

Business Strategy and Performance of Small and Medium Manufacturing Firms: Evidence from Saudi Arabia

Mohamed El Amine Mokadem^a, Oussama Saoula^b, Indraah Kolandaisamy^{c*}, ^{a,b,c}School of Business Management, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah, Malaysia, Email: indra@uum.edu.my

Business strategy plays a crucial role in determining the success of business enterprises such as small and medium-sized enterprises (SMEs). Despite the importance of business strategy to SMEs, the review of the literature indicates that there are limited studies that investigate the relationship between business strategy and performance of small and medium manufacturing firms (SMMFs) in Saudi Arabia. As a result, there is not only limited information but also lack of knowledge concerning business strategy and its relationship to the performance of SMMFs in the country. In an attempt to address this limitation, this study examines the relationship between six business strategies and the financial performance of SMMFs in Saudi Arabia. The data for the study was collected from 77 SMMFs located in Riyadh by using a structured questionnaire. The results indicate that the six types of the business strategy adopted by the SMMFs are significantly associated with their financial performance.

Key words: *business strategy, financial performance, manufacturing, small and medium-sized enterprise, Saudi Arabia.*

Introduction

The business environment in which small and medium enterprises (SMEs) operate their business activities is consistently volatile and becoming more global in nature as well as increasingly more complex, dynamic and mysterious. There are both opportunities and challenges faced by the SMEs sector, especially within manufacturing firms, due to the changes in the business environment. More importantly, manufacturing SMEs need to adopt an effective business strategy to exploit the opportunities and cope with the challenges (Hashim, 2011).

Numerous researcher has linked business strategies with organizational performance, distinguishing between approaches related to high and low performance (Chell, Haworth & Brearley, 1991; Covin & Slevin, 1986; Köseoglu, Topaloglu, Parnell, & Lester, 2013; Yuliansyah, Gurd & Mohamed, 2017). The literature reveals that some researchers have investigated the different strategy typologies and firm performance and identify which strategy typologies generated high performance for firms (Kotey & Meredith, 1997; Köseoglu et al., 2013; Seifzadeh & Rowe, 2019; Yuliansyah et al., 2017).

Despite the importance of business strategy to organizations such as SMEs, it is surprising that business strategy among these firms has only attracted little and somewhat fragmented research interests (Beal, 2000; Chowdhury & Lang, 1996; Ebben, 2007; Hashim, 2000, 2015; Hashim & Ahmad, 2016; Hashim & Zakaria, 2010; Kim & Choi, 1994). In the context of Saudi Arabia, SMEs play an essential role in the national economy and contribute significantly towards GDP as well as to the manufacturing sector. Despite their importance to the Saudi economy and the increased knowledge in the area of study, there is still a scarcity of studies in the field of strategy in general (AlKahtani & Adulwahab., 2008; Al Ghamdi, 2005; Alotaibi, 2016).

Therefore, research and information on SMEs in the manufacturing sector from the business strategy perspective suggest that more empirical studies are required in this field of study. Accordingly, this current study is an attempt to bridge that gap by contributing to a better understanding of the relationship between business strategies and organizational performance. Specifically, the study investigates the types of business strategies adopted by the manufacturing SMEs and determines whether the business strategies used by these firms are linked to their financial performance.

Literature Review

The concept of a business strategy contains many different definitions. Although there are numerous various definitions of business strategy, the literature revealed that it has been most frequently referred to as the way in which a firm in a particular industry chooses how to compete, seek and maintain its competitive advantage as well as achieve its overall objectives (Harrison & Harrison, 2003; Hunger & Wheelen, 2014; Koch, 2011; Leinwand & Mainardi, 2016; Lynch, 1997; Mintzberg & Quinn, 1991; Reeves, Haanaes & Sinha, 2015; Rue & Holland, 1989; Rumelt, 2013; Spender, 2014).

According to Porter (1980), firms obtain their competitive advantage and provide value to customers by efficiently and effectively executing their core internal activities including: service, production, sales, human resource management, marketing, technology development, as well as procurement. Based on the competitive advantage and value obtained from these core internal activities, three generic business strategies that firms can develop are as follow;

low cost, differentiation and focus or niche strategy. The low-cost approach focuses on increasing sales and profits through the scope, technology and economics of scale, while the differentiation strategy emphasizes differentiating the products and services of the firm by developing various methods to make them appear unique and different. The focus or niche strategy concentrates on marketing efforts and product development in a particular market segment that has differentiation or cost as an advantage.

