



Only a matter of chance? How firm performance measurement impacts study results[☆]

Norbert Steigenberger^{*}

University of Cologne, Faculty of Management, Economics and Social Sciences, Seminar for Business Administration, Corporate Development and Organization, Albertus-Magnus-Platz, D-50923 Cologne, Germany

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ABSTRACT

Although strategic management research is well aware of the importance of construct measurement, surprisingly little rigor is applied regarding its core concept, firm performance. Using the example of the resource-based view (RBV), this paper demonstrates how divergence between theory-building and construct measurement regarding firm performance can produce misleading conclusions. The RBV seeks to explain value creation in the marketplace, yet empirical studies often measure various aspects of firm financial performance. Building on appropriation theory, I show that it is not possible to infer to changes in firm value creation from observed changes in firm financial performance measures and vice versa due to an omitted variable bias: the neglect of the relative bargaining power of stakeholders. This paper derives conclusions for research practice and suggests theoretically meaningful ways of bridging the gap between value creation and firm financial performance in the RBV framework.

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Introduction

“Could luck play a role in statistically significant results when a study is empirically based on one or two specific aspects of firm performance without a strong theoretical basis for their selection? The answer is most definitely ‘yes’. With many performance variables available for use, and with low or even negative correlations among them, lucky variable selection definitely could be driving significant results in any given sample of firms.” (Miller, Washburn, & Glick, 2013: 958)

The quest for the ‘right’ measure of firm performance has haunted the methodological discussion in strategic management research for decades (Boyd, Bergh, Ireland, & Ketchen, 2013; Boyd, Gove, & Hitt, 2005; Chakravarthy, 1986; Durand & Vaara, 2009; Hamann, Schiemann, Bellora, & Guenther, 2013; Orlitzky, Schmidt, & Rynes, 2003; Powell, 2001, 2003; Zimmerman, 2001). Strategy scholars apply a wide variety of different measures to capture aspects of firm performance and there is considerable doubt whether the various measures of firm performance actually represent one latent construct. It has been argued that the main problem concerning the practice of performance measurement is a misfit between the specification of the firm performance construct in theory and the way performance is measured in empirical research aimed at theory testing (Miller et al., 2013). While performance specifications in theory often refer to a broad and holistic understanding of firm success, measures applied in empirical research

regularly focus on one or a few distinct aspects of firm performance. Miller and colleagues, for example, conclude that different measures of performance are not capturing the same underlying construct, based on an extensive literature review as well as a meta-analysis. Spoken more technically, this means that the firm performance construct lacks convergent validity, a key requirement for reliable construct measurement (Nørreklit, Nørreklit, & Mitchell, 2007). There are some performance variables that are strongly related, such as ROE and ROA, but relations between different types of measures, e.g., accounting-based and market-based ones, seem vague at best.

If this is the case, it is difficult to compare the findings of studies that purport to refer to the same theory but are based on different performance measures (or at least on different types of measures). This is a highly problematic situation for research synthesis, theory testing, and theory development. If proxies are not sufficiently coherent, i.e., lack convergent validity regarding the latent construct they are supposed to measure, statistically significant relationships between explanatory variables and particular measures of firm performance do not provide a basis for inferences regarding the general construct of firm performance (Combs, Crook, & Shook, 2005; Mantere & Ketokivi, 2013). As a worst case, significant statistical results might even be the result of chance, as the likelihood that statistically significant results appear if one just tries out enough unrelated variables is high (Miller et al., 2013). The conclusion is that the divergence between theory and practice in performance measurement “must be stopped” (Miller et al., 2013: 959).

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^{*} Tel.: +49 221 470 2857; fax: +49 221 470 7883.

E-mail address: steigenberger@wiso.uni-koeln.de

The advantages and disadvantages of specific measures and types of measures of firm performance have been discussed at some length (e.g., Dalton & Aguinis, 2013; Richard, Devinney, Yip, & Johnson, 2009), and various efforts have been made to develop meaningful typologies of performance measures (e.g., Hamann et al., 2013; Rowe & Morrow, 1999). It remains widely unexplored, however, how different types of performance measures affect study results, i.e., how and why particular explanatory variables impact different dimensions of performance in different ways. It seems important to tackle this question, in order to arrive at sounder theoretical interpretations of research findings. In the present study I address this challenge.

To do that, I re-evaluate two meta-analyses that have examined the associations between firm resources in the resource-based view framework (RBV) and various indicators of firm performance. While concerns about performance measurement apply to various theories, the RBV is a particularly prominent example for a case in which the construct measured in research practice and the one defined in the theory diverge. Peteraf & Barney defined the dependent variable of the RBV as “[a firm’s ability to] deliver greater benefits to their customers for a given cost” (Peteraf & Barney, 2003: 311). In research practice, however, studies building on RBV frameworks rely heavily on performance measures like ROA or total shareholder return, which are not very closely related to the dependent variable specified in RBV theory (Powell, 2001). This deviation between the construct defined in the theory and measures employed in real-life research provides a fruitful field to study the impact of performance measurement on research results.

