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Antecedents of firm performance in emerging economies: Business groups, strategy, industry structure, and state support

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ABSTRACT

A rich literature has investigated the antecedents of firm performance in developed economies, resulting in a consensus view that firm resources and strategy are the key determinants. Several arguments, however, suggest that in emerging economies other factors are more important for firm performance. This study analyzes the impact of firm strategy and industry structure as well as business group membership and state support on firm performance in an advanced emerging economy, Turkey. Using a data set compiled from a selection of the 1000 largest manufacturing firms in this country, the study employs several regression models to identify the main determinants of firm performance as measured by productivity and net profit margin. In contrast to studies of developed economies, the investigation finds that firm-related factors (competitive strategies) do not significantly influence performance; instead factors related to industry structure and business group membership are the strongest determinants of firm performance; further, state support interacts with business group membership and is positively related to productivity.

1. Introduction

Which key factors make some firms more successful than others? This issue has been a central question in strategic management studies since the beginning of the field in the 1950s. According to the classical answers, industry structure is the main determinant of both a firm's strategy and its performance (Bain, 1959). Later studies, however, demonstrate that industry characteristics alone cannot explain all variation in firm performance. These findings lead to the query why firms within the same industry perform differently (Spanos, Zaralis, & Lioukas, 2004).

Stimulated by research on firm resources (Penrose, 1959) and competitive strategy (Porter, 1980), a multitude of studies have analyzed the impact of industry structure versus firm resources, for example Spanos et al. (2004). During recent years, a consensus has emerged that firm strategy and resources tend to be more important than industry structure in influencing performance, at least in developed OECD-economies. An increasing number of firms competing in global and national markets originate in emerging countries, however, and as Kim and Lim (1988) noted more than twenty years ago, these economies tend to have different institutional structures, and these differences may have significant consequences for firm performance. A distinguishing factor is the role played by large diversified business groups (Nair & Kotha, 2001). According to Chang and Hong (2002), the top thirty business groups contribute to 40% of Korea's total output; and in Russia, 22 large business groups account for almost half of total sales (Guriev & Rachinsky, 2005). Several studies have also demonstrated a positive relationship between business group and firm performance (e.g. Yiu, Bruton, & Lu, 2005). Another difference between developed and emerging economies concerns the role of state interventions in the economy. Several studies of Korea (Amsden, 1989; Amsden & Wan-wen, 2003) or China (Altenburg, Schmitz, & Stamm, 2008) demonstrate the importance of state and government initiatives, and this tends to be a general phenomenon in emerging economies, including Turkey (see Boratav, 2006; Kazgan, 2004).

Considering these differences, strategy research needs to specifically study factors impacting firm performance in emerging economies. This paper contributes to such an analysis by studying four types of factors influencing the performance of emerging economy-firms: strategy, industry structure, state support and membership in business groups. Kearney (2012) points out the lack of general agreement concerning how to categorize countries as emerging economies. This paper builds on the classifications used by the Financial Times Stock Exchange (FTSE), and Morgan Stanley Capital International. Both classify Turkey as an emerging economy, in the FTSE system as an "advanced emerging economy", ranked as No. 16 in the global ordering of economies based on purchasing power adjusted GDP (Kearney, 2012:161). Using data from 231 large manufacturing companies in Turkey, the study makes use of several different methods to investigate the key factors impacting firm performance, and to ascertain the relative role of firm strategies compared to industry factors.

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The following section presents an overview of the literature regarding factors influencing firm performance, and formulates hypotheses related to the impact of industry structure, strategy, state support and business group membership. Next, the method section provides details on data collection, the dependent and independent variables, and the methods used: hierarchical regression and importance analysis. The results section reports the main findings in relation to the hypotheses and additional explanatory variables. The concluding section summarizes the results and discusses ways to interpret the key findings. The paper ends with listing some limitations and suggestion for future research.

2. Theoretical framework and hypotheses

2.1. The role of structure on performance

Historically, industrial organization researchers claimed that industry structure determines firm performance (Bain, 1956). Several different dimensions of industry structure have been used; two of the most common being competitive intensity and threat of substitute products or services (Porter, 1980; Powell, 1996). Researchers such as Spanos et al. (2004) have included related aspects e.g. industry concentration, entry barriers and growth as important industry dimensions. A rich literature in the United States has attempted to establish the precise impact of industry structure on firm performance but the results vary considerably, from significant and substantial, explaining 30% of firm performance as measured by return on assets (McGahan & Porter, 2003), to significant but very small (Adner & Helfat, 2003). Studies in Europe have found significant but rather small impact of industry characteristics on performance; Spanos et al. (2004), for example, report an impact of industry on performance at around 7%. As for Japan, Kotha and Nair (1995), however, observed a very high impact of industry on firm performance.

