

*National College of Business  
Administration & Economics  
Lahore*



**ENVIRONMENTAL FORCES AND  
FIRM'S PERFORMANCE – A BALANCED  
APPROACH: SOME EVIDENCES FROM  
READYMADE GARMENT SECTOR**

**BY**

*ZAHID ALI*

**MASTER OF PHILOSOPHY  
IN  
BUSINESS ADMINISTRATION**

**JULY, 2012**

# **NATIONAL COLLEGE OF BUSINESS ADMINISTRATION & ECONOMICS**

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**BY**

**ZAHID ALI**

**A dissertation submitted to  
School of Business Administration**

**In Partial Fulfillment of the  
Requirements for the Degree of**

**MASTER OF PHILOSOPHY  
IN  
BUSINESS ADMINISTRATION**

**July, 2012**



**IN THE NAME OF ALLAH  
THE MOST BENEFICENT  
AND THE MERCIFUL**

**NATIONAL COLLEGE OF BUSINESS  
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**Dissertation Committee:**

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Administration & Economics

## **DECLARATION**

This is to certify that this research work has not been submitted for obtaining similar degree from any other university / college.

**ZAHID ALI**  
**July, 2012**

**DEDICATED TO**

*My Wife, Children  
and Parents for their love,  
support and prayers  
for my success*

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Finally, I would like to thank National College of Business Administration and Economics (NCBA&E), my alma mater.

## **RESEARCH COMPLETION CERTIFICATE**

Certified that the research work contained in this thesis entitled **“Environmental Forces and Firm’s Performance –A Balanced Approach: Some Evidences from Readymade Garment Sector”** has been carried out and completed by **Zahid Ali** under my supervision during his M.Phil. Business Administration Programme.

***(Dr. Karamat Azim)***  
**Supervisor**

## SUMMARY

Globalization, trade liberalization and technological advancements at one end has increased opportunities for the firms, but at the other end it has increased competition as competitors can also operate beyond geographical national boundaries without much difficulty. Organizations operate in an open system. Organizational strategy must entail both external and internal environmental factors to match with organization's resources for improving performance. This study makes an extensive review of the external environmental factors affecting firm's strategy and performance.

This dissertation theoretically and empirically investigates impact of PESTEL factors on the strategic decisions and performance of the firms in readymade garment (RMG) sector registered with PRGMEA, Lahore. All the firms in target population are engaged in manufacturing and export of readymade garments and compete with other firms in international markets. No study has been made on this important sector in the past. This study comes across relationship between firm's performance, PESTEL factors and consideration of PESTEL factors in strategy formulation. Results of this study also empirically validate relationships under discussion.

*Customer retention* is seen to be one of the important performance indicators for the firms. It is evident from the previous literature that *customer retention* improved performance and profitability of the firms and this study empirically explores this relationship in RMG sector. Regression results of mediation of *management belief* in *developmental investment-performance* relationship also validate the previous literature where researchers have emphasized on investing in technology, R&D, training & skill development. Regression results for mediation of *management belief* in *age-performance* relationship are another important finding of this study.

This study emphasizes use of Balanced Scorecard (as given by Kaplan and Norton in 1992) to track firm's performance against four perspectives. Keeping an eye on internal and external environmental factors will enable firms to match their strengths with the opportunities as well as weaknesses and threats in global environment. Investing on technology, R&D and skill development is found to be an effective tool to face the challenges of the globalization and the study empirically proves this relationship in RMG sector.

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# CHAPTER 1

## INTRODUCTION

### 1.1 BACKGROUND

Organizations operate in an open system and their performance is affected by internal as well as external environmental factors. Globalization offers opportunities and threats to the firms. To operate successfully and achieve their goals, firms need to keep an eye on both internal and external environmental factors. Koo (2007) recognizes that favorable external situations are opportunities and unfavorable are threats, it is important for the organizations to monitor the changes that are happening around them and explore the possible external factors that may impact firms' performance. Choo (1993) finds that environmental scanning is often positively correlated with organizational performance. Rose et al., (2010) are of the view that to have necessary information about the relative internal strengths and weaknesses of organizations can be used as a guide for taking strategic decisions and improve their overall position. According to Knight (2000), decision makers in organizations need to take into account environmental changes and respond to future challenges while making strategies.