Concerning the notion of business strategy in manufacturing SMEs, an earlier study by Galbraith and Schendel (1983) emphasized the need for companies operating in various industrial settings to employ a different type of business strategy. The study identified ten different types of business strategies. Of the ten strategies, six strategies were utilized by companies engaged in consumer markets. Those strategies were build, harvest, focus, cash out, climber and continuity. The remaining four business strategies employed by these companies, all involved in the industrial market, were growth, low commitment, maintenance and niche. The study results revealed that the growth and build strategy were suitable for the consumer market and industrial markets, respectively. However, it was found that the focus or niche strategy was appropriate for both types of markets.

Another study by Giglierano (1987) endeavored to investigate the effectiveness of business strategies emphasized by small firms. According to the outcomes of the study, the effectiveness of business strategies relied on the type of business as well as the products that the small firms produced. Hence, the study also found that small firms that were able to adopt various kinds of business strategies, associated with their business and the products they produced, were able to perform much better than those small firms which were unable to do so.

In the same period, the study by Chaganti (1987) investigated the link among business strategies and overall performance of 192 small-sized firms that operated in different manufacturing industries as well as at three various stages of growth. Findings of the study indicated a significant link between marketing strategy, competitive pricing strategy, low manufacturing costs strategy as well as a geographic concentration of market strategy and profitability of the small manufacturing firms.

In the context of the United States of America (USA), a study carried out by Dollinger, and Golden (1992) examined small manufacturing firms and found four specific joint strategies (confederate, agglomerate, conjugate and organic) that were predominant among small manufacturing firms in the USA. The study findings revealed that organic and agglomerate collective strategies seemed to be the most mutual strategies adopted by the small manufacturing firms in the USA.

The subsequent study by Mosakowski (1993) surveyed a total of 86 entrepreneurial firms. The results of the study indicated that these firms employed at least two of the three generic

strategies introduced by Porter (1980). Additionally, the outputs of the research revealed that the entrepreneurial firms that emphasized both differentiation and focus strategies were able to perform much better than those firms that do not employ these two generic strategies.

Another study was conducted on small Korean firms by Kim and Choi (1994) specifically investigating the strategic behavior of these small-sized firms. The findings of the study were that the three most successful strategy types emphasized by the small Korean firms include innovative, efficient and versatile strategies. Nevertheless, both researchers suggest that when choosing the kind of strategic focus, directors in small-sized firms should be aware of the industrial situation, as well as take into consideration the capabilities of their organizations.

The study by Schroeder, Congden, and Gopinath (1995) focused on examining the relationship between manufacturing technology process and competitive strategy by adopting the three generic business strategies introduced by Porter (1980) that include; low-cost strategy, differentiation strategy and focus strategy. The results of the study suggest that the manufacturing technology process and the three competitive strategies are linked to each other.

Hashim (2000) examined the business strategy adopted by SMEs in different industries in Malaysia. The study identified six business strategies, and the data were collected from 100 SMEs that represented more than 19 industries. Results of the survey indicated 30 firms used the product differentiation strategy, while 26 firms utilized low-cost strategy, another 18 firms employed the niche strategy, the other 17 adopted growth strategy, only six firms followed the harvest strategy and the remaining three firms implemented the vertical integration strategy.

In another study, Beal (2000) surveyed the business strategy implemented by 101 small manufacturing firms. The findings of the study showed that these small-sized firms employed five types of business strategies. They also indicate that these firms used marketing differentiation strategy, innovation differentiation strategy, cost leadership strategy, quality differentiation strategy and service differentiation strategy. Studies by Hashim and Ahmad (2009), Hashim and Zakaria (2010) and Hashim (2015) offered further empirical evidence that suggests not only that various firms operating in diverse business environment adopted different types of business strategy but also shows business strategy is linked to organizational performance. Six different types of the business strategy (Hashim & Ahmad, 2009) were identified as being used by the exporting SMEs: niche, product differentiation, marketing differentiation, service differentiation innovation and low-cost strategies.

