SMEs BUSINESS GROWTH MODEL AND THE MEDIATING ROLE OF MARKET ORIENTATION

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Abstract

SMEs business growth is a central point for their success. Literature suggests different factors which inculcate smaller enterprises to grow but a tripod of three factors: reward system, decentralization of organization and owners’ attitude with a mediating effect of market orientation have not been addressed. This study addresses the internal factors that contribute to the growth of SMEs with a mediating effect of market orientation. Data is collected using survey method from Pakistani SMEs. The study argues that a significant potential lies in smaller enterprises to grow by adopting stated factors if firms are market oriented.

Keywords: Small and medium enterprises, reward systems, decentralization and owner’s attitude.

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Introduction

Enterprises are formed to grow. The survival of small businesses, during their initial stages of life cycle particularly lies in the retention of customers. Small and Medium Enterprises (SMEs) know that the discrepancies to meet consumer demand, between the desired and the delivered states if not properly been addressed will eventually result in dis-satisfied customers and eventually in financial loss. To cover this issue one of the important factor is the owner’s decision. During the start-up phase, SMEs do face not only the problem of cash management and customer hunt but also a massive competition from the Large Enterprises (Les) which could only be properly handled if owner is proactive and risk taker. In challenging environment where threats and opportunities go side by side, owners are concerned about the issues to analyze the factors which let them survive, grow and retain the customers, in the presence and direct competition with LEs. Therefore the option left for owners of SMEs is to either grow or to close the business.

SMEs in developing countries are facing an immense competition from the multinationals. Multinationals do have very strong organizational systems and one of their formal systems is the reward to their employees which is totally missing or partially available in few of the SMEs. Consistent employees (that is only possible by a good reward system) are very helpful in capturing most of the market share in developing economies due to availability of abundant financial, informational and technological resources (Bhatta et al., 2008). SMEs are considered to have informal reward structure for their employees, resultantly SMEs do lack in their core competencies and capabilities which are essential for survival. SMEs have some common characteristics like diseconomies of scale, customization, less capital requirement and high flexibility, creativity and networking converse to the large firms but decentralization is a common performance parameter which has been highlighted in literature for the growth (Valchos, 2009), yet SMEs do lack in it because of its direct supervision.
Researchers have done much research to evaluate the constructs for SME’s growth (Roper, 1997). LEs are accustomed to marketing techniques. Their major focus is to attract new customers and to retain the old ones. Assessing customers’ needs, producing required goods and services, delivering them at exact time and location, taking feedback and finally twisting either performance or objectives accordingly are all related to the two basic objectives of customer retention and attraction. The marketing performance of LEs is better in different sectors of the economy. Though the textile, leather and light engineering have been considered as dominant low scale economy industries of emerging markets like Pakistan (Saleem & Saleem, 2014), yet they are still being dominated by LEs. SMEs do lack many resources and work as de-integrated units and are unable to compete with those giants. LEs do work as independent units but still in many different parameters they have to take support from the SMEs. Studies link SMEs growth with product and technological innovation (Roper 1997), but this study highlights the internal organizational factors i.e. reward system, decentralization and owners’ attitude towards growth with the role of market orientation for SMEs growth. More specifically the study answers the following questions:

1) How do decentralization in management structure, owner’s attitude and rewards system of employees are related with business growth?
2) Does Market orientation mediate between decentralization and business growth?
3) Does Market orientation mediate between rewards system and business growth?
4) Does Market orientation mediate between owners attitude and business growth?

Literature Review

SMEs do not have any formal systems and usually work with minimal systems (Quinn & Carson, 2003). These organizations usually do planning on the spot and mostly operate as a sole
propriety. SMEs also face another barrier to flourish including, goodwill and technological resources. It also lacks access to the desired market information, none or less focus of government on a particular sector, non-governmental support, have non-suitable infrastructure and confront large organizations’ competition which basically disturbs the whole market. SMEs are normally try to follow the footsteps of LEs, however SMEs lack resources to clearly follow this LEs steps. SMEs are also short of human and intellectual capital and are unable to perform according to the market principles. SMEs have to form their own value curve and to live in their own world. SME’s culture and work environment depends upon the owner’s will to form rules irrespective of the trends (Quinn & Carson, 2003). Normally the SMEs owners in developing economies like Pakistan (Bhutta et al., 2008) are not much literate as is the case of western countries (Golann, 2006). Howsoever market orientation is needed for the growth of any of the firm.