In a world having open competition globally firms require a global strategy where competition, according to Zou and Cavusgil (1995), is no longer seen to be on a market by market basis. Brooks and Weatherston (2000) are also of strong view that it is important for organizations to identify, forecast, monitor and evaluate key external environmental forces for their success as otherwise firms may fail to anticipate emerging opportunities and threats in the environment. Organizations require such a strategy which is aligned with their objectives and available resources. Ohmae (1989) is of the opinion that, in this century, competing effectively in the world market will determine the success or failure of the business firm. As per World Trade Report (2008), trade dependence among nations is increasing. The report takes inter-dependency of the nations in trade as globalization which is a multi-layered and complex phenomenon involving intensive political, social and economic interaction nationally and internationally.

Chief executives are responsible for the alignment of the environment of their organizations (Daft et al., 1988). Brooks and Weatherston (2000) find that PEST analysis is being used for identifying and evaluating political, economic, social and technological key external factors; and ultimately

threats and opportunities for the organization. Oxford University (2011) describes that analysis of the macro environment can be made using *PESTEL Analysis* to distinguish between Political, Economic, Social, Technological, Environmental and Legislative (or legal) factors to assist the firms analyze general environment. Adepoju and Famade (2010) highlight importance of scanning external factors and emphasize that an understanding of both internal and external factors can help in forming a vision for the future of the firm and in making proper decisions.

To help organizations track and improve performance, Kaplan and Norton (1996 a) offer *Balanced Scorecard* (BSC) to navigate towards success by translating their strategy and vision into a comprehensive set of performance measures. It is a major challenge for firms to determine that which of the hundreds of nonfinancial measures to track to improve their performance. Ittner and Larcker (2003) find that many firms are of the view that they have solved the issue of determining appropriate nonfinancial measures by adopting a framework like the BSC (Ittner and Larcker, 2003). Since the early 1990s, many companies have developed BSC to link their strategic objectives, financial performance, and metrics associated with initiatives related to customers, internal business processes, and learning and growth (Gjerde, 2007). Since the early 1990s, there are many companies which have developed Balanced Scorecard for linking their strategic objectives and financial performance (Gjerde, 2007).

However, relying on just one model to develop strategy and track performance has been seen as a problem by many researchers. Koo and Koo (2007) find that there are occasional problems in relying on a single strategic tool. Koo et al. (2008) find many different approaches for strategic development and these can be used together. Instead of using a single strategic tool use of combined and various integrated tools is urged to provide a more practical and holistic strategic framework (Koo, 2007; Koo and Koo, 2007).

Textile and clothing is amongst one of the important exporting sectors and a major source of employment generation. Gereffi (1999) finds that apparel (clothing) sector is one of the largest and oldest export industries in the world. According to him, apparel (clothing) is one of the most global of all the industries as most of the nations are engaged in producing for the international textile and clothing market. He also observes that it is the typical buyer driven 'starter' industry for the countries engaged in export-oriented industrialization which played a leading role in early export growth in East Asia. Javed (2000) also finds that just like as Pakistan; export

earnings of India, Bangladesh and China are also dependent upon their textile sector.

For a developing country like Pakistan, this may be very challenging for the export oriented firms to survive in the international arena. Textile industry is amongst one of the major exporting industries of Pakistan and studying their international performance, therefore, presents an interesting research avenue.

Clothing sector is selected for the research study as this sector is prone to globalization challenges and external environmental threats. From export, investment and employment point of view Textile and clothing is the largest industrial sector of Pakistan (Malik, 2000). He also finds that contribution of this sector in Pakistan's export earnings is 60 %, approximately 27 % of Pakistan's industrial output comes from this sector and it absorbs about 38 % of industrial labor force. End of Multi Fibre Agreement (MFA) was one such rule in GATT that affected Pakistan the most just like any other textile exporting developing country (Yoganandan, 2010).

The performance of export oriented firms of Pakistan may be better for those which are more experienced in international trade. This experience is helpful in enabling them to use PESTEL analysis more efficiently. The management expertise and knowledge to deal with external environmental forces is likely to be helpful in exploring opportunities and threats in the international market. The managerial attitudes about usefulness of PESTEL analysis in all types of organizational success factors under four perspectives of balanced scorecard may be important for organizational performance in the international markets.