Furthermore, the study by Hashim and Zakaria (2010) also discovered that small and medium manufacturing firms (SMMFs) employed six types of business strategies. Among the six strategies highlighted in the study contain innovative, turnaround, niche, low cost, growth and

differentiation. Results of the study further suggested that the performance of the SMMFs varied according to the type of business strategies they practised.

A recent study by Hashim and Ahmed (2016) indicated that SMEs in Malaysia embraced seven different types of business strategies (low cost, differentiation, harvest, niche, growth, vertical integration and concentration). The empirical evidence provided in this study posits that SMEs operating in different industries in the manufacturing sectors need to adopt different types of business strategies. Interestingly, the findings of this study indicated that Porter's (1980) three generic strategies are not only relevant and applicable to large firms but also they are useful to the SMEs in the Malaysian manufacturing sector.

A more recent study by Yuliansyah et al. (2017) showed that performance measurement systems should be designed in conjunction with business strategies to attain higher performance. More precisely, applying a differentiation strategy rather than low-cost strategy is found to be most effective in obtaining competitive advantage and superior performance in the Indonesian financial institutions. Similarly, the study of Seifzadeh and Rowe (2019) pointed out that business units pursuing product differentiation strategy in Iranian corporation achieve higher financial performance than those following operational excellence strategies.

Hypothesis

In an attempt to bridge the research and information gaps in the area of business strategy and performance of Saudi SMEs, this study strives to advance the knowledge in this area of study by empirically investigating the linkage between business strategy and performance. Based on the suggested relationships of these variables as presented in the literature and past studies, it was hypothesized that business strategy is positively associated with the performance of SMEs in Saudi Arabia.

Methodology

Sampling and procedures

The target population of this study involved manufacturing SMEs located in the industrial city of Riyadh, the capital of Saudi Arabia. The firms selected in the study were registered with the Riyadh Chamber of Commerce and Industry. A list of 793 small and medium manufacturing firms obtained from the Chamber of Commerce for Riyadh city was used as the sampling frame of this study. From the listing, the study investigated 355 small and medium manufacturing firms (SMMFs). The SMMFs in this study were carefully determined. Moreover, the sample of SMMFs represents diversified manufacturing firms, and all of them met the SMEs size criteria; firms with not more than 249 employees and their revenues less than 200 million SR.

Owners and managers of SMMFs were selected to be the respondents in this study as they are more proficient and knowledgeable about the financial information of their companies than no management workers. Further, they work closely with concerned sales departments in the organization. The researcher distributed a well-constructed and pre-tested Arabic version questionnaire to the sample of SMMFs during the work period. The investigator kept close contact with respondents to ensure a high response rate. All this effort yielded in receiving 102 questionnaires. However, of the 102 surveys, only 77 were completed and useful, and this resulted in a response rate of 21.69%.

Questionnaire

The first section of the survey contained 12 items that were adapted to obtain general information concerning the characteristics of the respondents. Following this, 20 items in the second section of the questionnaire concentrated on gathering information about the background of the manufacturing SMEs.

The 42 items in the third section, adapted from previous research were used to describe and measure the six business strategies adopted by the manufacturing firms. The six strategies were: low-cost strategy, differentiation strategy, growth strategy, harvest strategy, focus strategy as well as concentration strategy. The respondents were asked to rate the business strategy by utilizing a five-point numerical scale ranging from (1) totally disagree to (5) totally agree. Finally, the fifth section assesses the organizational performance of the manufacturing SMEs. Three performance indicators were utilized in order to measure the average performance of the manufacturing SMEs. The three items include sales, gross profit and net profit. The data on the performance of the firms was collected over four years (2013, 2014, 2015 and 2016).

