other strategies, such as those based upon personal or political relationships (Peng and Luo, 2000), may provide a better "fit" with the environment than cost-leadership. In a test for new entrants in a given industry – i.e. new small firms in early stages of their life-cycle, for some selected industries in Italian manufacturing (Coad, Alex; 2007), it was observed that they grew faster than the established large firms.

Tang (1984) observes that the product is standardized in the maturity period of the PLC of the product. Wright (1987) also connects strategy with size and opines that focus is for small firms which are resource constrained, whereas cost leadership and differentiation is the domain of larger firms.

This leads us to our first set of research hypotheses.
Hypothesis 1:Firms' generic strategies are correlated with its contextual factors.

A) Domestic firms pursue cost leadership strategy, while foreign owned firms pursue differentiation and focus strategies.
B) Firms pursue differentiation strategy in the initial phase of their product life cycle, and cost leadership strategy at the maturity and decline phase of their product life cycle.
C) Larger firms pursue a combination of cost-leadership and differentiation strategy, while smaller firms pursue focus strategy.

Porter's Generic Strategy and Marketing Mix

In Porter's generic strategy framework, the options that can be exercised by firms are cost-leadership, differentiation, and/or focus. In cost-leadership strategy, the objective of the firm is to compete on price and price alone. Differentiators, on the other hand, offer something unique (product, service component, geographic location etc.) for which they charge a price premium. Some firms follow a "both" strategy while others is "stuck-in-the-middle". Marketing mix has been accepted as a fundamental concept of marketing. Strategy will be implemented through the use of the components of marketing mix – namely product, price, place, and promotion.

Wright(1987) claim that firms pursuing cost leadership strategy primarily concentrates on price, while those pursuing differentiation normally concentrates on product.Miller (1986) asserts that cost leaders supply at the most competitive possible price, while differentiation creates a product that is uniquely attractive.Lynch et al (2000) proved that there is a positive relationship between process capabilities (and efficiency) and cost leadership strategy. Also, there is a positive relationship between value-added service capabilities and differentiation strategies. Cost leadership and differentiation strategy – both lead to good firm performance (contrary to Dess and Davis, 1984).Process capabilities and value-added service capabilities are not linked to firm performance.Tang (1984) says that cost leadership specifies the product-market served and the competitive advantage chosen (price).In a product differentiation strategy, quality is chosen as the competitive advantage.Product differentiation strategy should have high quality and high prices.Kim et al (2004) says that cost leadership requires standardized products with few unique or distinctive features or services so that costs are kept to a minimum. On the other hand, differentiation usually depends on offering customers unique benefits and features, which almost always increase production and marketing costs (Hitt, Ireland, & Hoskisson, 2001).

Marketing performance refers to the number of products sold or services provided by a company in a particular period of time, market share such as the total sales earned over a specified period of time, total revenue and profitability which refers to the relationship between costs and benefits (Kotler & Keller, 2011).

So, we arrive at the second set of research hypothesis.

Hypothesis 2: Generic strategies are correlated with marketing mix decisions.

A) Firms emphasizing cost-leadership strategy will emphasize on competitive and penetration pricing, while firms emphasizing differentiation will focus on premium pricing.
B) Firms pursuing differentiation strategy will emphasize on product features relatively more than firms emphasizing cost leadership.
C) Firms emphasizing cost leadership will focus on distribution channels, whereas firms emphasizing differentiation will focus more on location.
D) Firms emphasizing focus strategy will emphasize on product.

Impact of Marketing Strategy (4 Ps) on Performance

Marketing strategy has been viewed as any feasible combination of decisions relating to the components of the marketing mix (Cook, 1983).

In one study (Al-Dmour et al,2013) evidence is provided that the emergent scope of (a) product, (b) price, (c) distribution and (d) promotion is positively related to market performance. The outcomes show that strategy is made to the intended plan of product, price, place, and promotion, regarding market share, sales, volume and growth. The study of the effectiveness of the marketing tools is essential for an appropriate marketing strategy (Sengupta, Kalyan and Chattopadhyay, Atish; 2010). So, marketing strategy plays an instrumental role in the performance of firms – financial or non-financial.