To respond to globalization and external environmental challenges (opportunities and threats) firms need to make *developmental investment* (DI) viz. investing in R&D, technology up-gradation and training & skill development. Along with technology, importance of skill development and training is also emphasized in the literature and researchers have found a positive impact of training and development on organizational productivity and performance. In this era of technological advancements and trade liberalization firms need to focus on new product development, R&D, and training and skill development to develop new innovative products and services with higher efficiency to meet the demands of the buyers. Buyers of readymade garments in international markets (especially in developed countries) demand best quality and eco-friendly products which require investing in innovative designs, products, and processes etc. Thus *developmental investment* is seen to be a logical result of the management's

commitment to respond the needs of the markets and adopt a growth and/or stability strategy for their firms. The long term *developmental investment* in research and development, human resources and technology acquisition may further improve the chances of international success of the firms.

On the basis of the above discussion, this study focuses on some of the variables which are presented in the next sections.

## **1.2 STUDY VARIABLES**

*Firm Performance* is the dependent variable in this study. Independent variables include firm's age and *developmental investment*. *Management belief*, a new concept introduced in this study, also appears as a mediating variable between the independent variables and the dependent variable. This section provides the operational definitions of all the study variables in next paras.

### **1.2.1 Firm Performance**

The percentage of international customer retained successfully during the last three years by a firm represents the firm's performance in this study. *Customer retention* is an important proxy indicator of the firm's performance and profitability and has been often used in the literature (Rust et al., 1995; Bolton et al., 2000; Winer, 2001; Ranaweera and Neely, 2003).

### **1.2.2 Firm age**

Firm's *age*, an independent variable, represents the number of years a firm is in business. The study hypothesizes relationship between age and performance.

### **1.2.3 Developmental Investment**

*Developmental investment* is the second independent variable in this study. It is the investments made by a firm for technology up-gradation; research and development and training & skill development. It shows the percentage of the profit spent by the firms on the above three types of development investments.

#### **1.2.4 Management Belief**

This variable represents the ‘belief of the management that the factors under PESTEL (viz. political, economic, social, technological, environmental and legal) can have a significant effect on the firm’s performance which is reflected under the four perspectives of the BSC’.

*Management belief* (MB) as a concept explains how management perceives the relationship between external environmental factors and their impact on firms’ performance. The concept may be explained in context of attitude of the management in scanning external environmental factors which may affect the performance of the firms. It is about theorizing the relation of considering environmental assessment important in every aspect of organizational performance. Choo (1993) finds a growing awareness of the importance of the environmental information that external scanning increases with environmental uncertainty, information about the market and competitors are the most important, and that scanning is often positively correlated with organizational performance. Pfeffer and Salancik (1978) also highlight the similar approach which can be explained as managerial attitude that unless management perceives external events as important to organizational performance uncertainty by itself will not lead to scanning behavior. Firms manufacturing and exporting readymade garments and competing globally are more affected by PESTEL factors in terms of the performance.

#### **1.2.5 Other Variables**

Size of the firm (measured using number of employees) also shows relation with the performance of the firm. The study also inquires about the use of a formal corporate strategy by the firms and measures emphasis of the firm’s strategy (i.e. growth, stability and downsizing) on firm’s performance.

### **1.3 AIMS AND SCOPE OF THE STUDY**

This study makes an empirical investigation to understand the impact of *age* and *developmental investment* on the *performance* the firms, measured in terms of successful *customer retention*. The study also investigates the role of *management belief* as a mediating mechanism in understanding the relationship between the two independent variables (i.e. *age* and *developmental investment*) and firm’s performance.

This study is confined to the manufacturing-cum-export firms of the readymade garments registered with Pakistan Readymade Garments Manufacturers and Exporters Association (PRGMEA) in Lahore. Textile and clothing is one of the most neglected areas in research in Pakistan. No much literature is available on the sector which explains the competitive position of this sector. Researchers in Pakistan have not yet investigated the impact of exposure of Pakistan's textile and clothing sector to the global competition. This study is unique in a way that it attempts to provide a starter to the researchers on the subject.

#### 1.4 OBJECTIVES OF THE STUDY

Present study attempts to:

- explore whether external environmental factors affect strategic decisions of the firms?
- explore the relationship between a firm's *age* and its *performance*.
- study the impact of *developmental investment* made by a firm upon its *performance*.
- investigate the role of *management's belief* (that PESTEL factors influence the firm performance in all of the four perspectives of Balanced Score Card) in explaining *performance* of the firm, and
- find the mediating role of *management belief* in explaining the relationship between (a) *age* and *Performance* and (b) *developmental investment-performance*.

