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## The Effect of Market Orientation as Mediator to Strategic Planning Practices and Performance Relationship: Evidence from Malaysian SMEs

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### Abstract

The aim of this research is to examine direct relationship between strategic planning practices and market orientation and the mediating effect of market orientation (MO) on the relationship between strategic planning practices (SPP) and SMEs' performance in Malaysia. It proposed a quantitative analysis in which market orientation and strategic planning practices are key success factors of SMEs. Data were collected by means of a mail survey questionnaire completed by owner/managers randomly selected from a sampling frame of registered SMEs. The integrated questionnaire was used to measure the strategic planning practices of firms using thirty four items developed from several authors and market orientation was measured using a nine item scale adapted from Narver & Slater (1990). Firms' performance measurement was based on subjective evaluation involving self-reported measures. The findings reveal that significant relationships exist between strategic planning practices and performance, and also between market orientation and performance. While market orientation was found to partially mediate the strategic planning practices and performance relationships. These findings may be of help to the owner/managers of SMEs to be more market oriented and practicing strategic planning in order for them to survive the intensely in competitive market environment.

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**Keywords:** SMEs; strategic planning practices; market orientation; performance.

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## 1. Introduction

Small and medium enterprises (SMEs) play an increasingly important role in the economic growth of most nations. SMEs have become important as a source of employment and maximize the efficiency of the resource allocation and distribution by mobilizing and utilizing local human and material resources (Cunningham & Rowley, 2007).

The contribution and roles of SMEs has become an important engine to the economy (Van Gils, 2005). SMEs have been characterized as dynamic, innovative, efficient and their small size allows for flexibility, immediate feedback, short decision-making chain, better understanding and quicker response to customer needs (Singh, Garg & Deshmukh, 2008). The contribution and roles of SMEs has become an important engine to the economy (Van Gils, 2005). SMEs have been characterized as dynamic, innovative, efficient and their small size allows for flexibility, immediate feedback, short decision-making chain, better understanding and quicker response to customer needs (Singh, Garg & Deshmukh, 2008). Nevertheless, they are on tremendous pressure to sustain in domestic as well as global markets owing to global competition, technological advances and changing needs of customers. SMEs in Malaysia too, face enormous pressures as the nation integrates more into the world economy. As a result, a vast majority of new businesses failed and only few managed to survive. Its' performance to stay competitive in long term is becoming crucial as nation's future. They need to develop a managerial cultural style in adopting the strategic activities to influence the firms' performance. They need to be market oriented by focusing into three behavioural components namely customer orientation, competitor orientation and interfunctional coordination (Narver & Slater, 1990). This is an important process that provides a strategic platform for decision-making through analysis and understanding of various characteristics of industry, market and competitors (Khairuddin, 2008).

## 2. Market Orientation and Performance Links

Market orientation (MO) is the firm's culture that most effectively and efficiently creates the necessary behaviours for the creation of superior value for customers, and this creates continuous superior performance for the business (Narver & Slater, 1990). MO comprises of three elements; customer orientation, competitor orientation, and inter-functional coordination. In other words, market orientation strategy is related to the SMEs' performance as it puts customers as a focal point in strategy (Levitt, 1986). Empirical evidence on the relationship between market orientation and firm performance appears to be mixed. Some researchers found positive association between market orientation and performance (Narver & Slater, 1990; Jaworski & Kohli, 1990; Slater & Narver, 1995; Green, Rudolf & Stark, 2008), while others could not find any direct relationship between MO and firm performance (Greenly, 1995; Harris, 2001; Diamantopoulos & Hart, 1993; Han et al., 1998). However positive relationship was reported by several authors on different industrial and country contexts such as those by Bhuin (1998), Deng and Dart (1994), Horng & Chen (1998), Appiah-Adu & Ranchhod (1998), Kumar, Subramaniam and Yauger (1998), Chang and Chen (1998), and Raju and Lonial (2002). This inconclusiveness shows a need for research to identify factors that attenuate the strength between MO and performance. Thus, the hypothesis from this study seeks is: H1: There is significant relationship between market orientation and SME performance.