In one study (Acar, Avni Zafer; Zehir, Cemal; 2010) the authors found that cost-leadership strategies have direct positive effects on both financial and growth performance of the business. So, the authors claim that cost leadership strategy leads to good firm performance. On the other hand, differentiation strategy has more direct impact on the growth performance, and not on the financial performance, of the firm. The authors also found that management and marketing-sales capabilities are the critical resource-based capabilities that lead to good firm performance. In a study (Kim, Linsu; Lim, Yooncheol; 1988) of the electronics industry in Korea, the authors found that at the aggregate level firms emphasizing a strategy of overall cost leadership outperformed the rest in both ROA and ROE, while firms emphasizing the marketing differentiation strategy outperformed the others in terms of sales growth rate. The authors also claim that firms emphasizing the product differentiation strategy did not perform as well as overall cost leaders in terms of either ROA and ROE, yet they still performed well above the industry average, and their sales growth rate were far higher than that of the cost leaders. Those stuck in the middle were underperformers on every measure. Both ROA and ROE were negative, and their sales growth rate was less than one-third the industry average. One longitudinal study (Leitneret al, 2010) of Austrian SMEs found evidence that SMEs that persistently follow a cost-efficiency or differentiation strategy performed equally well. However, cost-efficiency strategy was associated with a comparatively low (though not significant) employment level. The authors also found that SMEs that pursue a combination strategy achieved equal or greater financial performance compared to SMEs which followed only cost efficiency or only differentiation strategy. The results also found that combination or mixed strategies perform equally well as or better than pure strategies. So, we arrive at the third set of research hypothesis.

Hypothesis 3:Performance of firms is correlated with generic strategies adopted by firms.
A) Firms pursuing cost-leadership strategy have higher growth in profits.
B) Firms pursuing differentiation strategy have higher growth in market share and sales.
C) Firms pursuing focus strategy have higher ROI.

Hypothesis 3A:Performance of firms is correlated with its marketing mix.
a) Price has the highest correlation with business performance of firms.
b) Product has the highest correlation with market performance of firms.
c) Promotion and place are correlated with business performance of small firms.

Research Design

The questionnaire designed was targeted at a large number of senior executives. Data of about 7000 firms were available from Industry database. In addition, a database of some 45000 firms in the country was available with the business school the author works in – with complete names of the top executives and their contact details. The questionnaire was sent by e-mail to the top executives of all these firms for their responses. The questionnaire was sent twice within a span of a fortnight. The overall response was approximately 500 (or, almost 1%). Out of these 500, responses completed in all respects were approximately 280. Responses received were from the entire spectrum of the Industry.

This questionnaire was pretested on approximately fifteen respondents who are either senior academicians or senior practitioners. Some changes like modification of structure of some questions were done. There were certain variables which were deemed as irrelevant. They were also dropped. These changes were carried out for both, generic strategies as well as marketing mix.

Variables

Contextual factors are the independent variables in this study. They are: size, industry, and ownership, number of years of operation in India, and the stage in the product/firm life cycle. All variables were converted to categorical variables in the questionnaire.

The variables considered in the strategies adopted by firms are derived from Porters generic model. Many studies have established the variables, methods and questions which help the researcher to measure and identify the generic strategies being pursued by the firms.

Marketing mix variables too are well researched in the literature and hence all the variables pertaining to marketing mix are also obtained from literature.

Measures of Performance

Many measures of market success have been used in the literature. The primary measurement of superior performance is the company's profitability compared to that of other companies in the same industry. Profitability, in turn, is measured by the returns on capital invested. Similarly, percentage growth in unit volumes, revenues, and assets is a good indicator of the firm's performance. Another indicator of the company's performance is the gain or loss in market-share of the company's products/brands.

Scale Development

It was done based on literature.

