

# CHAPTER I

## INTRODUCTION

### 1.1 Background of Study

Corporate strategy is the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals, produces the principal policies and plans for achieving those goals, and defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and on economic contribution it intends to make to its shareholders, employees, customers, and communities.

—Kenneth Andrews

The business environment have become more complex. Globalization and technology advancement have reformed the market structure and redefined business competition. Things like the ASEAN Economic Community (AEC) that will take in effect in 2015 (Sile,2015), which changes the playing field for business in the region, now not only they need to factor in the competitor in the country, they will also need to include the competition from outside and also the new market opportunities. Before, companies only have a few competitors, now not only they have direct competitors, they also have many indirect competitors due to globalization and technology advancement.

Before the year 2000, hand phone is not a substitute good for hand held digital cameras, meaning that it does not have similar functions as digital cameras and cannot be used for the same purpose (Pettinger, 2012). After the first hand phone with build in camera is released in November, 2000 by SHARP, now hand phone, or now have developed to smart phone are substitute goods for hand held digital cameras (Hill, 2013). Bear in mind that the first digital camera is made in 1973 by Kodak (Estrin, 2015), thus in the span of 27 years, there is a change in business environment for digital cameras with the addition of indirect competitor.

Similar things also happen at the case of PlayStation Portable (PSP), but in much shorter time span. PSP is first released in 2004 (Thomas, 2012), four years later, Google release android phone and Play Store (Dobie, et al. 2015) which now could serve as perfect substitute to PSP. These shows how fast the business environment changes and brings up the importance in responding to these external pressures.

It is important for business to responds correctly towards the changes in business environment. An example of company which fails in responding correctly towards the business environment changes is Kodak. The case study is unique and interesting because Kodak has all the tools and they are the pioneer to the changes on their business environment.

As previously stated, Kodak develops the first digital camera in 1973, they also understand that this technology could replace their current business in approximately ten years, yet they does not prepare for the upcoming competition and instead insisting on chemical based film as they holds big market share in it. Their decisions not to changes create losses for them, with a company market value of \$140 million and moving in the direction of bankruptcy (Mui, 2012). This highlights the importance in responding correctly towards these changes, which requires correct business strategy and strategic decisions.

Strategy was established as one of the key factor that influences business and their performance (Chandler, 1962; Ansoff, 1965; Andrews, 1971). Research made by Charoenngam indicates the positive and significant relationship between strategy and firm performance (Teeratasirikool, Siengthai, Badir, Charoenngam, 2013). Study made by Powers mention how Porter generic strategy explains performance in the field of bank, with those who follows the generic strategy will have higher performance than those who is "stuck in the middle" (Powers, Hahn, 2004).

At the business level, strategic decisions are typically identified as those involving long-lasting commitments of resources (Ghemawat, 2002). Therefore, investments in physical capital, Resources and Development and brand development could be identified as strategic decisions (Shapiro, 1989). In strategic choice theory, it is mentioned that managers have considerable decision power which includes the allocation of resources to business units, functions and programs (Child, 1972). These decisions were influenced by the perceived environment, i.e. the view and interpretation towards the environment, of the decision makers.

Although there is many approach towards business strategy, Miles and Snow typology remains one of the popular choices as its validity have been tested throughout many fields such as hospitals, banking, industrial products, life insurance, college (Hambrick, 2003). The Miles and Snow typology divide companies into four types: Defender, Prospector, Analyzer and Reactors.

In contingency theory, it is believed that the type of managerial effort combined with the context of the organization will influence the organizational performance (Meier, O'Toole, Boyne, Walker, Andrews, 2010). One of model which reflects this is Miles and Snow typology. Miles and Snow typology classify businesses into four, Prospector, Defender, Analyzer, Reactors based solely on the internal factors, which is by how organization response, i.e. decision made by top management, to the three problem in the adaptive cycle: the entrepreneurial problem, the engineering problem and the administrative problem (Miles & Snow, 1978).

The typology states that the organizational pattern of strategic behavior is an 'adaptive cycle', which could be characterized using the solution of the three strategic problems: Entrepreneurial, engineering and administrative. The entrepreneurial problems are problems that appear in the product-market domain, where as the engineering problem are problem in the selection of technology and the administrative problem are problem involving the company system (Miles &

Snow, 1978). From the solution of these three problems, companies are then classified into four categories, Prospector, Analyzer, Defender and Reactors. Further studies describe the use of secondary data to classify companies into the four categories by using several variables which can be summarized as Risk disposition, Innovativeness and Operational efficiency (Cool and Schendel, 1987; Segev, 1989; Douglas and Rhee, 1989).

Defender is described as company which creates an environment in which they could have a stable form of organization (Miles, 1978). Instead of focusing on product development, they focus more on establishing and defending their niche market by improving their price, distribution, quality and service (Mehlika, 2014). Thus they generally do not take risk and focus on efficiency in order to achieve their financial performance. A good example of Defender Company is BIC. Starting from being a prospector in writing instrument industry, BIC switch to less aggressive approach in the 1970s, where the writing instrument industry become saturated and focuses more on efficient manufacturing and customer satisfaction (Barney & Griffin, 1992).

Prospector could be said as the polar opposite of Defender. When Defender took profit from stability, Prospector seeks on exploiting new product and market opportunities (Miles, 1978). They tend to be the pioneers in product/market development and try to meet new market opportunities (Mehlika, 2014). Thus they are willing to take risk in order to achieve their financial performance. An example of Prospector is 3M, which boast itself as one of the most innovative corporations in the world that have many range of products from invisible tape to anti stain fabric treatments (Barney & Griffin, 1992).