Initiating the debate from the yelling statement by Shapiro (1988) for the exact frame of market orientation and taking it as an opportunity. Kohli & Jawroski (1990) presented the working definition comprehensively and proposed 19 research propositions on it. From the seminal work of (Kohli & Jawroski, 1990) a debate on the topic is engrossed. Market orientation has also been discussed in different contexts of SMEs (Jawroski & Kohli, 1993). Performance of different enterprises were linked with market orientation (Kwan & Kim, 1994) growth (Golann, 2006) and even debated under the context of countries which are developing (Saleem & Siddique, 2014). A study on market orientation with the perspective of cross culture was conducted on the companies of the United States and Scandinavia (Golann, 2006). The aim was to catch the antecedents of market orientation in different cultures. Golann (2006) found the positive effects almost of similar magnitude for every variable in both cultures. Growth of the firms is dependent upon the external environment and market structure is also an important part of external environment. If such structure is more turbulent then it may have an impact on market orientation and
eventually on growth. In a prolonged economic crisis and recession which collapsed the manufacturing units, Naidoo (2010) proposed the importance of market orientation as the only source of competitiveness for the survival of smaller firms. A connection was established with innovation which is declared as the base of competitive advantage and found that those enterprises can only continue in crisis which will be market orientated coupled with innovation.

*Theoretical Perspective on SMEs growth*

There are various business theories that can fall in the domain of the SMEs growth within the context of developing economies. The model of the study integrates behavioral, agency and stakeholders perspectives. For behavioral perspective the study undermines the basic theory X and Y of management presented by McGregor in 1960s and later modified as theory Z by Ouchi, (1981). The theory X of management claims that employees are never willing to work and thus reliance upon external managerial factor is needed to control the working behavior of the employees. According to Theory Y, the owner of the SME considers that employees are motivated, self-directed and willing to work with positive attitude. Therefore theory Y relies on employee’s self-control and direction for enhanced business growth. This study is also inspired from theoretical assumptions of Agency theory (Jensen & Meckling, 1976). In the SMEs context, agency theory (Mole, 2002) the principal’s and agent’s issue become critical in smaller organization to define the owner-worker relationship. The owner and worker work more closely in working environment to satisfy all stakeholders. In view of this if the relationship between principal-agent are optimal in SMEs, this can result in satisfied stakeholders (i.e. customers, suppliers and society at large for a firm’s growth (Golann, 2006). So keeping in view the integration among the stated theoretical perspectives, the study contributes theoretically by presenting SMEs business growth model
using integrated theoretical perspective in developing economy’s context.

Defining Concepts

This section presents the basic concepts of the variable of interest for this study followed by theoretical relationship among the variables

Decentralization

The SMEs of small size are usually centralized in nature. In terms of ownership structure when there are two or more partners then one partner may be dominating the other but would somehow be considered as decentralized (Keskin, 2006). Usually owners perform different tasks of marketing etc. Nonetheless, there is an equal chance in medium size organizations that with the more employees hired the structure within management is more centralized in nature (Saleem & Khurshid, 2014).

Reward to Employees

Reward of the employees is usually known as salary given to them in the developing economies like Pakistan (Saleem, 2014). Monitory reward (Saleem & Khurshid, 2014) is generally the source of reward in SMEs. But the classical research shows that it’s not all that we know about these terms. Nowadays the employees at SMEs demand better environment along with market offered salaries (Saleem & Saleem, 2014). Classical research in western organization (McGregor, 1960) and recent studies in Pakistani service sector (Saleem, 2014) in the area of organizational behavior have identified that non-monitory rewards are equally important. The human resources are as critical as land and capital for continuous growth of the firm (Saleem & Khurshid, 2014). In the developing economies like Pakistan, SMEs salaries vary from organizations to organizations. Depending upon the life cycle of
the firm, firm size and rate of growth, firms offer market based salaries to employees (Saleem, 2014). In SMEs in particular, usually in the starting phase of the business, owners perform most of the task themselves (Mole, 2002). However, as the firm grows they start hiring employees to fulfill the growing needs of the business at nonstandard wages. Nonetheless as the firm grows up to medium sized within the industry they start offering market based salaries with proper introduction of human resource department and a responsible manager to deal with employee relations.

Owner’s Attitude

The owner’s attitude in SMEs of Pakistan is normally considered as negative due to lack of knowledge, nature of business and size of the organization (Bhutta et al., 2008). Due to a recent change in literacy level the owner’s attitude is being reported positive for family businesses which falls in medium size category and have some previous experience of working in the same industry of Pakistani market (Saleem, 2014).

Market Orientation

Firms which survive and grow are always on the continuum of market orientation. Their level of market orientation can be less average or high dependent upon the different internal variables. The sensible entrepreneur is usually very market oriented that leads to growth (Golann, 2006). The literature claims that market orientation of the firm means that the firm has all the capabilities and resources to combat the competition within the industry in order to meet market demands (Keskin, 2006).

