Marketing Strategy And Business Performance: The Case Of Small Firms In China

Yiming Tang, Macquarie Graduate School of Management, Sydney, Australia
Paul Wang, University of Technology, Sydney, Australia
Yuli Zhang, Nankai University, Tianjin, China

Abstract

This study investigates the effects of marketing-related variables on business performance of small firms in China. In this paper, we present the findings from a qualitative pilot study and a quantitative main survey. The results show that *long-term differentiation marketing strategy, R&D as a percentage of sales*, and *years in business* are positively associated with a small firm's business performance in China. These findings suggest that small Chinese firms should adopt long-term differentiation strategy by investing in new product development in order to better adapt to the more competitive environment following China's accession of WTO.

Background

There is a plethora of research on small and medium-sized enterprises (SMEs) around the world. Many have pointed out the significant contributions that SMEs make to a national economy (eg, Chow and Tsang, 1994; Graham, 1999; Lyberaki, 1994). Some have attributed SMEs' contribution in employment growth to their entrepreneurial and innovative culture (Acs and Audrtsch, 1990). Compared to large enterprises, SMEs face many unique challenges, including (1) limited resources and lack of experience in conducting market research (Bamforth and Brookes, 2002; Siu and Kirby, 1998; Verhees, 1998), (2) lack of marketing skills (Callahan and Cassar, 1995; Carson and Cromie, 1990), and (3) the tendency of limiting their marketing to "selling" within their own industry (Carson, 1990). Specific challenges confronted by SMEs in China include both internal financial resources constraints and high barriers to obtaining external finances, government policy restrictions, and so-called "triangle debt" problems. Triangle debt is a common word used in China to refer to debt collection problems that involve three or more companies (Tang and Zhang, 2002). Because these companies tend to be government-owned large enterprises in China, they know that the government will not let them go into liquidation. As a result, many poorly managed government-owned large enterprises in China run up huge debts, not only to each other, but also to SMEs who are often privately owned. As all the major banks and other financial

institutions are government-owned, their lending policy favours the large state-owned enterprises, thus creating unique challenges for many privately owned SMEs in China.

Drawing data from Western market economies, several studies have examined the associations between market orientation, marketing strategies, market environment and SMEs' business performance (Appiah-Adu and Singh, 1998; Narver and Slater, 1990; Pelham and Wilson, 1996; Pelham, 2000). The results show that market orientation is positively associated with business performance. Although low-cost and product differentiation are identified as two dominant marketing strategies used by SMEs, their relationship with business performance was mixed in a limited number of empirical studies. Little evidence was found to link an SME's market environment to its business performance.

Given the important role played by SMEs in China's emerging market economy, it is vital to study SMEs' marketing practices and their relationship to business performance. However, rigorous empirical research in this area remains inadequate in China. In the studies reviewed above, all the key marketing concepts originated from the West. By and large, their applicability to SMEs in China remains an unresolved question. This study is part of an ongoing large empirical research project designed to bridge the research gap by examining the association between marketing practice and business performance of SMEs in China across multiple industries. In this paper, we present the findings from a qualitative pilot study and a quantitative main survey of small construction firms in Tianjin, which is one of China's largest cities with a vibrant SMEs sector.

Methodology

To explore Chinese SMEs' marketing practices, a pilot study was first conducted in early 2000 via semi-structured personal interviews with chief executives at ten SMEs in Tianjin, China. Based on the findings of the pilot study and the literature review, a structured survey was sent to 11,000 SMEs on the registration list of Tianjin Bureau of Industry and Commerce, together with the Bureau's cover letter endorsing the survey in late 2000. The questionnaire for the main survey was designed in Chinese by researchers who are bilingual. A total of 3,669 usable surveys were received, achieving a 33.4% response rate. To control for possible industry effect, we focus on the fast growing construction industry in this paper and utilise data from the 141 surveys completed by small construction firms. These firms in our sample averaged RMB 13.76 million in annual sales, RMB 4.34 million in assets, and 172 in employees. They are within the upper limits of the classification benchmarks for small

construction firms in China: RMB 30 million in sales, RMB 40 million in assets, and 600 employees (National Statistics Bureau of China, 2003).

In this study, we chose to use objective performance measures based on sales revenue, net profits and profitability to form the dependent variable. We are fortunate to have the local government's support, which enabled us to collect the needed objective performance data. Specifically, high performers are defined in this study as firms showing positive growth trends in all three areas over the previous three years. Low performers are those showing opposite trends in each of these dimensions, while average performers are those showing mixed trends, over the same period. Accordingly, the low, average, and high performers accounted for 30.5%, 53.2%, and 16.3% of our sample, respectively.

Two marketing strategy dimensions were used in this study: (1) *current product focus strategy* and (2) *long-term differentiation strategy*. Following Pelham and Wilson's (1996) approach, each of the marketing strategy dimensions was measured using five items on a 5-point Likert type rating scale, ranging from 1 being "not practiced at all" to 5 being "practiced to a great deal". Two business environment-related constructs were also used in this study: (1) *government policy towards SMEs* and (2) *service quality & availability to SMEs*. All items were measured on a 5-point Likert type rating scale, ranging from 1 being "very dissatisfied" to 5 being "very satisfied". In addition, following Storey's (1994) approach, the survey includes a number of other independent and control variables such as an SME's *R&D spending as percentage of sales*; *whether an SME faces financial resources challenges*, and *number of years in business* (see Table 1 for the complete list).

