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STRATEGY TYPES AND SMALL FIRMS' PERFORMANCE: AN EMPIRICAL INVESTIGATION

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ABSTRACT

This empirical research examines strategy types in (220) small firms and identifies a number of strategic directions and competitive devices that are associated with a high level of performance (profitability). The study underscores the importance of selecting an appropriate strategy for the small firm and of building distinct competence and sustainable competitive advantage.

The study of strategy types in the context of small business is an area of research that deserves greater attention. In particular, little is known empirically about strategic types most frequently associated with profitable small firms. While there are many strategic directions offered in the strategy literature, only a few hold promise and are relevant to small business. Indeed non- availability of key data on small businesses has contributed to the problem.

THE CONCEPT OF STRATEGY

The concept of strategy has received much attention in the literature. Chandler's (1962) pioneering research defines strategy as the formulation of long term goals and objectives of the organization and the implementation of these goals and objectives. Andrews (1971) as well as Hofer and Schendel (1978) define strategy as a pattern of objectives, purposes and goals, together with plans to implement them, in a fashion congruent with the company's existing or intended type of business. Mintzberg (1982) contends that companies may implement strategies they never intended. He defines "realized" and "intended" strategy as a pattern in streams of decisions or actions.

Finally, Michael Porter (1980, 1989) distinguishes between two types of strategy: competitive and corporate strategy. Competitive or business strategy refers to the distinctive competence of the firm. Corporate strategy on the other hand refers to the firm's mission and the business in which it should be (Ibrahim and Ellis, 1990).

STRATEGIC DIRECTIONS

The strategy literature offers a number of strategic directions, some of which are relevant and which have been extensively pursued by small firms, in particular Porter's (1980) generic strategies and Miles and Snow (1978) typology.

Michael Porter (1980) identified three types of generic strategy that can be pursued by almost any organizations—namely, focus, cost leadership and differentiation. These strategies help the organization achieve, build, defend and sustain its competitive advantages. Focus strategy involves concentrating on a specific market, group of customers, product or service. The firm pursuing a focus strategy creates a competitive advantage in a narrow and well-defined niche to avoid head-on collisions with large competitors. The second generic strategy described by Porter (1980) is cost leadership. This strategy implies that the firm intends to be a low cost producer, hence cost efficient. Differentiation, the third strategic direction, involves the offering of a unique product or service that allows the small firm to charge a premium price.

Miles and Snow (1978) identified three types of strategic direction that may be effective for a small business, referred to by the authors as the defender, the prospector, and the analyzer. The defender-type involves the developing of a narrow product/market niche and the erection of barriers to protect it. Unlike the defender, the prospector is constantly scanning the environment for new opportunities, be they new products, services or markets. Finally, the analyzer is a combination of the defender and prospector in that it simultaneously defends its niche while scanning for new opportunities.

METHODOLOGY

The purpose of this research is as follows: (a) to identify strategy types most frequently pursued by small firms, (b) to examine whether these strategy types are associated with different levels of performance (profitability), and (c) to identify competitive devices which contribute significantly to profitability in small firms.

Two hundred and twenty-three out of 1240 owners and managers of small firms from New York City, Montreal and Toronto returned usable responses (18%). A profile of the sample population is displayed in Table 1. Owners and managers were asked to identify their own strategy using a detailed description based on Miles and Snow (1978) typology and Porter (1980) generic strategies.

Table 1

Sample Population Profile

Types of Business		Education of the Owner/Manager	
Retail	16%	Elementary	5%
Distributor	9%	High School	24%
Manufacturing	56%	College	68%
Service	19%	Graduate Degree (Diploma, Master, Ph.D.)	3%
Age of Business: Longevity		**Sales**	
1-3	9%	0 - 150,000	6%
4-6	22%	151,000 - 250,000	26%
7-10	46%	251,000 - 500,000	16%
over 10 years	23%	501,000 - 1,000,000	36%
		1,000,000 - 2,000,000	6%
		2,000,000 - 3,000,000	4%
Profitability: ROI		3,000,000 - 4,000,000	3%
ROI		4,000,000 - 5,000,000	2%
0-7%	11%	5,000,000 - 7,000,000	1%
8-10%	20%		
10-12%	48%		
12-14%	9%		
14-16%	7%		
16-20%	4%		
over 21%	1%		

A major question contained in the questionnaire was "Which of the following six descriptions most accurately reflects your firm's strategic direction?" Table 2 presents descriptions of the different types of competitive strategy as they appeared in the questionnaire.