Business Growth

Business growth is a very subjective term. Financial experts usually define this in terms of difference between sales volumes of
the two years of the firm (Roper, 1997). Alternatively, the behavioral scholars define business growth as relative term and defined the business growth in terms of market image (Golann, 2006). Other school of thoughts takes all three measures in one perceived term i.e. perceived market growth, financial performance and operational performance (Saleem & Saleem, 2014). However the scholars mostly agree that business growth for SMEs is one of the frequently used indicators that can ensure the survival of the firm (Kara et. al, 2005).

*SMEs Growth Model*

It is assumed that the decentralization within SMEs along with market orientation leads to business growth (Golann, 2006). Similarly, historic studies purport that equity based reward system with an eye on market based salaries helps to grow business (Roper, 1997), subject to the condition that the firm is market oriented (Keskin, 2006). The study of Bhutta et al. (2008) claims that ownership attitude matters for business growth and firm market orientation in terms of employee’s competitive salaries and meeting customer’s demands also ensures business growth for the firm for its long term survival.

This study focuses the relationship of reward system, decentralization and owner’s attitude on the market orientation of small and medium sized enterprises to present subsequent framework. Different studies focused on market orientation for their antecedents and consequences but this study is more precise to the impact of reward, decentralization and owner’s attitude on the SME’s growth through market orientation.
Hypothesis: The following hypotheses are developed:

H1: Market orientation mediates between decentralization and business growth in SMEs.
H2: Market orientation mediates between reward system and business growth in SMEs.
H3: Market orientation mediates between owner’s attitude and business growth in SMEs.

Research Design and Strategy

A unique research design called “Black Box approach” is adopted as research strategy. Black-box approach is usually used in the field of software engineering (Fleming, 1999; Harachi, et al., 1999). However in social science Black-box testing can be used if paths are unknown and researcher needs to explore mediating relationships (Aken, 2004). Therefore study has adopted Black Box approach for mediation analysis using Sobel test for mediation (Preacher & Hayes, 2004).

Data Collection
The primary data is collected from SMEs of leather industry in Lahore Pakistan. As most of the SMEs in Pakistan are unregistered and the sampling frame of respondents was not available therefore non-probability sampling is opted. In non-probability, a convenience sampling technique is used to verify model (Preacher & Hayes, 2004). The sampling units consisted of the SMEs which are engaged in manufacturing and composed of less than 250 employees (Bhutta et al., 2008) as bracketed by Small and Medium Development Authority policy (SMEDA, 2007) Pakistan. A surface and e-mail questionnaires are used. 85 out of 250 SMEs responded. The usable response was 36.5% i.e. 73 responses. The data was collected from owners, senior managers (head of employees) or any employee being designated as supervisor in case of non-existence of any hierarchy.

Measurements of Concepts

To measure the market orientation of manufacturing SMEs sector, a full market oriented scale (Kohli et al, 1993) of 32 items was used. Growth, decentralization, employee reward and owner’s attitude is measured with separate questionnaire consisting of 20 questions. National language Urdu and regional language Punjabi have been used to explain the questionnaire because of the variation in education level among respondents. The reliability results are presented in table 1, which shows that all the items surpass the threshold of 0.70 for the reliability test. However, some variables have weak reliability ranging from 0.640 (ownership attitude) to 0.692 (RSP). These figures can easily be improved up to 0.70 through dropping one or more items. But as this is well tested questionnaire, so it is decided not to delete the items of scale.
The regression assumptions are tested before running the final model. Firstly, the association of the reward for employees, decentralization of organization and owner is tested to see the multi co-linearity (see Table 2). No multi co-linearity has been observed as all the independent variables revealed a correlation less than 0.9 and the tolerance level is also greater than 0.2 whereas the VIF proved to be less than 5. The results are significant at 99% confidence interval. To check the mediation of market orientation on business performance by decentralization, reward and owner’s attitude, a test proposed by Preacher and Hayes (2004) has been used.