### 2.1. *Strategic planning practices and performance Links*

SMEs need dynamic capabilities that enable them to sense and seize new opportunities and renew the existing market base by developing a systematic means by enhancing their internal and external capabilities (Lai-Yu, 2001). Thus for those firms which are undergone a growth expansion, they demand a strategic planning to sustain their extended operations and a pressure from competitors as well as the changes in the

market environment. Therefore, the concept of strategic planning practices is taken as systematic organizational activities that explore the competitive environment across organization (Anderson, 2004). The function of scanning intensity is to search information that provides opportunities or treats while locus of planning refers to the level of employee involvement in decision making and planning flexibility refers to degree of flexibility of firm to respond, adapt quickly to any changes in external environment of the firm. By doing these, SMEs will protect their existing firms' competitive advantages and will continue create wealth (Rouse & Daellenbach, 1999).

Thus, the next hypothesis that this study seeks is: H2: There is significant relationship between strategic planning practices and SME performance.

### **3. Sampling and Data Collection Procedures**

Data were collected by means of a mail survey questionnaire completed by owner/managers of SMEs systematically and randomly selected from a sampling frame of registered SMEs in Malaysia. The sampling frame represents a listing of all SMEs and is highly representative of the industry as a whole. Although there are limitations in the use of questionnaire based research, the benefits arising from cost savings, convenience, anonymity, and reduced interview bias seem to outweigh the limitations. There is also the risk of common-method bias using self-report data, and as such the results of this study should be viewed as presenting the owner/managers' perceptions which could provide the most precise assessment of the conditions with a firm (Lyon, Lumpkin & Dess, 2000). A total of 2000 owner/managers from the sampling frame were sent with the questionnaires and 356 usable responses were returned giving a response rate of 17.8 percent. Given the nature of SMEs and the low response usually associated with mail surveys, this response rate was considered reasonably adequate. There is also an issue of non response bias which is pertinent to a survey method of data collection. Non response bias exists when there are significant differences between the answers of those who have responded and those who do not respond. This study followed the convention of comparing the respondents of the first wave with those of the second wave (Armstrong & Overton, 1977). The early wave group consisted of 213 responses whereas the final wave group consisted of 143 responses. The t-tests performed on the responses of these two groups yielded no statistically significant differences on demographic characteristics. Thus, it can be concluded that there is no significant non-response bias in this study.

#### *3.1. Measures*

The integrated questionnaire was used to measure the strategic planning practices of firms using thirty four (34) items developed from several authors such as Miller & Friesen (1982); Hambrick (1982); Boyd & Reuning Elliot, (1988) and Barringer & Bluedorn, (1999) by using five (5) Likert scale to indicate on their agreement on each of statement asked within three sub-dimensional of scanning intensity, locus of planning and planning flexibility. All attributes are aggregated together as one variable. Market orientation was measured using questionnaires adapted from Narver and Slater (1990). A total of 9 question items were utilized to measure sub-dimensions; customer orientation, competitor orientation and inter-functional coordination as a single construct. These items were measured on a five-point scale where 1 indicated 'strongly disagree' and 5 indicated 'strongly agree'. This market orientation measures has previously demonstrated acceptable validity and reliability. Although there has been no agreement among researchers on an appropriate measure of performance, previous studies, however, have suggested that performance measures include growth and financial performance can be considered (Wiklund, 1999). It has also been generally recognized that objective measures of performance are more appropriate than subjective evaluation of performance. However, collecting objective data is very difficult largely because SMEs' owner/managers are generally unwilling to release firm's information to outsiders. In addition, they may provide biased evaluation of their firm's performance

(Sapienza, Smith & Gannon, 1988). Therefore, subjective approach was adopted in this study where the performance of the firm is measured by the perception of the owner/managers providing responses to the survey. They were asked to state their firms' performance on criteria likely profitability and market share, product development for the past three years using 5-point Likert scale items.

#### 4. Reliability and Validity

The instruments in this study were developed from prior research and previously tested for reliability. Some of the questions used were slightly modified to make them more relevant to the purpose of the study. Thus, a reliability test was conducted to determine the internal consistency of the measures used. Table 1 below shows all the variables have Cronbach Alpha values of more than 0.7 which is higher than that recommended by Hair et al., (2006).