The RBV is a theory of value generation (Peteraf & Barney, 2003: 311). Many performance measures applied in research practice, however, capture the value appropriated by a specific stakeholder group, typically the shareholding stakeholders. The separation between value creation and value appropriation is the focus of appropriation theory. According to appropriation theory (cf. Coff, 1999), a firm creates value in the marketplace by transforming inputs into outputs that are more valuable than the inputs had been. The involved stakeholder groups then aim to appropriate as large a share as possible from this created value. Performance measures like ROE or ROA reflect the value appropriation of shareholders, other measures, like innovativeness or sales, measure a firm’s ability to create value in the marketplace. The relative bargaining power of a firm’s stakeholder groups links value creation measures to measures capturing value appropriation. The appropriation theory framework provides a promising approach to analyzing the impact of performance measurement on study results.

The analysis presented in this paper reveals that seemingly discordant findings in the RBV literature can be reconciled when considering whether or not the studied performance measures reflect the generation or appropriation of value, respectively. Building on this finding, the paper makes a number of contributions to the literature. First, it suggests that by not considering the bargaining over the appropriation of the value generated by a firm, many empirical studies are subject to an omitted variable bias that calls into question extant interpretations of their findings. Second, with regard to theory-building it submits that appropriation theoretical arguments provide a resilient explanation for systematic heterogeneity regarding the associations between RBV explanatory variables and different types of performance measures. Third, the paper derives recommendations for theory and research practice regarding what type of performance measure is appropriate for what type of research questions. Finally, by incorporating the bargaining over value appropriation into the RBV framework, the study offers a theoretical extension of the resource-based view of the firm that helps to clarify an important ambiguity of empirical research on the theory.

Hypotheses development

According to appropriation theory (Asher, Mahoney, & Mahoney, 2005; Brandenburger & Stuart, 2007; Coff, 1999; Crook, Ketchen, Combs, & Todd, 2008; Lepak, Smith, & Taylor, 2007), firm performance is a two-step game: The first step is the creation of a certain amount of economic value in the marketplace by transforming inputs such as raw materials into outputs more valuable than the transformed inputs had been. The second step is the distribution of this value among the firm’s stakeholders. The outcome of this distribution process depends on the relative bargaining power of the involved stakeholder groups (Coff, 1999).

This theoretical conceptualization builds on the theory of explicit and implicit contracts, a stakeholder theory (Simon, 1952; Tirole, 1999). Stakeholders are people and groups of people with a legitimate interest in the organization (Freeman, 1984; Rowley, 1997). Customers and suppliers, equity holders, management and employees, the state and society in general, creditors, lobby groups and trade associations are stakeholders (Donaldson & Preston, 1995). The theory of explicit and implicit contracts states that a stakeholder will demand a compensation for his or her contribution to the firm. This compensation must be at least as valuable as his or her ‘suffering’ from contributing. In the case of suppliers, for example, the perceived value a supplier receives from selling his goods or services to the focal firm must be at least as high as the value the supplier would receive if he would sell the supplies to someone else instead. An employee will only uphold an employment contract with a firm as long as the perceived value gained from the contract compensates the hardships associated with the work, such as being unable to use one’s time and skill in another way or another job. These opportunity costs define minimum or reservation prices for contractual relationships between a firm and its stakeholders (cf. Blau, 1991; Kristensen, 1997; Tsang, 2006; Williamson, 1999). An organization which has been able to survive will usually generate a certain amount of value exceeding the threshold of minimum prices set by its stakeholders. This excess value is then available for distribution among the organization’s stakeholders. The distributional outcome depends on the relative bargaining power of the stakeholder groups, which depends, for example, on the access to and control over critical information or the capacity for unified action (Blyler & Coff, 2003; Bourne & Walker, 2005; Chacar & Hesterly, 2008; Coff, 1999, 2010).¹ Powerful stakeholders acquire more value. In a firm with strong unionization, for example, employees might be able to enforce higher salaries for the same work compared to a firm in which the workforce is not so well organized. Bargaining power is the concept linking stakeholder value appropriation to firm value creation.

Measures of firm financial performance, such as ROA or total shareholder return, measure only the value captured by shareholders, not the value created by a firm. The financial performance of a firm depends on two distinct issues: (1) The ability of a firm to create value in the marketplace, and (2) the power of shareholders to appropriate substantial parts of that value. This distinction implies that it is not possible to infer to changes of a firm’s ability to create value in the marketplace from observations of the value appropriation of a particular stakeholder group. An increase in value appropriation of shareholders over time, in a longitudinal study design, could either be due to an increase in value creation of the firm, caused e.g., by a newly gained competitive advantage, or by a shift in the relative bargaining power of stakeholder groups. If one compares the value appropriation of shareholders of two firms within a cross-sectional design, it is impossible to tell if the firm with higher

¹ For a formal analysis of stakeholder bargaining processes and its link to value appropriation see also Brandenburger and Stuart (2007).

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