Analyzer is a mixture between Prospector and Defender (Mehlika, 2014). They aim to minimize the risk while maximizing profit opportunities, while in the same time they risk of being inefficient and ineffective if poorly implemented (Miles, 1978). This tends to made them a second-in as they adopt wait and see attitude towards new product or market (Miles, 1978). Although difficult to

identify in a glance, an example of Analyzer is IBM. IBM shows a defender characteristic by; protect their market share by improving their services such as helping their customer to move from the old system to the newer system. They also tried new market by imitating Apple to manufacture personal computers, which makes them a second-in, thus identifying them as company that adopts Analyzer Strategy.

Reactors on the other hand, are considered inconsistent and unstable when it tries to react to the environment which usually the result of improper implementation of the three strategies (Miles, 1978). Due to its inconsistent strategic disposition, many studies does not include reactors as they viewed it as "unviable strategy" (Mehlika, 2014). An example of Reactor is Honeywell, which once deals with manufacturing mainframe computers. They have inconsistent approach in which they sometimes do innovation and at other time reduce cost by firing their skilled workers.

Many studies in strategic management focused on identifying and understanding the strategic direction of companies in various industries (Moore, 2005). These studies tried to find the relationship between organizational environment, strategic process, strategic content, organizational performance and other variables (Gnjidic, 2014). Studies of private firms have found that the effects of strategy on firm performance are moderated by the environment (Davies & Walters, 2004; James & Hatten, 1994), organizational structures (Jennings & Seaman, 1994), and processes (Slater, Olson & Hult, 2006). However, none of these studies are able to explain the effects of multiple variables that is proposed by Miles and Snow (Walker et al., 2010).

Although there are several existing conceptual and empirical concepts of strategies such as Three Generic Strategy, Core competence (Porter, 1980; Prahalad, Hamel, 2003), the typology proposed by Miles and Snow (1978) remains one of the most popular and frequently-used approaches in measuring business level strategy (Zahra, 1990). The Miles and Snow typology results have

been verified to be generally accurate (Zajac, 1990). Further studies indicates its validity in many field such as banking, life insurance, college, industrial products, retail (Hambrick, 1983), (Moore 2005). In addition, this typology allows the use of archival data for a period of time (Segars, Kettinger 1994) which helps in data mining process of the study.

This paper aims to use Miles and Snow typology to explain the performance of Indonesian businesses. In Indonesia, Miles and Snow typology were mainly used in its original context, to classify companies into the three categories (Manurung, 2010). On the other hand, most research uses Porter three generic strategy and SWOT analysis as their foundation (Abadiyah, 2013), (Jati, 2006) knowing that there were limitation to both concepts. With the Porter strategy, he states that a company that fail to chose one of the generic strategy will be classified as 'stuck in the middle' (Porter 1980), making the firm lose their direction and at the end lose their competitive advantage. This brought the critiques of the strategy being too static and only applicable to stable conditions (Mintzberg, 1988). On SWOT analysis, it gives the false impression that all the important data could be looked at a glance to create a strategy analysis. It also does not assign weight on which factors were important, thus making them looks equally important, while in reality it isnot (Valentin, 2005).

## **1.2 Research Problems**

1. What are the characteristic of Indonesia companies from the view of Miles and Snow's perspective?
2. Which Miles and Snow's typology gives the best financial performance in Indonesia?
3. How far Miles and Snow's typology with can explain the variance in Indonesia companies' performance?

## **1.3 Research Objectives**

1. To identify the characteristic of Indonesia companies from the view of Miles and Snow's perspective

2. To identify which of the Miles and Snow's typology that produces highest average performance.
3. To explain the extend of Miles and Snow's typology in Indonesia companies' performance variances

#### **1.4 Research Contributions**

The result of this research is expected to provide enrich and deepen the existing theory about management strategies. Specifically, the research will be beneficial to the following:

1. Current and future researchers

This research may help current and future researchers to have more perspective of how Miles and Snow's typology can help the companies to make their strategies.

2. The author

This study gave the author the opportunity to enhance the theoretical knowledge gained from lectures, textbooks, and other literature, as well as practice the analytical skills in solving managerial problems.

#### **1.5 Research Limitation**

This research is limited on the influence of Miles and Snow's typology, which are prospector, defender, and analyzer typology to firm's performance. This research took place in Indonesia by using secondary data. The research was conducted using data from 2010-2015 financial year.

#### **1.6 Research Outline**

Research outline explains the systematic writing of this study. The outline is divided into three chapters as follows:

##### Chapter I

This chapter sets up the research problem for the reader. It also provides the background information defining the issue and important terms. It specifies the research objectives explored in greater detail to contribute to understanding the research problems.

## Chapter II

This chapter summarizes the major studies and findings that have been published on the research topic and how this study contributes or adds to what has already been studied. This chapter also states a clear description of theories that apply to the research problem, an explanation of why it is relevant, and how the modeling efforts address the hypothesis to be tested.

## Chapter III

This chapter explains the detailed technical and scientific activities which include the research design, sampling plan, instrumentation, statistical tools, and treatment of data.

## Chapter IV

This chapter organizes the logical presentation of all findings in the research questions, and focus on how these key findings relate back to the theory and prior researches presented in the beginning of the study.

## Chapter V

This chapter outlines the implications, conclusions, and recommendation supposed to advance the study of the research topics by its theoretical, methodological, or substantive contributions that may be necessary to overcome the limitations of existing empirical facts.