

The influence of size on winery performance: Evidence from Italy

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Abstract

The aim of this paper is to analyse the influence of firm size on the economic performance of wineries. To achieve this, the paper employs both different traditional profitability and productivity measures and a non-parametric technique to estimate efficiency as indicators of performance. Further, several parametric and non-parametric tests are used to analyse the influence of firm size on these performance indicators. Overall, the results obtained with a sample of 723 Italian wineries (limited companies and cooperatives) in 2013 show that size has a positive influence on the economic performance of wineries. Managers should be aware of the importance of monitoring their own performance in order to guarantee the competitiveness of their wineries.

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1. Introduction

The globalisation of markets has increased the level of competition in most industries during recent decades. In the particular case of the wine sector, the growing competitiveness deriving from the appearance of New World wine-producing countries and the decline in the wine consumption in some western countries has given rise to an economic environment where it is becoming increasingly difficult for wineries to survive. Within this context, winery managers should be aware of the importance of monitoring and controlling their economic performance in order to guarantee survival in the long term, in addition to implementing all possible strategies to improve their position. In fact, assessment of performance is a critical component of the management process in any type of organisation (Sellers-Rubio, 2010). However, as Zhu (2000) states, a company's performance is a complex phenomenon

requiring more than a single criterion to characterise it, which has led many authors to characterise economic performance as a multidimensional construct (Lewin and Minton, 1986; Venkatraman and Ramanujam, 1986; Flood et al., 1994; Morgan and Piercy, 1998; Raju and Lonial, 2001).

This paper analyses the influence that the size of the firm has on winery performance. The relationship between firm size and profitability is an issue often discussed in the industrial economy. Traditionally, it is considered that company size involves a number of characteristics that may influence the economic performance of the company (Baumol, 1967). Size can be a source of competitive advantage because bigger firms are presumed to be relatively more efficient than smaller ones, as well as benefitting from economies of scale to attain higher profitability. Further, economic theory argues that increasing firm size will bring incremental advantages because the size of the firm enables it to raise barriers to potential entrants. However, despite the numerous contributions made on this topic, the causal relationship between firm size and economic performance remains unclear, with ambiguous results. In general, although firm size is one element affecting performance, it is not possible to infer the extent of its importance in explaining the heterogeneity of company performance.

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More specifically, this paper estimates the economic performance of wineries using different approaches widely employed in management literature and analyses the influence that the size of the winery can have on these estimations. The methodology applied is based on traditional profitability and productivity measures and a non-parametric technique to estimate efficiency. The influence of size is assessed through different parametric and non-parametric tests. The empirical application is carried out on a sample of 722 Italian wineries in 2013. Given the availability of information, only limited companies and cooperatives have been considered.

Having defined the goal of the paper, the rest of the paper is structured as follows. The second section reviews the literature on the relationship between firm size and performance. The third describes the methodology and sample used. The fourth section presents the main results and the deriving managerial implications. Finally, the last section outlines the conclusions of the paper and its main limitations.

2. The influence of size on firm performance

The importance that profitability has for a firm has justified the existence of a broad strand of research that aims to provide empirical evidence about how and why firms attain profitability levels. Broadly speaking, previous articles on this topic can be classified in two categories (Capon et al., 1990). On the one hand are papers that attempt to analyse the influence of certain specific company characteristics on profitability. This resource-based view suggests that factors internal to each firm explain the existence of more or less profitable firms within the same industry, and firm size is one of them (Barney, 1991; Peteraf, 1993). On the other hand there are articles that also consider factors related to the structure of the industry within which the firms develop their activities. In this line of research certain scholars have indicated specific industry effects (e.g. concentration levels, industry growth), using the structure-conduct-performance model (SCP), as the most important factor explaining firm profitability (Scherer, 1980; Porter, 1981). However, the results do not show definitive conclusions, and it has not been possible to clearly confirm the effect that firm size has on profitability. While some articles indicate no relationship between size and profitability, in others a clear correlation is observed, although the sign thereof is discrepant.

The arguments to justify a direct and positive relationship between size and profitability focus on the competitive advantages associated with larger size. First, the theory of the firm or technology perspective, which views the firm as a production function, so that the production unit will be more efficient as its size approximates the optimum size where unit costs are minimised. Second, the focus of classic industrial organisation or industrial economics, according to which the behaviour of the company, and hence its performance, is determined by the structure of the sector. On this hypothesis there have been studies about the relationship between concentration and market share and profitability, assuming the thesis of the positive relationship between size and profitability

via market share or concentration. Thus, the causal relationship can be explained by two hypotheses: 1) the traditional or market concentration theory (Demsetz, 1973), whereby high concentration facilitates collusion, so that market power is what underlies the positive relationship between concentration market and profitability. However, even under this hypothesis several authors found an inverse relationship between size and profitability (Shepherd, 1972), perhaps because in certain situations the fixed costs associated with larger size outweigh the benefits of increased market power or, as shown by Chen and Hambrick (1995), because companies with low market share can be as profitable as those with the largest share, but to do so require different competitive strategies based on flexibility rather than on economies of scale. Then 2), the efficiency hypothesis, according to which the differences in yield sizes are a sign of the greater economic efficiency of large companies, since the most efficient firms tend to grow more and achieve greater profitability (Demsetz, 1973; Scherer, 1979).

Third, the latest approach to building a Strategic Theory that considers size a source of competitive advantage. This theory holds that big firms have all the options of the small – though not vice versa – having competitive advantage in five areas (Hall and Weiss, 1967): economies of scale and experience curves, financial, human, marketing and technical resources. Thus, big firms can benefit from economies of scale and access to capital markets from which small firms are excluded, thus leading to higher profitability.

However, some studies consider that the firm size-profitability relationship tends to show non-significant results (Capon et al., 1990), or that it only influences certain specific industries (Marcus, 1969). Given the fact that profitability is determined by several factors (e.g. the production function, prices or costs) this relationship varies between industries and cannot be readily identified. Further, among the arguments justifying the absence of a relationship between size and profitability there is also the law of proportional effect, which states that corporate growth is a stochastic process that arises from the action of countless random and insignificant factors, regardless of size. One implication of this proposition is that there is no optimal size for companies and, consequently, there is a spurious association between profitability and size.

In this sense, the Industrial Economy Theory argues that the behaviour and performance of companies within an industry are conditioned by the structural characteristics of the industry. Thus, the distinctive features of each sector, such as the size of the market, the degree of concentration and competition or the existence of entry barriers, among other variables, can help to explain the disparity of companies' results (Scherer and Ross, 1990).

Finally, a negative relationship between size and profitability has been justified in the more capital-intensive sector operating through large companies, which means lower interest rates, as well as the separation of ownership and control that creates agency conflicts between managers and shareholders, which in turn could shift the objective from maximising

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