This methodology allowed the researcher to collect data from a larger sample and focused on owners and managers' perceptions of their own strategic directions. The method was reported by Snow and Hrebiniak (1980).

Table 2

Description of Different Types of Strategy As They Appeared in the Questionnaire

Please read the following six descriptions of different competitive strategy and select the one which most closely describes your business activities as well as your philosophy of competition.

1. ____________	This strategy involves concentrating on a specific market, group of customers, product or service. The firm pursuing this strategy creates a competitive advantage in a narrow and well defined niche to avoid head-on collision with large competitors.
2. ____________	This strategy implies that the firm intends to be a low-cost producer. Therefore, the strategy emphasizes cost efficiency throughout the whole operation. This requires an in-depth study of the firm's cost structure and an efficient cost control system. Cost advantages can be achieved by economies of scale and/or experience curve.
3. ____________	This strategy involves offering a unique product or service that allows the firm to charge a higher price for its product. There are different ways to differentiate the firm's product such as improved product design, features, appearance, reliability, durability, quality, faster or free maintenance and repairs service, warranty, and/or providing sufficient information to customers.
4. ____________	This type of strategy involves carving a narrow product/market domain and tries to protect it heavily. This strategy involves the following characteristics: intensive planning, centralized control systems and functional structure with a high degree of formalization and cost efficiency.
5. ____________	This strategy involves scanning the environment continuously looking for windows of opportunities such as a new market, product or service. As a result, the firm tends to be highly decentralized, flexible, less formalized, emphasize R & D activities and use flexible-type technologies.
6 ____________	This type of strategy involves pursuing two different strategic directions. That is maintaining the traditional market product domain while scanning for new opportunities. Therefore, the traditional domain is highly centralized and cost efficient, while the scanner par is highly decentralized.

Further data collection was carried out through the use of a questionnaire designed to collect information related to the business, strategy type and level of performance. In the first section general information was sought concerning the business including type of business, level of education of the owner/manager, age of the business (longevity), sales volume and rate of return on investment (ROI). In the second part a number of questions were designed to reveal, albeit indirectly, the type of strategy being pursued by the firm and dealt with competitive devices such as technological superiority of product or service, pricing strategy, competition, product uniqueness, special service to customer, cost structure and marketing strategy. These strategy variables were selected from items used in the PIMS studies of Anderson and Paine (1978) and the research of Dess and Davis (1984) which have been previously validated.

After data were collected, statistical analysis was performed. First, cross-tables were used to identify strategy types most frequently pursued by small firms. Second, simple regression analysis was employed to examine the relationship between strategy and level of performance (ROI). Finally, a separate bivariate regression was run for each area of distinct competence (competitive device) using ROI as the dependent variable.

RESULTS

Results as shown in Table 3 suggest that niche strategy is the most frequently pursued type (31.8% of total sample) while analyzer type is reported to be the least pursued strategy (0.8%).

Table 3

Number of Small Firms Pursuing Different Types of Strategy and Percentage to Total Sample

Strategy Types	Respondents	
	n = 223	Percent of Total Sample
Niche	71	31.8%
Defender	59	26.4
Prospector	54	24.2
Differentiation	31	13.9
Cost leadership	6	2.6
Analyze	2	.8
	223	

Concerning the relationship between strategy type and performance level, reported results shown in Table 4 indicate that profitability (ROI) was significantly different ($p \leq 0.05$) under different types of strategy. Strategy types most frequently pursued by small firms reported higher ROI means compared to the least pursued types. Niche type strategy, for example, reported the highest ROI (mean = 14.1) while analyzer type reported the lowest ROI on average (mean = 7.4). Thus, results suggest a strong relationship between type of strategy being pursued and level of performance.

