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INFLUENCE OF FIRM LEVEL INSTITUTIONS ON THE RELATIONSHIP BETWEEN COMPETITIVE STRATEGY AND FIRM PERFORMANCE OF NON-TIMBER FOREST PRODUCTS SMALL AND MEDIUM ENTERPRISES IN KENYA

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Abstract

Empirical evidence on the influence of firm level institutions on firm performance is inconclusive. While some studies have advanced the moderation effect, others have renounced it. Thus, this study performed multiple linear regression analysis to test the moderation effect of firm level institutions on the relationship between strategy and firm performance. The study was conducted as a cross-sectional survey covering 314 small and medium enterprises in the non-timber forest products sub-sector in nine counties of Kenya. The coefficient of determination, F-statistic, and t-value were used in presenting fit of the model and the relationship between variables. It was observed that the resource based and administrative based firm level institutions significantly influenced the relationship between competitive strategy and performance of non-timber forest products small and medium enterprises. The conditions for moderation effect were made demonstrating that causal effect of competitive strategy on firm performance as moderated by firm level institutions. This demonstrated that improved performance was visible with only firms that had manifested firm level institutions to implement competitive strategy. It was concluded that firm level institutions enhance relationship between competitive strategy and firm performance by defining milieu in which strategy choices are made and implemented. Thus, firms should enhance their capacities through appropriate staff *recruitment policies and development to manifest right firm level institutions. This study enriches institutional theory by adding some insights that firms require resources and administrative systems that form internal institutional milieu to drive through strategy choices to achieve competitiveness and performance.*

Keywords: Competitive Strategy, Firm Level Institutions, Firm Performance, Moderation, Non-Timber Forest Products, Small and Medium Enterprises

INTRODUCTION

Interest in institutional analysis, particularly the influence of institutions on the performance of business enterprises is gaining momentum following the works of North and Robert (1973), North (1990), and Levy and Spiller (1994). The importance of institutions is based on the context that business actions are embedded in social milieu. A business is a social activity (Byers, 1997), and that its performance is dependent on the prevailing institutional environment (Bruton et al., 2010). The institutional milieu creates conditions that entrepreneurs must navigate and that policy makers can address (North, 1990; Meyer and Rowan, 1991). It has been demonstrated that institutions create a stable structure to human interaction. Institutions can govern the relations among groups and among individuals (Nabli & Nuggent, 1989). They help establish a milieu for effective decision making by the business organization. Global Entrepreneurship Monitor (GEM, 2012) observed that an institutional environment affects sustainability of a firm by governing social behaviour, thus enhancing cognitive and moral legitimacy necessary for survival in business.

The term institution is described differently by various studies. Some studies have described institutions either plainly as norms of behaviour or as a set of rules. However, there is a near consensus that institutions are the formal rules (North, 1990), less formal shared interaction sequences (Jepperson, 1991), assumptions (Meyer & Rowan, 1991) and agreements (Bonchek & Shepsle, 1996) expected to be followed by organizations and individuals. They are the "rules of the game," both formal legal rules and informal social norms that govern individual behavior and structure social interactions. Historical institutionalists refer to institutions as formal and informal procedures, routines, norms and conventions embedded in the organizational structure (Hall & Taylor, 1996). North (1990) refers to institutions as rules of the game in a society or humanly devised formal (rules) and informal (codes of behaviour) constraints that shape human interaction. Scott (1995) defines institutions as formal (rules and regulations) and informal (norms and cognitions) arrangements that provide stability and meaning to social behaviour. Ostrom (1999) on the other hand observes that institutions could be looked at either as entities like organizations, firms and public bureaus, or as invisible properties of these entities including rules, constitution, norms, and strategies that shape interpretations and behavior.

The New Institutional Economics has envisaged four levels of institutions: informal institutions as level 1; formal rules or constitution as level 2; governance as level 3; and the market or resource allocation and employment as level 4 (Williamson, 2000). The informal institutions level is that of embeddedness and informal rules including traditions, customs, values and religion. These institutions arise spontaneously over a long period of time and are very slow to change (North, 1990; Williamson, 2000). The second level is focused on the institutional environment and formal rules using the economics of property rights and positive political theory. The third level focuses on the play of the game, which is governance and interactions of actors within transaction cost economics. Finally, the fourth level is the allocation of resources and employment and is governed by neoclassical economics.