Table 1. Reliability scores for variables

Variable	No. of items	Alpha value
Strategic Planning Practices	34	.920
Market orientation	9	.744
Performance	5	.823

The variables in this study were validated through factor analysis. Before performing the analysis, the suitability of the data was assessed through two tests; Kaiser-Meyer-Olkin measure of sampling adequacy (KMO) and Bartlett's Test of Sphericity. The KMO has to be more than 0.50 and Bartlett's Test of Sphericity has to be significant. For factor analyses, principle component analysis and Varimax rotation were performed. It was suggested that items that had factor loadings lower than 0.30 should be eliminated (Hair et al., 2006). The varimax rotated principle component factor analysis applied has resulted in single factor loading in each of the two variables; strategic planning practices and market orientation that explained 60.82 percent and 66.22 percent of the variance, respectively (See Table 2). Only factors with a loading value of 0.30 and above were considered, and therefore no items were deleted.

##### 4.1. Sample Characteristics

The profile of the respondents is illustrated in Table 3 below. Majority of the owner/managers were male (81.2 percent) compared to only 18.8 percent of them females. Most of them had achieved a SPM (O level equivalent) and below in terms of academic qualification and only 4.5 percent had obtained university degrees. More than 50 percent of the firms have been operating 10 years and below, and only 23 percent have been in existence for more than 15 years. 62 percent of the firms under study were in the manufacturing sector, and 54 percent of these firms employed at least 20 workers.

Table 2. Factor analysis of SPP and MO

Item	Factor loading
<i>Strategic Planning Practices</i>	
Shifts in economic conditions	0.731
Forecasting sales, customer preferences, technology, etc	0.704
Modifications in supplier strategies	0.675
The emergence of new technology	0.662
New product development	0.636

The market entry of new competition	0.625
Special marketing research studies	0.615
The emergence of an unexpected opportunity	0.609
About development of important capabilities	0.601
Explicit tracking of the politic and tactics of competitors	0.600
Changes in government regulations	0.595
Long term plans	0.589
Evaluation of strategic objectives	0.581
Shift in customer needs and preferences	0.575
Political developments that affect the your industry	0.565
Short-term action plan	0.562
About major product / service introduction	0.555
Economic factors [(interest rate, GDP	0.544
Routine gathering of opinions/survey	0.544
Annual goals	0.543
Development of mission statement	0.526
Can start major market activities freely	0.526
Gathering of information from suppliers and other channel members.	0.521
Technological factors [new products, processes, materials]	0.518
About changes in new policies and practices	0.518
Competitor strategies [pricing, distribution.]	0.518
About moves into new customer segments	0.509
Political factors [new laws, regulations and policies]	0.483
Demographic [(life styles, social value]	0.477
About changes the firm's market position	0.458
Can introduce new practices easily and fast.	0.445
Can market to new customer segments easily	0.406
The emergence of an unexpected threat	0.401
Can introduce new practices often and openly	0.450
Need no higher approval to develop new internal capabilities	0.381
<i>Percentage of variance explained: 60.82</i>	
<i>KMO = 0.895, Bartlett's Test of Sphericity Sig p&lt; 0.001</i>	
<i>Market Orientation</i>	
My marketing department is very dedicated	.954
My customer satisfaction is important	.651
In general, my firm put hardest effort to know about market environment	.626
In general, my firm will put best effort to fulfill customer's specific order	.443
Advertisement expenditure is useful for the growth of my firm	.429
My price in comparison to my competitors is very competitive	.414
My product offerings are well accepted compared to those of competitors	.364
In general, my firm encourages employees' creativity and ideas within marketing	.489
Quality of my communication with my customers is the highest priority	
<i>Percentage of variance explained: 66.22</i>	
<i>KMO = 0.725, Bartlett's Test of Sphericity Sig p&lt; 0.001</i>	

Table 3. Profile of respondents

Characteristics	Frequency	Percentage
<i>Gender</i>		
Male	289	81.2
Female	67	18.8
<i>Education</i>		

SPM and below	302	84.8
Diploma	38	10.7
Degree	16	4.5
<i>Type of Business</i>		
Manufacturing	221	62.0
Service	102	28.7
Agriculture	33	9.3
<i>Number of employees</i>		
5 and below	64	18.0
Between 6 and 19	99	28.0
20 and above	193	54.0
<i>Years in operation</i>		
Below 5	84	23.6
Between 6 to 10	107	30.1
Between 11 to 15	83	23.2
Above 15	82	23.1