Table 2.  
**Multi Co-linearity**

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>Tolerance</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Owner</td>
<td>1</td>
<td>0.39</td>
<td>0.23</td>
<td>0.83</td>
<td>1.20</td>
</tr>
<tr>
<td>2. Decentralization</td>
<td>1</td>
<td>0.35</td>
<td>0.76</td>
<td></td>
<td>1.30</td>
</tr>
<tr>
<td>3. Reward</td>
<td>1</td>
<td>0.86</td>
<td></td>
<td></td>
<td>1.16</td>
</tr>
</tbody>
</table>

Note: VIF: variance inflation factor

**Research Findings**

This section has two parts. The first part consists of descriptive study, while the second consists of mediation analysis.
**Descriptive Analysis**

The sample has been collected from the SMEs working in leather footwear sector of Pakistan. Restricting the definition of SMEDA policy 2007 to their number of employees i.e. less than 250 is the only factor taken for this sample. The data has been collected either by the owners of the enterprises, the chief/general managers or in case of informal SMEs where there is no formal organizational structure available and only one person (supervisor) is authorized for whole operations.

The manufacturers are further divided into five categories. It could be the one with only manufacturing or besides manufacturing there are enterprises which are also exporters, traders, suppliers to other businesses or doing different works at the same time. 23.3% response is from the SMEs which are only manufacturing leather shoes for some other brands as a contractor or sub-contractor. 24.7% response is from those SMEs which are manufacturing and also selling under their own brands/names. SMEs that are manufacturers and suppliers to other business have the response of 27.4%. As SMEs generally fall under informal sector so their percentage in sample for those SMEs which are manufacturers cum exporters is 6.8% and 17.8 % is for all mix categories.

Regarding the number of employees, there are 60 SMEs having 1-50 employees. The employees of SMEs ranging from 51-100 and 151-200 are under only one (01) in each group. Two of SMEs fall under the employee category of 101-150 and there are five (05) SMEs which fall in 200-250 employees. Four SMEs which are reluctant to provide their data have been mentioned missing.

**Mediation Analysis**

SPSS is used to test the mediation model for this study as recommendation by Preacher and Hayes (2004). Accordingly to our study dependent variable is “G” Independent variable “RWD” and mediator “MO”, where G is for growth, RWD is for reward system and MO is for market orientation. The indirect estimate lies between 0.2978 and 0.6715 with 95% confidence interval which shows that there is no zero in the confidence interval (See Table 3). So we can sum up that
indirect effect is significantly unlike from zero at p < 0.05. Whereas 5000 bootstrap samples are requested. This model verifies the indirect effect hence H1 is accepted.

Table 3:
Mediation Model 1

<table>
<thead>
<tr>
<th></th>
<th>B</th>
<th>S.E</th>
<th>t-Stat</th>
<th>Sig(two)</th>
</tr>
</thead>
<tbody>
<tr>
<td>b(YX)</td>
<td>0.4316</td>
<td>0.1004</td>
<td>4.2994</td>
<td>0.0001</td>
</tr>
<tr>
<td>b(MX)</td>
<td>0.3466</td>
<td>0.0448</td>
<td>7.7377</td>
<td>0.000</td>
</tr>
<tr>
<td>b(YMX)</td>
<td>1.3579</td>
<td>0.2132</td>
<td>6.3706</td>
<td>0.000</td>
</tr>
<tr>
<td>b(YM)</td>
<td>-0.039</td>
<td>0.1092</td>
<td>-0.3568</td>
<td>0.7223</td>
</tr>
</tbody>
</table>

Note: The direct and total effect (Model 1)
X: Independent; M: Mediator; Y: Dependent

Direct and total effect is given in table-4. The indirect estimate lies between 0.2761 and 0.6335 with 95% confidence interval which shows that there is no zero in the confidence interval. We can sum up that indirect effect is significant, p < 0.05 using 5000 bootstrapping. This model verifies the indirect effect hence H2 is accepted.

Table 4:
Mediation Model 2

<table>
<thead>
<tr>
<th></th>
<th>B</th>
<th>S.E</th>
<th>t-Stat</th>
<th>Sig(two)</th>
</tr>
</thead>
<tbody>
<tr>
<td>b(YX)</td>
<td>.8411</td>
<td>.1236</td>
<td>6.8051</td>
<td>.0000</td>
</tr>
<tr>
<td>b(MX)</td>
<td>.4700</td>
<td>.0651</td>
<td>7.2221</td>
<td>.0000</td>
</tr>
<tr>
<td>b(YMX)</td>
<td>.9516</td>
<td>.1964</td>
<td>4.8445</td>
<td>.0000</td>
</tr>
<tr>
<td>b(YM)</td>
<td>.3938</td>
<td>.1419</td>
<td>2.7757</td>
<td>.0071</td>
</tr>
</tbody>
</table>

Note: The direct and total effect (Model 2)
X: Independent; M: Mediator; Y: Dependent