There are two kinds of institutional forces: internal driving forces and external institutions (Grais & Pellegrini, 2006; Bruton et al., 2010). Internal institutions often referred to as firm level institutions are the firm-specific attributes in a firm's internal environment defining the context in which strategic decisions are made and implemented (Fuduric, 2008; Bruton et al., 2010). The firm level institutions are categorized into two dimensions as administrative based firm level institutions, and resource based firm level institutions. The administrative based firm level institutions include structure, management style, internal controls, systems, and procedures, while resource based ones include financial resources, skills and competencies, knowledge base, culture, and human resources (Powell & DiMaggio, 1991; Bruton et al., 2010; Machuki et al., 2012). The external institutions, on other hand are those socio-cultural norms, relationship among organizations and political pressures by government and other authoritative bodies (DiMaggio, 1991; Scott, 1995). External institutions occur externally to the firm and include regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance, and institutions of conflict management.

Although there is emerging consensus on the importance of institutions in influencing firm performance its literature is ambiguous. Notably, influence of firm level institutions on firm performance is not clear and is debatable in literature. While some studies have advanced the moderation effect, others have discounted it. Furthermore, the evidence presented by studies is based mostly on large corporations. The study by Machuki et al. (2012) concentrated on large organizations leaving out small and medium enterprises (SMEs) and the findings were mostly not statistically significant. Equally, studies conducted have focused less on businesses like the non-timber forest products (NTFPs) firms and others in the agri-business sector that deal with products with origin from agricultural resources.

The NTFPs are described as biological resources of plant and animal origin other than wood derived from forests, other wooded lands and trees outside forests and includes fruits, aloe, herbs, essential oils, resins and honey (Food and Agriculture Organization [FAO], 1995; Ahenkan & Boon, 2011). The recent past has witnessed increased focus on NTFPs labeled green businesses because of the dual economic and environmental roles they play. Notably, NTFPs contribute significantly to livelihoods (Marshall et al., 2006); act as source of employment and income (Ahenkan & Boon, 2011); offer opportunities for businesses (Subedi, 2003); and are more beneficial to forests than timber based products that enhance logging (Marshall et al., 2006). At global level, NFTPs generate US$115.5 to US$117 billion annually (Shanley et al., 2008).

Despite vast potential of NTFPs firms, they are poorly organized with most of them remaining informal and uncompetitive. Distinctly less focus has been placed by studies on firms dealing with NTFPs resulting in most of them operating without benefit of homegrown solutions for improved competitiveness and performance. Studies conducted on such firms elsewhere (Schreckenberg et al., 2006; Dubey, 2008) show that strengthening of internal capacities would enhance their competitiveness and performance. Such internal capacities include structures, resources, knowledge and skills (Marshall et al., 2006; Zoysa and Herath 2007). However, studies done have not clearly demonstrated how these factors which are often summed up by studies as internal institutional arrangements to enhance competitiveness and firm performance.

This paper, therefore tested the moderation effect of firm level institutions on the entrepreneurship to performance relationship of NTFPs firms. Moderation effect may reduce or enhance direction of the relationship between predictor variables and dependent variable, or it may even change direction of the relationship between two variables from positive to negative or vice versa (Lindley & Walker, 1993). The decision rule for moderation effect that introduction of a moderation variable reduces/alters the strength between independent and dependent, and the interaction term has a significant relationship with performance was applied.

THEORETICAL FOUNDATIONS OF THE STUDY

The argument that a business is a social activity and that the internal environment is crucial to its performance anchored this study on the institutional theory. Institutional theory advances how organizational structures and individual behaviour are influenced by cultural, political and social forces surrounding them (Fogarty, 1996). The organizations are affected by normative pressures arising from external sources and the organization itself (Zucker, 1987). Thus, an organizational structure is seen as a reflection of rationalized institutional rules (Meyer & Rowan, 1991) or shared knowledge of belief systems (Scott, 1995). It attends to social structure considering the processes by which structures, including schemas, rules, norms, and routines become established as authoritative guidelines for social behavior (Scott, 2004).

Institutionalism theory helps in understanding determinants of policies and practices with impact on performance of an individual or organization (Wright & McMahan, 1992). The theory indicates that an organization that follows institutional prescriptions can survive easily and is stable (Oliver, 1995). This is based on an understanding that institutional environment is socially constructed, that is it can shape individual behaviour as well as be shaped by individuals acting within the environment (Berger & Luckmann, 1967).

