

Small firm performance: modelling the role of innovative differentiation

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Principal Topic

Ansoff (1965) theorises early on in the development of strategic management as a field of study that structure follows strategy. Although this assertion has been the basis for considerable debate (e.g. Peters, 1984), what has been widely accepted is that the use of different types of strategies under suitable conditions, including firm structure and environment, will improve firm performance (Anderson & Atkins, 2001; Borch, Huse, & Senneseth, 1999). This argument forms one of the cornerstones of strategic management theory, and has been the topic of a great number of studies (Dess & Davis, 1984; Porter, 1980). In particular, the role of business or competitive strategies in firm performance has been studied widely (Cooper, Willard, & Woo, 1986; Covin, 1991; Mosakowski, 1993; Smallbone, Leigh, & North, 1995; Porter, 1980). Best known of these studies is the seminal work of Michael Porter (1980), who developed a typology of business strategies, or generic strategies as he termed it, to describe how firms will compete in a particular market. He identifies differentiation, cost-leadership and focus strategies as the broad strategies which most firms will use to compete. Mintzberg (1988) builds on this work, explaining that most of these business strategies can be viewed as some form of differentiation. The existence of a refined typology of business strategies is supported by Miller (1988) who suggests that the richer examination of business strategies by the above mentioned authors, have allowed for an improved understanding of the relationship between strategy and the context in which it occurs. Miller studies 89 small and diversified firms in the province of Quebec, Canada, to explore the relationships between structure, environment and Porter's generic strategies, using such refined typology which includes innovative and marketing differentiation.

Variyam and Kraybill (1993) explain that the business strategies adopted by small firms will differ from large firms due to a number of factors, including economies of scale and organisational structure. Although received wisdom holds that a focus or differentiation strategy is most likely to be associated with a high level of performance in small and/or new firms, this assertion has not been widely investigated in empirical studies, and the existing evidence is conflicting. For example, Variyam and Kraybill (1993) suggest that small firms use numerous strategies, including product development, marketing and innovation in order to gain competitive advantage. On the other hand, Scozzi, Garavelli and Crowston (2005) argue that the number of innovative small firms may be limited. More specifically, Miller (1988) compares the behaviour of high and poor performing firms and finds that innovative differentiation is most likely to be pursued by high performers in uncertain environments. Specifically, he suggests that for small firms the nature of the environment will have a significant effect on the choice of business strategies.

A number of other environmental factors have been identified as influencing the choice and success of business strategies in small firms. Variyam and Kraybill (1993) state that business strategies differ depending on industry sector, for example wholesale and retail sectors may use quality and product effectiveness strategies. Miller (1988) finds that corporate life cycle may also influence the choice of strategy, in particular, that innovative and focus strategies are more common in young firms. The firms in Miller's study were defined as small, employing fewer than 500 employees. This and other studies (e.g. Kamien & Schwartz, 1975; Tushman & Nelson, 1990) show that Schumpeter's (1947) earlier assertion that large firm size is essential for innovation does not hold for all small firms.

Methodology/Key Propositions

The preceding arguments, which are elaborated in the completed paper, lead to the formulation of the following hypotheses:

H1 Innovative differentiation will be associated with high firm performance in small firms. H2 Firms with organic organisational strategies will use innovative differentiation strategies. H3 Firm age will be related to innovative differentiation strategies, specifically younger firms will use innovative differentiation strategies. H4 The relationship between innovative differentiation and firm performance will be moderated by: H4a Hostile environments H4b Dynamic environments

These hypotheses were tested in an empirical study of 320 small New Zealand firms with between 10 and 99 employees, using a questionnaire containing scales which have been developed and tested in previous studies to test the concepts set out in the hypotheses.

Results and Implications

Structural equation analyses of the data using AMOS 5 provided support for hypotheses H1, H2, H3 and H4b but hypothesis H4a was not supported. In particular it was found that, in support of the findings of Miller (1988), innovative differentiation is significantly associated with performance only for firms operating in dynamic environments. In addition it appears that although the effect of organicity on innovative differentiation is significant in environments with both low and high dynamism, it is only in dynamic environments that younger firms have a significant advantage in terms of innovative differentiation. Several implications result from these findings. For example, firms not operating in dynamic environments should look to market differentiation rather than innovative differentiation in order to improve performance. Furthermore, firms wanting to follow a strategy of innovative differentiation will find an organic structure beneficial, but older firms may still have difficulty in pursuing this direction. These and other findings and implications are elaborated in the full paper.

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