In case of marketing mix, Yoo et al (2008) used a Likert type 5-point scale. The authors also used Cronbach's alpha and EFA for confirming the reliability and construct validity of the scales used. There are many other

authors who used the same approach (Hu, 2011; Garg & Verma, 2010; O'Cass & Craig, 2003; Cavusgil & Zou, 1994).
In case of generic strategies, Dess & Davis (1984) used a 5-point scale, followed by Davis & Miller (1993). Alpha coefficients and Factor Analysis has been done to assess the reliability and validity of the scales/data. Modern literature has followed a combination of 5-point and 7-point scales for their questionnaire (Allen et al, 2007; Ramaseshan et al, 2013; Lester, 2008; Akan et al, 2006; Allen & Helms, 2006; Eonsoo et al, 2004).
In this research, a 5-point scale has been adapted for the questionnaire. One represented "least importance" while five represented "maximum importance".

Data Collection Method

The questionnaire was administered through e-mails.A reminder was sent after two weeks of the initial mailing. About 63% of the responses were received before the reminder and 37% of the responses were received after the reminder. There does not seem to be any difference in the pattern of the responses between those received before the reminder and those that were received after the reminder. The variables in the questionnaire were the variables pertaining to strategy and marketing mix. The primary data, thus collected was used for statistical analysis in order to arrive at our intended conclusions.

Hypothesis Testing Results

Cronbach's alpha was used to determine reliability. All constructs returned results of the test which are much above 0.7 (except focus strategy). Content validity was checked by pretesting (pilot study) of the questionnaire. The scales have been validated by previous studies.

Measurement of convergent as well discriminant validity was carried out. For convergent validity, the AVE values for BF, MMF, and ST are all much above 0.5. Only CF has an AVE value of 0.376, which is also in the acceptable range. Convergent validity was also checked through EFA which was positive. For discriminant validity, the estimated value between MMF and ST is less than their correlation. However, the correlation between MMF and ST is a very high value of 0.896 and hence the discriminant validity is acceptable. For all other estimates, the values obtained are more than the correlations between the respective constructs. In other words, the AVEs are more than the MSVs.

Hypothesis testing was carried out by SEM (AMOS) as well as SPSS and STATA software.

The SEM was carried out with Maximum Likelihood Estimation and a sample size of 479. The model is recursive. Total number of variables in the model is46; out of which 25 are exogenous (unobserved) and 21 are endogenous (observed). Minimum was achieved in the default model, with a Chi-square value of 544.799. The degrees of freedom were 183 with a probability level of 0.000. So, the value of CMIN/DF in the default model comes to 2.977 which are acceptable. In the SEM (shown in Figure 1), the four constructs (exogenous variables) are depicted in the following manner: CF represents contextual factors with its nine components (endogenous variables), ST represents strategy with four components, MMF represents marketing mix factors with four components, and BF represents business performance factors with its five components.

Hypothesis 1 is not proved from the study. It is seen from the implied correlations table of the default model that none of the contextual factors have any significant correlation with strategy and/or with any of the components of strategy. The hypothesis was also tested using SPSS and STATA software. Table1 enumerates some of the outputs obtained through the statistical tests of t-test, regression analysis and ANOVA. It is seen that there is no difference in strategy pursued by firms depending on any of the contextual factors – whether it is ownership pattern, stage of the PLC, nature of the industry etc. However, in terms of size, smaller firms seem to have less emphasis on cost leadership strategy – while, larger firms follow a combination of strategies. Again, as can be seen from the above table, firms do not follow cost leadership strategy in the initial years of operation (t-value of 1.57). Results show that older firms in terms of their number of years of operation in India tend to follow more of combination strategy.

Hypothesis 2 is proved from the study. The correlation between ST and MMF as obtained from the implied correlation table of the default model of SEM is 0.896. The correlations between the components of ST and MMF ranges from 0.445 to 0.764. These results are also corroborated by that obtained from regression analysis and ANOVA.Marketing mix decisions are definitely based on the strategy of the firm and flows from the objectives that the firm has set out to achieve. It isobserved that both differentiation strategy as well as cost leadership strategy is highly correlated with price component of marketing mix decisions. Cost leadership strategy has a stronger relationship, with t-value of 5.17, compared with t-value of 3.42 of differentiation strategy.