Institutional theory has undergone metamorphosis resulting in two schools of thought; old and new institutional theories. The old institutional theory is concerned with the understanding of what constitutes values, how organizations adapt or change their culture and structure to socially accepted values, and how such values become weak and de-institutionalized (Selznick, 1957). The old theory suggests that to institutionalize norms and values in organizations, those who hold power, such as entrepreneurs or managers, must be able to motivate and drive members of an organization to follow their behaviour. This old theory has often been advanced as sociology/organizational branch. On the other hand, the new institutional theory advanced as economic/political branch is based on the reasoning that organizational practices are influenced by institutional environments and internal institutions; that is structure, conduct and performance of an organization depend on the characteristics of the environment in which the organization's activities take place (Zucker 1987; DiMaggio & Powell, 1983; Meyer & Scott, 1983). Institutional environments include social, political and economic environments, while internal institutions include the objectives, structure and culture of the organization.

The application of institutional theory in entrepreneurial studies is based on the understanding that entrepreneurs are both constrained and enabled by the institutions in their environment (Bruton & Ahlstrom, 2003; Scott, 2004; Bruton et al., 2010). Institutional environment affects the rate and size of new venture creation by defining and limiting entrepreneurial opportunities (Hwang & Powell, 2005; Bruton et al., 2010). Inadequate institutional development complicates new venture development (Baumol et al., 2009) while a more developed institutional environment with overly restrictive regulation hampers venture establishment (de Soto, 2000). Entrepreneurs may be discouraged from starting ventures if there are no formal institutional structures, or if they are forced to comply with too many rules and procedural requirements that are costly to fulfill (de Soto, 2000).

Effect of Firm Level Institutions on Firm Performance

Studies have demonstrated varied results of the influence of firm-level institutions on firm performance. Suggestions for a moderating effect of institutions on the relationship between strategy and firm performance have emerged. The support for the influence of resource based firm level institutions on the relationship between competitive strategy and firm performance is offered by various studies (Peng, 2006; Peng et al., 2008; Machuki et al*.,* 2012). Peng (2006) observed that strategic choices were the outcome of dynamic interaction between institutions and organizations. Peng et al. (2008) noted that strategic choices were not only driven by industry conditions and firm capabilities, but were also a reflection of the formal and informal constraints of a particular institutional framework that managers confront. Mahler (2009) and Machuki et al. (2012) observed internal or firm level institutions to influence the relationship between competitive strategy and performance.

The administrative based firm level institutions have been demonstrated by studies (Certified Practicing Accountants Australia [CPA], 2007; Machuki et al., 2012) to influence the relationship between competitive strategy and performance. The CPA (2007) lists the types of controls used to ensure accurate and reliable financial controls within an organization. These include internal control structures and procedures. Machuki et al. (2012) observed that the identified strategy would require alignment with the internal factors of the organization which defines the context in which decisions are made and implemented.

Although there is emerging consensus on the importance of institutions in moderating the entrepreneurship to firm performance relationship, empirical evidence supporting such propositions on performance of SMEs is inconclusive with some findings being either not significant or entirely relying on evidence adduced from large corporations. The results by Machuki et al. (2012) were not statistically significant and the observations made were on large corporations instead of SMEs especially those dealing with NTFPs. Thus, the argument for influence of firm level institutions especially the moderating effect in entrepreneurship to firm performance relationship needs empirical support. Therefore, this study formulated the following hypothesis for testing:

H_0: There is no significant moderating effect of firm level institutions on the relationship between competitive strategy and performance of NTFPs small and medium enterprises

Conceptual Framework

From the theoretical perspectives and conceptual arguments, it could be deduced that strategy development and implementation by an organization may be influenced by internal institutional dimensions (Peng et al., 2008; Machuki et al*.,* 2012). This logical thinking envisages a process whereby institutional dimensions provide a prediction of competitive strategy and firm performance. Based on the foregoing, it was conceptualized that competitive strategy could affect firm performance directly or was influenced by the moderating effect of firm level institutions. Figure 1 presents this conceptual model, which formed the road map for this study.