Less research of this type exists in emerging economies, but published studies indicate a strong impact of industry characteristics on firm performance in these countries. In Korea, for example, Chen (2010) observes a very high industry impact on the performance of IT firms. Studies of Chinese firms also report a strong impact of industry structure and Lou (1999) e.g. noticed that factors such as general sales growth, increase in the number of firms in the industry, and industrial uncertainty levels significantly affected the performance of firms. As for Turkey, Karabag (2008) found that industry structure had a significant impact on firm performance.

On the basis of these studies, and the standard argument in studies in developed economies that competitive intensity, threat of substitute products, threat of suppliers and low entry barriers will negatively affect firm performance (Porter, 1980) this paper proposes the following Hypothesis $H_{1:}$ Industry characteristics, defined according to the dimensions above, have a significant negative impact on firm performance in emerging economies.

2.2. The impact of strategy variables

Firm strategy and resources constitute another group of factors influencing firm performance. According to Porter (1980), a firm can build its performance by implementing one of three core strategies: differentiation, low-cost, or focus. This is one of most used typologies of competitive strategies (e.g. Gopalakrishna & Subramanian, 2001), and will also be used in this paper. Although a few researchers report a small or insignificant impact of firm factors on performance (cf. Schmalensee¸1985), most studies of American firms show that firm factors significantly explain performance (Davis & Schul, 1993). Porter (1980) strongly suggests that competitive strategies differ from each other in distinctive ways. Empirical studies in several countries, however, show that a combination strategy might be a complementary alternative (Hill, 1988). Thus, for example, the European study by Spanos et al. (2004) analyzes three different strategies (low cost, differentiation, and combination) and finds them to significantly affect firm performance.

Some studies in emerging economies also report a significant impact of firm strategies. Using the Miles and Snow typology (1978), prospector, analyzer, defender and reactor, Tan and Litschert (1994) find the defender strategy to significantly explain performance, whereas the other strategies do not have any significant effects. The authors explain this by referring to the Chinese economic environment with its high level of uncertainty, where firms tend to prefer defensive strategies. The present study will test the impact of firm strategies on performance in Turkey, using the Porter classification, including combination strategy. The study suggests hypothesis H_2: Firm strategy in emerging economies has a positive and significant impact on firm performance.

2.3. Comparison of the impact of strategy and structure on firm performance

According to the original proposition in industrial organization theory, industry structure is a primary antecedent of firm performance, whereas recent studies in OECD-economies find strategy to be more important for performance (Galbreath & Galvin, 2008; McGahan & Porter, 2002). Studies of industry versus strategy outside the OECD core, for example in Taiwan and China, tend to report a weaker impact of strategy factors. The study of Tan and Litschert (1994) of firms in the Chinese electronic industry, using the Miles–Snow framework, find no significant relations between most of the studied strategies and firm performance. In a study of Taiwanese firms, Duh, Chow, and Chen (2006) do not observe any positive relation between strategy and firm performance; Dong, Liu, and Yin (2008) only find insignificant relations between strategy and performance in their study of Chinese firms. Kotha and Nair (1995) report a much higher impact of industry factors than firm factors also in Japan. Using growth as a performance indicator they find firm factors to be almost insignificant ($p > 0.05$), and none of the studied firm factors is significantly related to this measure of performance. Summarizing their study Ofori-Dankwa and Julian (2012: 13) argue that “conventional wisdom drawn from developed nations….” cannot be totally employed in emerging economies and in some cases that wisdom “might work in the opposite direction”.

Studies in financial economics using stock market returns as an indicator of firm performance try to explain the strong impact of industry on performance in emerging economies. One important aspect is the high share of non-operating income in some industries, especially in times of economic volatility (Bai & Green, 2010; Cavaglia, Brightman, & Aked, 2000; Phylaktis & Xia, 2006). As Kearney (2012: 162) points out, “greater uncertainty and risk” is a common feature of emerging economies. Another factor is the high (but uneven) growth characterizing these economies, implying that firms tend to invest in general growth rather than in development of any specific strategy. Already Abegglen and Stalk (1987) observed this paramount importance for firms of investing in growth to maintain market shares in their classical analysis of Japan´s high-growth era.

Turkey presents an industrial context similar to other late industrializing countries, with a quadrupling of GDP from 1970 to 2005 and with recurring financial crises and volatility, including nine destructive crises between 1980 and 2002. In a recent study, Efendioglu and Karabulut (2010) do not observe any significant relation between firm factors and performance. In another study Karabag (2008) argues that industry can affect firm performance more than firm factors but her study, based on subjective (perceived) performance, does not confirm this, although several circumstances point to a huge variation in industry characteristics in Turkey. Some sectors display high levels of concentration, with significant entry barriers (Zeybek, 2005) related to traditions of state intervention and protection (Kazgan, 2004).

Other sectors (e.g. vehicles, paper products and printing, food, beverage, furniture, apparel and leather) are exposed to intensive international and domestic competition (Zeybek, 2005). Studies of R&D and