Once again to run the send model three variables are identified, i.e. G dependent, “ATT” is independent and mediator “MO”. The direct and total effect is given in under given table-5. This model also verifies the indirect effect. As indirect estimate lies between 0.1184 and 0.5475 with 95% confidence interval which shows that there is no zero in the confidence interval. So we can sum up that indirect effect is significantly unlike from zero at p < 0.05. Whereas 5000 bootstrap samples are requested. Hence H3 is accepted.
Table 5:
Mediation Model 3

<table>
<thead>
<tr>
<th>Coefficient</th>
<th>Standard Error</th>
<th>T</th>
<th>Sig(two)</th>
</tr>
</thead>
<tbody>
<tr>
<td>b(YX)</td>
<td>0.7010</td>
<td>0.1315</td>
<td>5.323</td>
</tr>
<tr>
<td>b(MX)</td>
<td>0.2785</td>
<td>0.0772</td>
<td>3.6097</td>
</tr>
<tr>
<td>b(YMX)</td>
<td>1.0843</td>
<td>0.1571</td>
<td>6.9023</td>
</tr>
<tr>
<td>b(YXM)</td>
<td>0.3990</td>
<td>0.1111</td>
<td>3.5913</td>
</tr>
</tbody>
</table>

Note: The direct and total effect (Model 3)
X: Independent; M: Mediator; Y: Dependent

Conclusion

The study authenticates previous studies showing the relationship between market orientation and growth with the special focus on the mediating effect. Despite of the consensus on market orientation construct developed for LEs and SMEs and tested on different sectors this study validates when market orientation is adopted with the actual zeal, it raises the business growth among SME. In literature there is a thorough debate on the positive (Kohli & Jaworski, 1990) and no effect of market orientation (Golann, 2006) but our sample shows a positive impact. The three independent variables for business growth through market orientation showed a positive impact while moving through market orientation. So our findings are partially consistent with previous studies (Jaworski & Kohli, 1993; Kara et. al, 2005). In view of this, SMEs should seriously ponder upon market orientation by understanding the customized demands of customers and analyzing the competitors for making the enterprises market oriented. The reward system should be made for the employees not only on the basis of their sales targets but also on their contributions pertaining to information sharing regarding new product, new market or new idea generation. The SMEs should follow the steps for decentralization as the responsiveness is the major pillar of market orientation which depends upon decentralization especially for the lower tier to take decision at their own. The study highlights the importance of reward, decentralization and owner’s attitude with mediating effect on market orientation in a particular context of SME’s in Pakistan. As the data is cross sectional so it paves the path for other researchers to study the same model of different industrial sectors.
with the longitudinal data. The study has been conducted only on the leather footwear sector which comes under the manufacturing category only. This limits our findings to a specific sample and may not be generalized to other industries (e.g. service sector) or may not be to other sectors of the same industry as well. Secondly a quantitative technique is applied to a limited sample with non-probability sampling that may limit the broader generalization of our finding. But in our study, most of the SMEs are unregistered and none of these maintain its compact data and list. So therefore, we are left with only one choice of non-probability sampling. The limitations can be further overcome by future researchers who may investigate the same findings in other sectors or industries and can develop a generalized theory on it.

This study elaborates the importance of market orientation in a specific industry with a special emphasis on SMEs. Market orientation is a behavior of a business which develops the path for its survival. It is as vital as business itself. To achieve some objectives, businesses need strategies and market orientation is a strategy for many distinct goals.

While addressing the issues of SMEs sector which is least supported by government of Pakistan, the study helps SMEs to form their strategies and consider the intelligence generation, intelligence dissemination as important components whose combination appears as market orientation. Small and medium enterprises of Pakistan contrast from one another in terms of size, nature and capacity. The differences can be seen in different industries and even within the same sector of an industry we may find a number of diversified characteristics in them. Particularly SMEs of Pakistan are found as a member of informal economy. Mostly they are unregistered, don’t pay tax, lack formal organizational structure and normally run by sole proprietors. They confront tough competition from large organizations domestically and in terms of product they face competition with cheap foreign products (mostly smuggled) in local markets but still are trying their best to survive. Interestingly, they do have the capacity to cater for the domestic and foreign demands as well, but they need to think proactively in each sphere of their business activities and the most important survival strategy is to focus more and more towards market orientation. Role of the government sponsored offices (e.g. Pakistan
trade development Authority, SMEDA) and the concerned Chambers of Commerce & Industry cannot be avoided, and SMEs should get themselves registered to benefit from such offices which have been incorporated to help them out. Summing up, the traditional business philosophy of “produce and sell” is considered obsolete now. In this era of cut throat competition and TQM philosophy, it is worthwhile for the SMEs to incorporate performance based reward systems, decentralization and positive employer attitude (Theory Y) in their organizational culture so as the reap the benefits of business growth through appropriate market orientation.
References