Figure 1: Conceptual Model

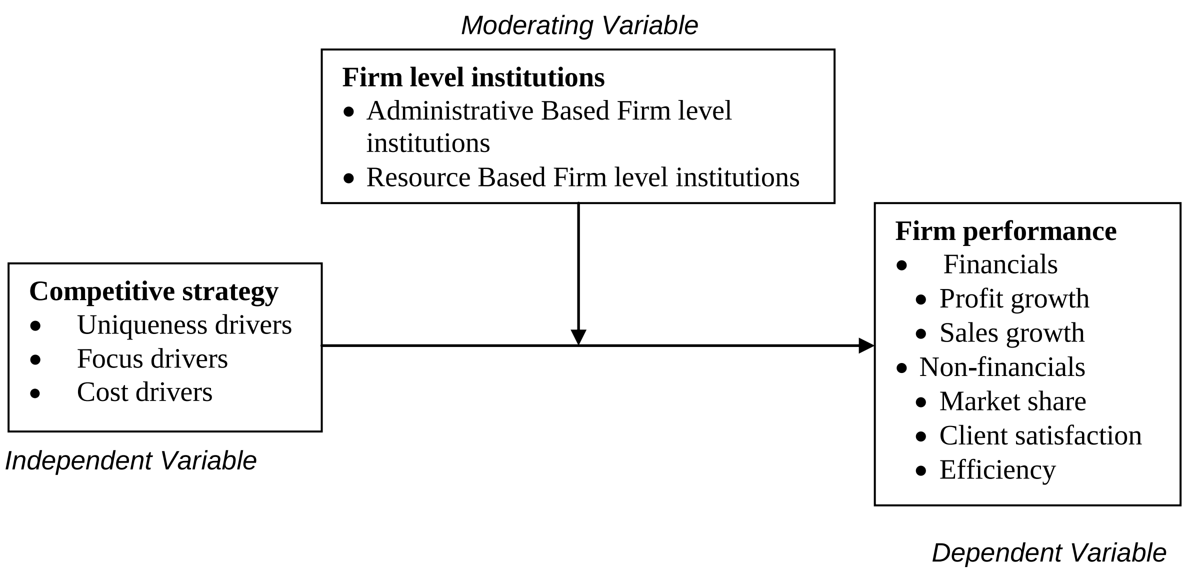

Figure 1 highlights the influence of firm level institutions on the relationship between competitive strategy and firm performance. In the conceptual model, causal effect of competitive strategy on performance is moderated by firm level institutions. In this study, it was postulated that a firm pursues Porter's generic strategies including differentiation, focus and cost leadership while mobilizing resources, and manifests internal institutions to drive the firm to fruition. Studies (Namusonge, 2014) show that Porter's generic strategies are appropriate for SMEs.

This study captured the realized outcome of implementation process using both financials and non-financial metrics. Studies have demonstrated that SMEs are complexity with diverse goals precluding use of single metric to capture performance. SMEs are complex and their entrepreneurs may be more interested in survival rather than growth and expansion. Some studies on SMEs show a preference for non-financial measures due to difficulties in obtaining objective financial data as managers may manipulate data to avoid personal or corporate taxes (Zulkiffli & Perera, 2011). Thus, this study used multi item measures including market share, client satisfaction, sales growth, efficiency and profit growth to capture complexity of the target SMEs and offer better prediction of their performance.

METHODOLOGY

This study was conducted as a cross-sectional survey covering 314 NTFPs small and medium enterprises from nine counties in Kenya. A stratified sampling procedure was applied to establish sampling units and individual firms as units of study selected randomly for interviews using a questionnaire from the nine counties: Garissa (13), Kajiado (13), Kilifi (22), Kitui (25), Kwale (16), Machakos (13), Makueni (16), Mombasa (61) and Nairobi (135). A total of 277 questionnaires forming 88 percent of the sample size were found usable and adopted in this study for further analysis following data cleaning process.

In order to obtain valid measures, the researchers reviewed relevant literature and held consultations with subject matter specialists. In addition, the researchers elucidated operationalization of variables by specifying scales of measurements and analysis, and piloted the study to validate data with real research content. Validated indicators from previous studies and multi item measures were used to cover multidimensionality of variables. Firm level institutions were operationalized through rating the degree of extent to which each institutional arrangement was availed for use on a Lickert scale and was captured using an interval measure. Indicators for operationalizing performance construct were captured as trends in performance indicator over the years and were measured using interval scale. Reliability was established through computation of Cronbach's alpha coefficient for each construct. The Cronbach's alpha values for firm level institutions (0.945), competitive strategy (0.900) and firm performance (0.822) were above the cut-off coefficient of 0.7 defined for the study indicating that the items were accurately measured and had adequate levels of internal consistency.