Results

Characteristics of the Respondents

Of the 77 respondents, 65 (72.7%) respondents were only managers of their firms, another 21 (15.6%) were owners as well as CEO and the remaining nine (11.7%) respondents were owners and managers of their firms. The age of the respondents ranged from 25 years old to more than 44 years old. As for marital status, seventy (90.9%) of the 77 respondents were married and the remaining seven (9.1%) respondents were never married. As for their education level, 66 (85.7%) respondents have a university level, while the remaining 11 (14.3%) respondents have secondary school level. In terms of certificate received, three (9.3%) had a school certificate, 13 (25.3%) respondents had a diploma, 44 (6.2%) obtained bachelor's degree, 16 (20.8%) earned a master's degree and only one (1.3%) respondent had earned a PhD degree. In terms of their work experience in the industry, the information gathered from the study indicated that

33 respondents had more than 14 years of work experience, twenty-six respondents were between 5 and 13 years and the remaining 18 respondents had less than four years of experience in the field of industry.

Profile of the Sample Firms

The following Table 1 presents the background of the 77 manufacturing firms that participated in the study. 45 (58.4%) of the 77 firms were private limited companies, the other 17 (22.1%) firms were a sole proprietorship, and the remaining 15 (19.5%) firms were a partnership. In terms of their breadth of operations, 44 (57.1%) companies operated internationally, another 23 (29.9%) operated nationally, the eight (10.4%) firms served locally and the remaining two (2.6%) firms worked regionally.

The following firm items were recoded based on their means and standard deviations. In terms of employment, 33 (42.9%) firms employed between 46 to 122 workers, 31 (40.3%) firms employed between 122 to 249 workers, and the remaining 13 (16.9%) firms employed between 13 and 45 workers. As for the starting year of the firms, the results indicate that, out of the 77 manufacturing firms, nine (11.7%) firms started their operations before 1979, 29 (37.7%) firms began between 1980 and 1991 and the remaining 39 (50.6%) firms began their service after 1992.

Table 1: Profile of the sample firms

Profile of the Firms (n=77)	Frequency	Percentage (%)
Legal Form		
Private limited companies	45	58.4
Sole proprietorship	17	22.1
Partnerships	15	19.5
Number of Employees		
13 - 45 Employees	13	16.9
46 - 122 Employees	33	42.9
123 - 249 Employees	31	40.3
Firms' Start Year		
Before 1979	9	11.7
1980 - 1991	29	37.7
1992 - 2013	39	50.6

Company Breadth of Operation		
International	44	57.1
National	23	29.9
Local	8	10.4
Regional	2	2.6

Business Strategies Emphasized by the Firm

The following Table 2 presents descriptive statistics concerning the first question related to the types of business strategies emphasized by Saudi manufacturing SMEs. In terms of business strategy ranking, Table 2 also shows the results on the level of emphasis on the business strategies put by the manufacturing SMEs from most to the least.

Table 2: Business Strategies as Emphasized by Saudi Manufacturing SMEs

Business Strategy	Mean	Rank
Growth strategy	4.19	1
Low-cost strategy	3.60	2
Harvest strategy	3.07	3
Concentration strategy	2.96	4
Focus strategy	2.92	5
Differentiation strategy	2.89	6

Business Strategy and Performance of SMEs

Table 3 summarizes the results of the correlations between the six business strategies and the average performance measures of the 77 manufacturing SMEs that participated in the study. The results in Table 3 showed a significant positive relationship between low-cost strategy and the financial performance of the manufacturing SMEs as measured in terms of average sales, average gross profit and average net profit.

In the case of differentiation, growth, harvest and focus strategy as presented in Table 3, the results show that these strategies are positively associated with three of average performance measures that include average sales, gross profit and net profit.

Table 3: Results of the Correlations between Business Strategy and Average Performance Measures

Business Strategy	Sales	Gross Profit	Net Profit
Low cost strategy	0.344**	0.448**	0.464**
Differentiation Strategy	0.316**	0.472**	0.485**
Growth strategy	0.252*	0.380**	0.388**
Harvest strategy	0.274*	0.396**	0.401**
Focus strategy	0.227*	0.406**	0.438**
Concentration strategy	0.293**	0.393**	0.390**

** Correlation is significant at the 0.01 level (2-tailed)

* Correlation is significant at the 0.05 level (2-tailed)

Finally, as indicated in Table 3, the results showed that concentration strategy is positively associated with financial performance as measured in terms of average sales, gross profit and net profit.