Results

Consistent with the findings by Pelham and Wilson (1996) and Pelham (2000), *current product focus* and *long-term differentiation* are two key marketing strategies practiced by all companies in our pilot study. The majority of housing products available in China remain very basic (i.e., apartments with bare walls, cement floor, and no closets, etc.). While there is a clear need for further adaptation of such products, our pilot study participants inform us that the potential for this *current product focus* strategy is very limited due to backward design and rapid change of market needs. At present, there is a growing market demand in China's metropolitan areas for better designed apartments (i.e., those with finished floors, ceilings and closets, etc.). While such differentiated products usually command a price premium, they seem to sell much faster. As such, companies adopting a *long-term differentiation* strategy with innovative product offerings seem to do better than their competitors.

Several business environmental factors identified by our pilot study participants as most important to an SME's success in China relate to government policy, the availability and quality of government services. They are similar to those found in other transitional economies (Fogel and Zapalska, 2001). In addition, financial resources and triangle debts were identified as the key challenges facing most SMEs in China.

Table 1: Marketing Strategy, Organizational Characteristics and Business Performance of Small Construction Firms in Tianjin

Predictors (independent variables)	Coefficient	Std Error	Z-value
Current product focus strategy	-0.083	0.284	-0.29
Long-term differentiation strategy	0.610	0.273	2.23**
Government policy towards SMEs	-0.363	0.424	-0.86
Service quality & availability to SMEs	0.212	0.416	0.51
Facing financial resources challenge	-0.443	0.210	-2.22**
Facing triangle debts challenge	0.047	0.289	0.16
Formal supplier to a few large companies	-0.434	0.319	-1.36
Having a few steady suppliers	-0.161	0.238	-0.68
R&D as % of sales	1.793	0.564	3.18***
Number of new products launched over last year	0.885	1.062	0.83
Conduct regular market research	0.378	0.339	1.12
Number of years in business	0.949	0.354	2.68***
Registered Capital (RMB million)	0.031	0.158	0.20
Number of employees	-0.093	0.163	-0.57
Model Goodness-of-Fit Statistics Log-likelihood McFadden's Pseudo R-Square Hit-Ratio or Total Correct %	-126.917 0.094 60.0%		

* p < 0.10;   ** p < 0.05;   *** p < 0.01

Based on the findings from the pilot study, we expect that *current product focus strategy* will not be positively associated with business performance of SMEs in China. Instead, we expect that an SME's performance will be positively associated with its *long-term differentiation strategy*, and its satisfaction levels with government policy towards SMEs and with the availability and quality of services to SMEs; while negatively associated with the challenges in obtaining financial resources and in dealing with triangle debt problems. Compared with other industries in China, the construction industry is much more labour intensive. Because of China's abundant labour supply, it appears unnecessary at this stage for small Chinese construction firms to forge strategic alliances with large firms in order to overcome their

capital investment and technology challenges. Thus, we expect that neither formalised supply contract with a few large firms nor formalised purchase contract from a few suppliers will be significantly associated with business performance of small construction firms in China.

Cronbach's coefficient alpha values for the two marketing strategy scales and two business environment scales range from 0.689 to 0.791, indicating acceptable reliability of these measures (Peter, 1979). Given that the dependent variable of our study is discrete and ordinal, ordered logit model was chosen for our hypotheses testing (Anderson, 1984). The results are summarized in Table 1. McFadden's pseudo R-square for the model is 0.094, showing acceptable model fit (Louviere, Hensher and Swait, 2000). The goodness of model fit is further supported by the hit-ratio of 60.0% being larger than 53.2%, the largest observed share of the dependent variable. As shown in Table 1, four independent variables are found to have a significant impact on business performance: *long-term differentiation strategy, facing financial resources challenge, R&D as percentage of sales,* and *number of years in business.*

Discussion

Since economic reforms began in the late 1978, China's GDP has been growing around 9% per annum and together with a population of 1.3 billion people (National Statistics Bureau of China, 2004), China is arguably the largest consumer market in the world. Given the growing importance of the Chinese market and the increasing competition between local and foreign brands following China's recent accession of WTO, there is a need to further enhance the understanding of various marketing issues in the emerging Chinese market.

The current study has examined the effects of marketing-related variables on business performance of small construction firms in China. In this paper, we present the findings from a qualitative pilot study and a quantitative main survey. The results indicate, among others, that *long-term differentiation marketing strategy, R&D as a percentage of sales,* and *years in business* are positively associated with a small firm's business performance in China. Taken together, findings from this study suggest that the key to the marketing success of small construction firms in China is to follow a long-term differentiation marketing strategy, focusing on R&D and on the development of new housing products that can better serve the changing market needs.

Our data analysis has produced some interesting results. First, *the current product focus* strategy is not significantly associated with the business performance of the small firms in our sample, while *the long-term differentiation* marketing strategy is. This suggests that the

housing market in China has developed into a stage in which a market penetration growth strategy based merely on current product offerings no longer seem to be sufficient. Successful companies tend to be those that have followed a long-term differentiation strategy (e.g., quality brand, new product & service, and unique advertising & promotion).

Second, the satisfaction level of neither *government policy towards SMEs* nor *services quality & availability to SMEs* is associated with business performance. Further analysis shows that mean ratings for the *government policy towards SMEs* and for *services quality & availability to SMEs* were 3.30 and 3.28, respectively. In both cases, they exceeded 3, the mid-point for a five-point scale. These findings suggest that firms in our sample appeared to be generally satisfied with government policies, perhaps reflecting the success of recent Chinese government's economic and housing reforms.

Third, there are mixed results for the control variables used in this study. Specifically, *registered capital* and *employee numbers* are found to be not associated with business performance, confirming Siu's (2000) findings. However, a small firm's *number of years in business* is positively associated with its business performance, suggesting that experience matters in China's construction business. And finally, neither *supply contract with a few large firms* nor *purchase contract with a few suppliers* is associated with business performance, thus suggesting that alliance in China's construction industry seems unnecessary at the current stage of development.

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