The study performed tests of various assumptions to ensure appropriateness of the data collected for analysis. Examination of scatter plot pointed to linear relationships between firm performance (dependent), and firm level institutions and competitive strategy (independent variables). It was also observed that the data was normally distributed. Both the graphical and numerical methods performed confirmed normality of the data. The CI, VIF and tolerance fell within the acceptance ranges pointing to lack of multicollinearity problem in the regression models used for this study. The assumption of homoscedasticity was confirmed with error term being same across all values of the independent variables. Thus to meet the three conditions demonstrating existence of moderating effect, this study performed multiple linear regression using three models with linear relationships of firm performance (dependent), competitive strategy (predictor), firm level institutions (moderator) and the interaction term. Model 1 was aimed at showing existence of a relationship between the predictor (competitive strategy) and dependent (performance). Model 2 was aimed at showing how the moderator (firm level institutions) reduced/altered strength between predictor (competitive strategy) and dependent (performance). Model 3 was aimed at showing effect of the interaction term. The three models are elucidated hereunder.

$FP_{41} = \beta_{041} + \beta_{411} CS +$ □□□□□□ (1)

$FP_{42} = \beta_{042} + \beta_{412} CS + \beta_{422} FLI +$ □□□□□ (2)

$FP_{43} = \beta_{043} + \beta_{413} CS + \beta_{423} FLI + \beta_{433} ITT +$ □□□□ (3)

Firm performance was inputted as performance index computed as mean value of sales growth rate, profit growth rate, market share growth rate, client satisfaction and efficiency. On the other hand, competitive strategy was inputted as mean value of uniqueness, focus and cost drivers. Firm level institutions was inputted as mean value of various items used to measure level of manifestation of resource based and administrative based firm level institutions using a five point Likert scale: 1 = to a great extent 2 = high extent 3 = moderately 4 = small extent 5 = not at all. Interaction term was computed as a product of competitive strategy and firm level institutions.

EMPIRICAL RESULTS AND DISCUSSION

Three models of multiple linear regressions were run to establish the moderating effect of firm level institutions on the relationship between competitive strategy and firm performance. The regression results are shown in Table 1.

Table 1: Effect of Firm Level Institutions on Relationship between Competitive Strategy and Firm Performance

Item	Model 1		Model 2		Model 3	
	B	t-ratio	B	t-ratio	B	t-ratio
Constant	1.235	13.034**	.953	6.521**	1.281	6.624**
Strategy	.127	8.424**	.072	3.794**	.044	2.062*
Firm level institutions	-		.202	2.967*	.075	.893
Interaction term	-		-		.001	2.552*
R^2	0.211		0.211		0.233	
Adjusted R^2	0.208		0.204		0.222	
F	70.956**		30.549**		23.027**	
N	277		277		277	

Asterisks of ** and * indicate significance at 1% and 5% significance levels, respectively

The regression analyzes results demonstrated that the model fit with the selected variables were varied. Regression of firm performance with competitive strategy alone resulted to model fit with R^2 and adjusted R^2 values of 0.211 and 0.208, respectively with coefficient of competitive strategy at 0.127. However, with introduction of firm level institutions in the model, the adjusted

R^2 value reduced to 0.204 with resultant reduction in the coefficient of competitive strategy to 0. 072 as indicated in model 2. Subsequent introduction of the interaction term resulted in improvement of both R^2 and adjusted R^2 values to 0.233 and 0.222, respectively. However, the coefficient of competitive strategy reduced further to 0.044.

The F statistics for the three models were statistically significant at five percent significance level. The F statistics were significant at p-values of 0.000 and 0.05, demonstrating that the models were highly significant. Thus, the null hypothesis that there is no significant moderation effect of firm level institutions on relationship between competitive strategy and firm performance of SMEs was rejected in favour of the alternative hypothesis that there was a significant moderation effect of firm level institutions on relationship between competitive strategy and firm performance of SMEs. It was therefore, observed that firm level institutions including resource based and administrative based firm level institutions significantly influenced as moderators relationship between competitive strategy and performance of the NTFPs firms.

From model 3, the calculated t-ratio for the estimated coefficients of competitive strategy (2.062) and interaction term (2.552) were significant at five percent significance level. However, t-ratio for estimated coefficients of firm level institutions (0.893) was not significant at five percent significance level ($p = 0.373$). Based on the foregoing results of regression analysis, the following regression equation (4) was specified.

FP = 1.281 + 0.044 CS + 0.001 ITT (4)

(0.000) (0.005) (0.005)

Based on the regression results, the intercept was 1.281, implying that performance would be 1.281 when all the independent variables were zero. Increase in interaction term (product of competitive strategy and firm level institutions) by one unit, that is, raising level of the moderation of institutions by one unit would increase performance of SMEs by 0.001, ceteris paribus.

