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Determinants of firm performance: a structural equation approach

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Abstract

This research analyzes specific determinants of firm Performance taking the Resource Based View (RBV) theory to explaining how firms achieve sustained competitive advantages based on their VRIN (valuable, rare, inimitable and not replaceable) resources and capabilities (BARNEY, 1991). TEECE et al. (1997) introduced the concept of Dynamic Capabilities (DC) as an RBV extension. Our conceptual model defines these capabilities as the result of firm's Learning, Market and Entrepreneurial Orientations, which mediate the development of Competitive Advantages (CA) and improving firm Performance.

Keywords: Business performance, Latent variables, Structural equation models.

Introduction

LIN et al. (2008) argue that Market Orientation (MO) is heavily determined by Learning Orientation (LO), and this is our first hypothesis (H1). Firms that learn quickly improve their ability to respond to the market and identify potential fields of entrepreneurial activities. Consequently, we test how LO affects Entrepreneurial Orientation (EO) (H2). A dynamic learning mechanism is a distinctive process that promotes the firm DC (LEE et al., 2011), i.e., we assume the relation between LO and DC (H3). One of the key firm resources and capabilities is MO, and its relation with DC defines a new hypothesis to be tested (H4). TEECE (2007) suggests that one of the DC antecedents is the entrepreneurial component, thus, it is suggested the relationship between EO and DC (H5). DC are one of the key antecedents to CA. This suggests testing the relation between DC and Differentiation (H6) and Cost Leadership (H7). Finally, the relationship between the development and/or the maintenance of a CA and the firm Performance has already been proven in literature. Thus, we assume that Differentiation and Cost Leadership positively influence the firm Performance (H8 and H9, respectively). All hypotheses are defined for cause-effect relationships. The operationalization of the constructs in our model is based on battery of items available in the literature. All these items use 7-point Likert-type scales (1 = totally disagree to 7 = totally agree).

Results

The empirical testing of the conceptual model is conducted on the population of 1,168,964 Portuguese firms in 2010 (INE, 2012). The sample of 1,190 Portuguese firms was obtained from a Portuguese database of approximately 91,000 firms. CEOs or other top manager from all those companies were contacted by e-mail and the scope and objectives of the study were clarified.

These scales were validated through an exploratory factor analysis (EFA) using software SPSS v20. Based on the EFA results, items with low factor loadings were eliminated as they were unreliable indicators to measure the construct. Then, the computation of Cronbach's alpha, composite reliability (CR), and average variance extracted (AVE) for all the scales show satisfactory levels of reliability, except for Cost Leadership, with a variance extracted below 0.5.

The structural equation model is estimated by the maximum likelihood method using software MPlus 6.0. The estimation of the structural relations shows that: LO positively affects MO, EO and DC (H1, H2 and H3); MO and EO positively influence DC (H4 and H5); the same conclusion can be drawn from the relationship between DC and CA differentiation (H6) and cost leadership (H7). Finally, both CAs (Differentiation and Cost Leadership) have a positive impact on Performance (H8 and H9).

Conclusion

For the first time, the mediator role of DC between major corporate strategic orientations – MO, EO and LO – and the development of CA and firm Performance is analyzed. The study supports the view that DC enhances CA (Differentiation and Cost Leadership) as well the chance to improve firm Performance.

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