Table 4

The Mean, Standard Deviation and Significance Level of Profitability Under Different Types of Strategy

Strategy Types	n = 223	Profitability*(ROI)	SD*
Niche	71	14.1	18.10
Defender	59	13.6	16.40
Prospector	54	12.1	15.55
Differentiation	31	10.4	17.92
Cost leadership	6	9.8	15.40
Analyzer	2	7.4	13.41
	223		

*Means and standard deviation. F-value 3.05 ($p = .05$, $df = 2,121$)

To further explore the relation between strategy and performance, areas of distinct competence (competitive devices) were examined in relation to profitability. A bivariate regression was run for each competitive device using ROI as the dependent variable, and the results reported in Table 5 clearly indicated that competitive devices such as pricing, location, uniqueness of product or service, quality of product and know-how, contributed significantly to performance (profitability). The belief that other competitive devices such as advertising or reduction in cost would help ROI was not supported.

Table 5

Bivariate Regression for Types of Competitive Device Using ROI as the Dependent Variable

Types of Competitive Advantage	Beta	R-square	p
Uniqueness of product or service	0.60	0.24	0.01
Quality of product or service	0.55	0.22	0.02
Location	0.60	0.34	0.01
Know-how	0.40	0.11	0.05
Pricing	0.56	0.09	0.02
Cost	-0.12	0.02	0.08
Advertising	-0.10	0.03	0.07

DISCUSSION

The present research suggests that focus (niche) is by far the most effective strategy for small business. Previous research by Ibrahim and Goodwin (1986) and by Watkin (1986) supports this conclusion. A small firm pursuing a niche strategy creates a competitive advantage in a narrow and well-defined niche to avoid head-on collisions with large competitors. In the present study a number of competitive devices were identified, and the extent to which they form a competitive advantage was explored in relation to performance. Areas of distinctive competence identified in the present study were similar to those identified by Stoner (1987) and include quality of product or service, location, know-how, uniqueness of product or service and pricing.

The present study suggests that defender and prospector-type strategies are highly pursued by small business owners and managers. This seems to confirm earlier studies. For example, Davig (1986) reported that small firms pursuing either defender or prospector types achieved better performance than those employing an analyzer-type strategy. Rugman and Verbeke (1988) reported that prospector-type strategy is the most pursued strategic direction followed by the defender-type. The researchers concluded that Miles and Snow (1978) typology is more appropriate for small business than Porter's (1980) generic-type strategies.

The present research also suggests that differentiation strategy is pursued by a large number of owners and mangers of small firms. As outlined above, owners and managers employed several means of differentiating their products or services such as improving product quality, uniqueness of product or service, pricing and location. A study by Cooper, Gary and Woo (1986) found that differentiation strategy is as effective as a niche type strategy in small business. Sandberg and Hofer (1987) reported similar results and suggested that differentiation strategy could be more effective than focus-type strategy. In addition, Chaganti (1987) found that differentiation-type strategy is more effective for small firms during an industry's declining stage.

This study indicates that cost leadership is not a highly pursued strategy by small firms, a result that may be surprising to some. This may be due to the fact that cost leadership strategy, as the name implies, stresses cost efficiency, which can be achieved by economies of scale, experience curve and capacity utilization, aspects difficult to achieve in the context of a small firm. Indeed, cost efficiency is a strong competitive advantage but only if the firm is able to sustain it over a long period of time. This may require an in-depth study of the small firm's cost structure as well as an efficient cost control system. It is interesting to note that a recent study by Hughes (1984) suggests that the use of process technologies (improvement in the manufacturing process rather than research on new product development) presents little risk to small companies and results in reducing cost, thus building a strong competitive advantage (Ibrahim, 1992).

Finally, analyzer strategy is by far the least pursued strategy and was found to be less effective than the above strategy types. Earlier research by Davig (1986) found similar results and suggested that this type of strategy be avoided in the context of small business because of its complex nature. Indeed, analyzer implies two different strategic directions and thus requires two different implementation mechanisms.

CONCLUSION

The purpose of this research is to identify strategy types most frequently pursued by profitable small firms. The present study identified four prevalent strategy types most frequently pursued by profitable small firms, namely niche, defender, prospector and differentiation type strategies. In addition, the present research identified a number of competitive devices that contribute positively to the profitability of the small business. These are uniqueness of product or service, quality of product or service, location, know-how and pricing.

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