The reduction in the adjusted R^2 value with the introduction of firm level institution construct in the model of firm performance (dependent) and competitive strategy (independent) indicated over-fitting of the model for the number of data points. However, improvement in the adjusted R^2 value with inclusion of interaction term in the model indicated well-fitting of the model for the number of data points. The R^2 value was average and consistent with observations in other studies. The R^2 value of 0.233 meant that the strategy, institutions and interaction term explained 23.3 percent variation in the performance of respondent SMEs. This was average and consistent with observations in other studies. The findings that performance was positively influenced by competitive strategy and moderating effect of institutions were supported by various studies. Studies by Mahler (2009) and Machuki et al. (2012) observed that firm level institutions influence the relationship between competitive strategy and performance.

The decision rule for moderation effect that firm level institutions as a moderator reduces/alters strength between competitive strategy and firm performance, and the interaction term had a significant relationship with firm performance was made. This implied existence of a moderating effect of firm level institutions on the relationship between competitive strategy and firm performance. It was therefore, observed that firm level institutions significantly influenced as moderators the relationship between competitive strategy and performance of SMEs in the NTFPs sub-sector.

The indication of a significant moderating effect of firm level institutions concurred with findings of past studies. Various studies (CPA, 2007; Peng et al., 2008; Mahler, 2009; Machuki et al., 2012) observed that firm level institutions influence the relationship between competitive strategy and performance. A study by CPA (2007) on internal controls for small business in Australia demonstrated that administrative based firm level institutions including internal control structures and procedures influence the relationship between competitive strategy and performance. Peng et al. (2008) in a perspective article on institution-based view of international business strategy of emerging economies opined that institutions drive firm strategy and performance. Machuki et al. (2012) in a study on firm-level institutions and performance of publicly quoted companies in Kenya offer support for the influence of skills and competencies, knowledge base, culture and resources categorized as resource based firm level institutions, and internal control structures and procedures classified as administrative based firm level institutions to influence the relationship between competitive strategy and performance.

CONCLUSION

The general objective of this study was to determine the influence of firm level institutions on the relationship between competitive strategy and performance of NTFPs firms in Kenya. Firm level institutions significantly influenced the relationship between competitive strategy and firm performance. The indicators for firm level institutions including resource based and administrative based firm level institutions had strong association with competitive strategy and firm performance.

The causal effect of competitive strategy on firm performance was moderated by firm level institutions. It was, thus concluded that firm level institutions moderates the relationship between competitive strategy and firm performance; firms require resources and administrative framework including working procedures, systems, internal controls, structures and good working culture in place to drive through the formulated strategy and enhance performance.

Although the relationship between competitive strategy and firm performance was true, it is nevertheless dependent on firm level institutions.

THEORETICAL IMPLICATIONS

The study was centered on the institutional theory. The theory provided a framework for the underpinning of the key variables and concepts adopted by this study. By applying the theory, this study makes contributions to the existing theories that guide entrepreneurship.

This study adds some insight that firms required resources, administrative systems and structures and good working culture instituted to drive through the strategy choices to achieve competitiveness and firm performance. Many arguments have been advanced on how to enhance competitiveness and firm performance but little mention has been focused on the institutions at the firm level. The study findings provide a basis to support that notion of importance of institutions at firm level in enhancing competitiveness and firm performance.

MANAGERIAL IMPLICATIONS

The firm level institutions are a key consideration in determining the competitiveness and performance of a firm. Improved performance is visible with firms that had manifested firm level institutions to implement competitive strategy. There is need, therefore for firms to enhance their capacities through appropriate staff recruitment policies and staff development to enhance manifestation of the right firm level institutions.

SUGGESTED AREAS FOR FURTHER RESEARCH

A cross-sectional design capturing perceptions of owners/managers of respondent SMEs at a point in time was applied by the study. Such an approach was cost-effective, time saving and helpful in predicting relationships among variables. However, such an approach was constraint in the provision of causal relationships among the constructs in the entrepreneurship to firm performance relationship. This study was also limited to the NTFPs firms. Thus, it was not possible to make inferences about the dynamics and the nature of the causal relationships in the entrepreneur-strategy-institutions-performance nexus. However, a longitudinal study captures well the dynamism state and causal effects and, thus calls for need to do such study from start-up to growth stage. The study was only limited to only few entrepreneur characteristics that explained about 17.6 percent of the variation in firm performance. Thus, there is need to increase scope of entrepreneur characteristics and assess their effect on performance.

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