Discussion

Firms with no business strategy are going to struggle in terms of competition. Thus, this undoubtedly leads to the significance of business strategy for Saudi manufacturing SMEs to compete effectively and proficiently in domestic as well as in international markets. The study adds support to the previous reviews about the importance of business strategy to business organizations such as manufacturing SMEs (Beal, 2000; Chaganti, 1987; Hashim & Ahmad, 2016; Hashim & Zakaria, 2010; Seifzadeh & Rowe, 2019; Seifzadeh & Rowe, 2019; Yuliansyah et al., 2017).

Several outcomes can be summarized based on the findings of the study. Firstly, in terms of the six types of business strategy, the results of the study revealed that the firms that participated in the survey had adopted the six types of business strategies to a certain extent. This result suggests that the SMMFs in KSA chose these strategies for their specific focus and scope, as indicated in past studies.

Interestingly, the findings of this study indicate that of the six types of business strategy investigated, the growth strategy appeared to be the most emphasized business strategy among the SMMFs in Saudi Arabia. The results showed that the low-cost approach is the second most emphasized strategy by the SMMFs. They are then followed by the harvest strategy, the concentration strategy, the focus strategy and the differentiation strategy. Second, the empirical information resulting from this study suggests that business strategy is positively associated to the financial performance of the manufacturing SMEs (Beal, 2000; Chaganti, 1987; Hashim, 2000, 2015; Hashim & Ahmad, 2016; Hashim & Zakaria, 2010; Mosakowski, 1993; Seifzadeh & Rowe, 2019; Yuliansyah et al., 2017).

Conclusion and Suggestions for Future Research

Despite the importance of competitive strategies to manufacturing SMEs, empirical research in the area of study is very limited in Saudi Arabia. This study is considered one of the first studies to examine the relationship between business strategy and organizational performance of SMMFs in Saudi Arabia. Theoretical arguments made in this study support the notion that business strategy has a connection with organizational performance. However, since these outcomes are based on one review, they should be regarded as only suggestive. Therefore, more empirical studies are needed to provide more evidence to support further the view that business strategy and organizational performance are firmly connected, particularly among the SMMFs in Saudi Arabia.

It is also important to replicate this study by utilizing more measures of financial as well as non-financial performance and other business strategies under different cultural settings. Furthermore, other studies on SMEs in the other different business sectors such as commercial and construction are required to develop a more comprehensive theory and understanding of the business strategy adopted by the SMEs in these sectors in particular as SMEs in these sectors consist 74% of the total SMEs in Saudi Arabia.

Finally, in order to improve the organizational performance and competitiveness of Saudi manufacturing SMEs, the study suggests that these firms should adopt different types of business strategies. Hence, the Saudi General Authority for small and medium enterprises in Saudi Arabia also can contribute to the development of SMMFs by providing business education programs to improve deficiency in the area of business strategy and other concerned sectors. Owners and managers of SMMFs ought to prepare themselves for global competition by acquiring the managerial skills to facilitate adoption of the right business strategy fit for their firm. They must also be aware of the contribution of business strategy to firm performance.

REFERENCES

- Al-Kahtani, & Adulwahab. (2008). The effect of sophisticated strategic plans on the performance of small and medium-sized manufacturing enterprises (SMMEs) in Saudi Arabia. *International Journal of Strategic Management Publisher: International Academy of Business and Economics*.
- Al Ghamdi, S. M. (2005). The use of strategic planning tools and techniques in Saudi Arabia: An empirical study. *International Journal of Management*, 22(3), 376.
- Alotaibi, H. J. (2016). Attitudes of Saudi SME Executives towards the Selection and use of Strategic Planning Tools and Techniques. *Asian Journal of Business and Management*, 04(03). Authority, S. a. M. G. Definition of Small and medium-sized enterprises kingdom of Saudi Arabia.
- Beal, R. M. (2000). Competing effectively: environmental scanning, competitive strategy, and organizational performance in small manufacturing firms. *Journal of small business management*, 38(1), 27.
- Chaganti, R. (1987). Small business strategies in different industry growth environments. *Journal of small business management*, 25(3), 61.
- Chell, E., Haworth, J. M., & Brearley, S. (1991). The entrepreneurial personality: Concepts, cases and categories.
- Chowdhury, S. D., & Lang, J. R. (1996). Turnaround in small firms: An assessment of efficiency strategies. *Journal of Business Research*, 36(2), 169-178.
- Covin, J. G., & Slevin, D. P. (1986). The development and testing of an organizational-level entrepreneurship scale. *Frontiers of entrepreneurship research*, 1(1986), 626-639.
- Ebben, J. J. (2007). Product Offering, Operational Strategy, and Performance of Small Firms. *Journal of Small Business & Entrepreneurship*, 20(3), 245-255.
- Galbraith, C., & Schendel, D. (1983). An empirical analysis of strategy types. *Strategic management journal*, 4(2), 153-173.
- Harrison, J. S., & Harrison, J. S. (2003). *Strategic management of resources and relationships: concepts and cases*: Wiley.
- Hashim. (2000). Business strategy and performance in Malaysian SMEs: A recent survey. *Malaysian Management Review*, 35(2), 1-10.