4.2. Testing of Hypotheses

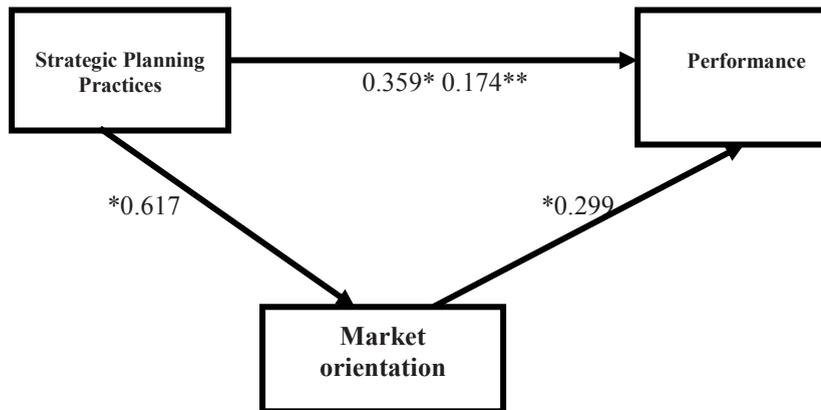
Regression analysis was used to test the relationship between MO and performance (H1) and the relationship between SPP and performance (H2). The regression analysis result in Table 4 indicates that SPP is positively and significantly related to performance. This finding supports H1. The result also indicates that MO is positively and significantly related to performance, and this supports H2.

Table 4. Regression of SPP and MO

	Beta	t-value	Sig
SPP	.359	7.235	.000*
MO	.407	8.379	.000*

Sig  $p < 0.001$

The mediating effect of MO on the relationship between SPP and performance was tested based on a regression procedure specified by Baron and Kenny (1986). According to this procedure, it must be demonstrated that SPP (which is a predictor variable) is related independently to both MO (which is a mediator variable) and performance (which is the outcome variable). To prove the mediating effect, it must be demonstrated that the regression coefficient associated with the SPP-performance relationship shrinks or goes to zero when MO as a mediator is added to the equation. If the effect goes to zero when the mediator is added than full mediation has taken place, however, if the effect only shrinks in the presence of the mediator, then partial mediating has occurred. Figure 1 indicates that the conditions for mediation suggested by Baron and Kenny (1986) are met. First there is an effect to be mediated ( $\beta = 0.359, p < 0.01$ ). Second there is significant relationship between SPP and the mediator ( $\beta = 0.617, p < 0.01$ ), and third, the coefficient of MO as mediator is significant with both SPP and MO as predictors ( $\beta = 0.299, p < 0.01$ ). Finally, the absolute effect of SPP on performance becomes less when MO as mediator was added in the regression (standardized Beta from 0.359 to 0.174). Thus, partial mediation was registered because the effect of SPP on performance was reduced to a significant level by the change of beta value  $0.185 = (0.359 - 0.174)$  or  $(0.617 \times 0.299)$  thus MO is mediating SPP to firms' performance is partially supported.



\* Individual coefficient values

\*\*Joint Coefficient changes of SPP to performance been mediated by MO reduce by from 0.359 to 0.174 by 0.185 (0.617x 0.299).

Figure1. Mediating effect of MO on SPP and performance relationship

## 5. Operational Implications

This study makes contribution to the literature by investigating and testing the relationship between SPP and SMEs' performance between MO and the mediating effect of MO to the SMEs' performance in Malaysia.

To the best of our knowledge, these efforts have not been empirically investigated even though there were numerous studies on the relationships between SPP and performance, and between MO and performance. This is true because the Strategic Planning Practices that resides in an organization can put that organization in a better competitive position.

## 6. Discussion and Conclusion

The findings of this study suggest that strategic planning practices of SMEs which aim to sustaining competitive advantage have to enhance MO to improve business performance. This proves that market oriented culture should enhance entrepreneurial behaviour within the SMEs' firm. In a competitive environment the market information obtained from customers and the competitors helps the firm to keep an eye on the market changes. Thus, MO can strengthen SMEs' performance through SPP. These findings may be of help to owner/managers of SMEs to intensify initiatives to encourage better understanding on the significance of SPP and MO which boosts firm's competitive position and superior performance. This may helps them to be more entrepreneurial and market oriented in order for the SMEs to survive the intensively competitive market environment.

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