As expected, differentiation strategy has the strongest relationship with premium pricing and cost leadership strategy having a weak relationship. With reservation pricing and relative/competitive pricing,the relationships are exactly opposite. Domestic firms also have a moderate correlation with relative/competitive pricing.

Differentiation strategy has the strongest relationship with product;whereas cost leadership and focus strategy as well as small and domestic firms do not have any relation with product. In case of the place component of the marketing mix decisions, cost leadership strategy has the strongest relationship followed by differentiation strategy. Focus strategy does not have any relationship with the place component of marketing mix. Cost leadership strategy gives more importance to distribution coverage than does differentiation strategy. However, Differentiation strategy places more importance on location than does cost leadership strategy. Focus strategy does not place much importance to distribution, overall. Small or domestic companies also do not have a strong relation with the place component of marketing mix.

It can thus be concluded that contextual factors do not have any influence on marketing mix decisions, while strategy being pursued by firms have a lot of influence on the marketing mix decisions of the firms.

For hypothesis 3, results obtained from the correlation table of SEM as well as regression analysis point towards the outcome that strategy pursued by firms and their business performance are not correlated. Also, there is no correlation between marketing mix and marketing performance of the firms. Business performance is represented by average sales growth, while marketing performance is represented by gain in market share. Small firms have correlation with average sales growth as well as gain in market share. There are similar relationships between performance and domestic firms as well as performance and age of the firms. ROI has sporadic relationships with cost leadership strategy, small, and domestic companies. However, ROI does not have any relationship with marketing mix elements.

It may be worthwhile to mention here that results from the implied correlation table of the default model shows that some components of the contextual factors have a moderate correlation with business performance. Age of the firm (C5) has a weak correlation (0.114 to 0.186) with all the five measures of business performance (R1 to R5). Sales turnover (C6) has a moderate correlation (0.210 to 0.343) with all five measures of business performance (R1 to R5). Similarly, number of employees (C7) has a moderate correlation (0.199 to 0.325) with all the five measures of business performance (R1 to R5). Also, profits (C9) have a moderate correlation (0.187 to 0.306) with all the five measures of business performance. So, it can be seen that size and age of the firm influences, to a certain extent, the business performances as measured by average sales and profit growth, percentage growth in ROI and market share, as well as ROA. The strongest correlation is between sales turnover and ROI/ROA (0.343/0.324).

II. Conclusion

It is seen from the research study that there is very strong correlation between strategy and marketing mix, and moderately strong correlation between contextual factors and business performance. There is no correlation between business performance and strategy, as well as between business performance and marketing mix. Similarly, there is no correlation between contextual factors and strategy, as well as between contextual factors and marketing mix. So, it implies that strategy does not have any impact on the performance of the firms. Marketing mix decisions, being highly correlated with strategy, also does not have any impact on the business/marketing performance of firms across all categories. In summary, it can be said simply that strategy and marketing mix are highly correlated whereas strategy and/or marketing mix are not at all correlated with the performance of firms. Also, contextual factors have limited correlation with performance of the firm. It may be reiterated that here strategy signifies distinct strategies as postulated by Porters generic strategies. All firms understand the requirements of the market as well as its nuances, and try to satisfy the consumer/customer with their product and distribution primarily. The relative importance given by firms to the strategic factors and the marketing mix elements decide their fate in the marketplace. The resultant strategy or marketing mix does produce varied results and the possibility of a correlation may not be ruled out.

An interesting dimension brought forth by some CEOs interviewed is that there is a gap between conceptualization and implementation of strategy. They are of the opinion that while top management of firms may decide on a particular strategy which they perceive to be of high importance, the ultimate implementation quality of the strategy is not of high quality. So, for most firms, there is a gap between the thought process (including importance rating) and actual delivery on the ground. So, future studies should be able to measure the ground reality of deliverables of the firms and not only the intention or thought process of what is important and what is not.

