ABSTRACT

Business Models and Firm Performance: Evidence from Indian SMEs

Rakesh Kumar Pati, Indian Institute of Mangement (IIMK)

The objective of this study is to identify the importance of business model attributes for firms in different conditions and explore factors that influence the business model attributes.

Business models help firms to create value. A business model is a framework through which firms manage their transactions with other stakeholders such as customers, partners, investors and suppliers. Because of the importance of business models, researchers have attempted to identify their various attributes and potential effects on firm performance. Even though prior research has enriched our understanding about the nature and role of business models, they have investigated only the direct effect of business model attributes on firm performance. They have paid less attention to the contingent effects of factors relating to the firm and external environment. ***This study primarily examines how business model novelty and efficiency affect firm performance by taking into consideration the contingent effects of firm age, environmental dynamism and hostility.***

Strategic management literature suggests that business models are derived from the strategies followed by a firm and hence strategic decisions-making approach affects the business model of an organization. Drawing on the theoretical framework of effectuation, the strategic decision making can be broadly classified into two approaches namely, predictive and non-predictive control. The predictive approach assumes that the characteristics of a firm are similar to those of the other firms operating in its domain and hence its future can be predicted using historical information. However, proponents of non-predictive control argue that the future of an organization cannot be predicted using historical information and hence the emphasis should be on creating a desirable future. ***Therefore, this study examines how decision-making approaches based on prediction and non-predictive control affect the business model efficiency and novelty.*** In this study, four important decision situations faced by firms are included and different choices advocated by prediction and non-prediction decision-making approaches are highlighted. Hypotheses have been developed by understanding the implications of these choices on the attributes of business models.

Based on the research questions identified from a review of the relevant literature, a number of hypotheses have been formulated. To test these hypotheses, cross-sectional data have been collected from Indian SMEs. The context of small firms is adequate to test the theory as entrepreneurs or owner-managers of SMEs are most knowledgeable about their firms and they take all the key decisions about their firms. Hence responses indicated by them would indicate the actual management practices of their organizations.

The survey-questionnaire was personally distributed to the entrepreneurs and owner-managers who attended various entrepreneurship and small business conferences, trade meetings, and short-term training programs. A total of 241 useable responses were collected. The demographic characteristics of the sample and the population census provided by Government of

India (MSME, 2011) were similar. Regression analysis was conducted to test the hypotheses. Although adequate care was taken in minimizing bias due to sampling method, single respondent, common method variance, the possibility of bias due to these issues cannot be completely eliminated.

Findings of this study indicate that business model novelty has a significant impact on firm performance. The results also indicate that novelty is more beneficial for younger SMEs while efficiency is more productive for their established counterparts. Focusing on both novelty and efficiency simultaneously helps established SMEs to improve their performance but is counterproductive for younger SMEs. The findings also suggest that a business model with high novelty is better in dynamic business environments, while the one with high efficiency is better in hostile environments. Finally, findings of the study also highlight that predictive decision-making approach influences business model efficiency positively, while non-predictive decision-making (except affordable loss approach) positively influences business model novelty.

The study contributes to the literature on business models in several ways. First, it extends the literature on business models by exploring the contingent effects of a firm's age and environment on the relationship between business models and performance. Second, the study examines the impact of predictive and non-predictive control decision-making approaches on business model efficiency and novelty. Third, the study augments the theoretical framework of effectuation by extending its influence on business model and SMEs in emerging economies. Finally, the study extends the limited empirical literature on SMEs in emerging economies.

The findings also inform the entrepreneurs and owner-managers of a firm to emphasize either business model novelty or efficiency or both simultaneously, depending on their maturity and capability. Moreover, the findings from the study also encourage entrepreneurs and owner-managers to focus more on business model novelty in highly dynamic environments while giving more attention to efficiency in hostile environments in order to achieve superior performance. Finally, the findings inform the owner-managers of SMEs to focus on predictive and non-predictive decision making approach to improve their business model efficiency and novelty respectively.