- Hashim. (2011). *managing small and medium-sized enterprises: The Malaysian perspective*: UUM Press.
- Hashim. (2015). *Business strategy in Malaysian Companies*. Alor Star: Asas Nadi Sendirian Berhad.
- Hashim, & Ahmad. (2009). Business Strategy and Performance of Malaysian Exporting SMEs. *Journal of Management & Muamalah*, 1-11.
- Hashim, & Ahmad. (2016). Business Strategy and Performance of SMEs in the Manufacturing Sector. *International Journal in Management and Social Science*, 04(05).
- Hashim, & Zakaria, M. (2010). Business strategy and performance of small and medium manufacturing firms in Malaysia. *World Review of Entrepreneurship, Management and Sustainable Development*, 6(1-2), 125-134.
- Hunger, J. D., & Wheelen, T. L. (2014). *Essentials of strategic management*: Pearson.
- Kim, Y., & Choi, Y. (1994). Strategic types and performances of small firms in Korea. *International Small Business Journal*, 13(1), 13-25.
- Koch, R. (2011). *The Financial Times Guide to Strategy: How to Create, Pursue and Deliver a Winning Strategy*: Pearson Education India.
- Kotey, B., & Meredith, G. (1997). Relationships among owner/manager personal values, business strategies, and enterprise performance. *Journal of small business management*, 35(2), 37.
- Leinwand, P., & Mainardi, C. (2016). *Strategy That Works: How Winning Companies Close the Strategy-to-Execution Gap*: Harvard Business Review Press.
- Lynch, R. (1997). *Corporate strategy*, London: Pitman Publishing.
- MENA Reports. (2003). *Saudi Arabia's IT Employment Sector Grows at Four Percent Per Annum*, MENA Business Reports.
- Mintzberg, H., & Quinn, J. B. (1991). *The strategy process* (2nd Ed). New Jersey: Prentice-Hall International.
- Mosakowski, E. (1993). A resource-based perspective on the dynamic strategy-performance relationship: An empirical examination of the focus and differentiation strategies in entrepreneurial firms. *Journal of management*, 19(4), 819-839.



- Porter, M. E. (1980). *Competitive strategy: techniques for analyzing industries and competitors*: New York: Free Press.
- Reeves, M., Haanaes, K., & Sinha, J. (2015). *Your strategy needs a strategy: How to choose and execute the right approach*: Harvard Business Press.
- Rumelt, R. P. (2013). *Good strategy/bad strategy. London Profile Books*.
- Spender, J.-C. (2014). *Business strategy: Managing uncertainty, opportunity, and enterprise*: OUP Oxford.
- Köseoglu, M. A., Topaloglu, C., Parnell, J. A., & Lester, D. L. (2013). Linkages among business strategy, uncertainty and performance in the hospitality industry: Evidence from an emerging economy. *International Journal of Hospitality Management*, 34, 81-91.
- Seifzadeh, P., & Rowe, W. G. (2019). The role of corporate controls and business-level strategy in business unit performance. *Journal of Strategy and Management*.
- Yuliansyah, Y., Gurd, B., & Mohamed, N. (2017). The significant of business strategy in improving organizational performance. *Humanomics*, 33(1), 56-74.