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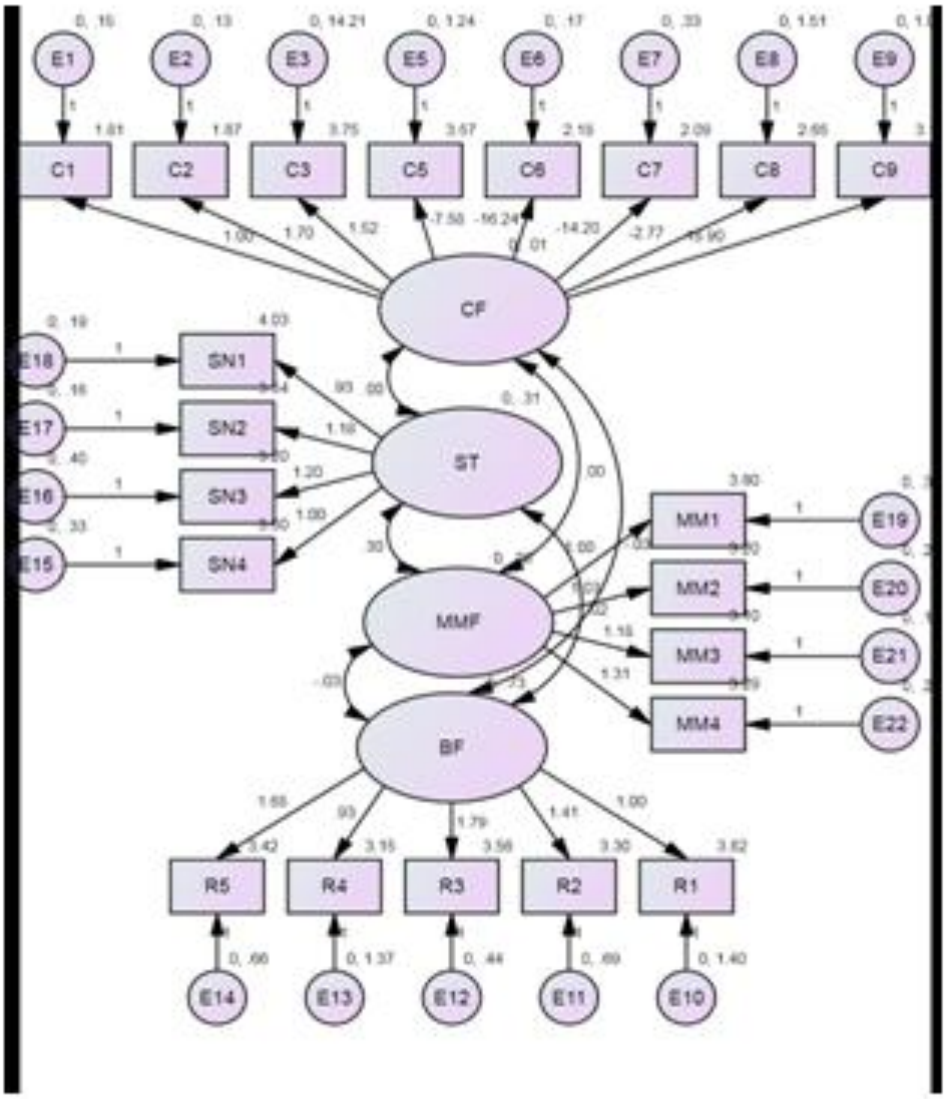

Table 1: Relation between Contextual Factors and Strategy

INDEPENDENT VARIABLE	DEPENDENT VARIABLE	R – SQUARE	COEFFICIENT	T - VALUE	SAMPLE SIZE
Domestic	Differentiation strategy	0.0037	-0.104071	-0.95	246
Domestic	Cost LeadershipStrategy	0.000	-0.0007341	-0.01	245
Small Size – Sales	Cost Leadership Strategy	0.0283	-0.2695164	-2.66	245
Large Size – Sales	Cost Leadership Strategy	0.0283	-0.0150425	-0.09	245
<=5 Years in India	Cost Leadership Strategy	0.0124	-0.2054738	-1.57	245
>=10 Years in India	Cost Leadership Strategy	0.0124	-0.0370726	-0.32	245
Origin (DOB & FOB)	Focus Strategy	0.000	-0.022	Sig. 0.738	244
PLC (Product Life Cycle)	Differentiation Strategy	0.003	-0.050	Sig. 0.434	244

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