## 1.5 RESEARCH HYPOTHESIS

This empirical study is conducted to examine the effect of external environmental factors (PESTEL) on the strategic decisions and performance of the firms in RMG sector. Keeping in view the scope and objectives of the study following hypotheses are formulated and tested (Table 1.1).

**Table 1.1**  
**Hypothesis Summary**

<b>S#</b>	<b>Description</b>
1	<i>Age of the firm positively relates to firm's Performance</i>
2	<i>Developmental investment made by a firm positively relates to firm's performance</i>
3	<i>Management's belief (that PESTEL factors influence the firm's performance in all of the four perspectives of BSC) positively relates to firm's performance</i>
4	<i>Management belief mediates the relationship between age and a firm's performance</i>
5	<i>Management belief mediates the relationship between developmental investment and firm's performance</i>

Rationale of the hypothesis and substantiation is given in literature review in chapter 2.

## 1.6 RESEARCH METHODOLOGY

The theory is built upon intensive literature review on external environmental factors (PESTEL), age of the firms, developmental investment made by the firms, management belief and their relationship with firm's performance. Literature also discusses use of BSC for tracking the performance of the firms and some limitations in use of a single performance measurement system.

For testing of the theorized hypothesis, an empirical investigation through questionnaire based survey from the organizations heads has been conducted. The methodological detail about research design, data collection and the sample are presented in Chapter 3.

## 1.7 STRUCTURE OF THE THESIS

The structure of the thesis is given in Table 1.2 below. This gives a brief description of the topics covered in different chapters.

**Table 1.2**  
**Structure of the Thesis**

<b>Chapter No.</b>	<b>Title</b>	<b>Brief Description</b>
1	Introduction	Introduction starts with background of the study, variables, and aims and scope of the study. Chapter also presents objectives of the study; research hypotheses; research methodology and structure of the thesis.
2	Literature Review	This chapter makes literature review of strategy and firms; globalization and firm's strategy; environmental scanning, strategy and firm's <i>performance</i> ; PESTEL analysis to scan external environment; balanced scorecard for measuring <i>performance</i> ; <i>customer retention</i> and firm's <i>performance</i> ; firm's <i>age</i> and <i>performance</i> ; developmental investment and firm performance; and literature on management belief as a mediator is given in this chapter
3	Research Methodology	Research design; population and sample; data collection; measures and methods are discussed in this chapter
4	Analysis and interpretation	The data collected through survey is analyzed and the results are interpreted in this chapter
5	Conclusion	Chapter includes conclusion, study limitations, contribution to the research work, practical limitations and future direction

# CHAPTER 2

## LITERATURE REVIEW

### 2.1 STRATEGY AND FIRMS

Early significant work in the field of strategic management can be traced back to the research work started in Harvard Business School in 1960s and 1970s. Chandler (1962) examines the relationship between strategy, structure and performance. For Bracker (1980) strategic management involves analyzing firm's external and internal environment for maximizing the utilization of resources in relation to objectives. This statement of Bracker (1980) can be described as a macro definition of the concept of strategic management or business strategy. Strategic decision making is taken by Bourgeois (1980) at the heart of the organization-environment co-alignment process. According to Bracker (1980) strategic management is important for firms as it gives them a framework to develop abilities for anticipating and coping with environmental changes and help deal with uncertain future.

Many authors have failed to comprehensively investigate historical evolution of the concept of strategy (Bracker, 1980). Word 'strategy' comes from the Greek word "strategos" which means to "plan the destruction of one's enemies through effective use of resources". Strategies are recognized as ex-post facto which deliberate plans conceived in advance of the making of specific decisions (Mintzberg, 1978). The concept of strategy has remained prominent throughout the history in a political or military context (Bracker, 1980). In management theory strategy defined by Chandler (1962) is that "strategy is the determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals". In game theory strategy is defined as "a complete plan: a plan which specifies what choices (the player) will make in every possible situation" (Mintzberg, 1987).

As Bracker (1980) observes that first modern writers who related the concept of strategy to the business were Von Neumann and Morgenstern who presented their theory of games in 1947. After World War-II, according to Bracker (1980), the need for a concept of strategy related to business became greater as businesses moved from a relatively stable environment into a more rapidly changing and competitive environment.

Strategy reflects both long and short term responses of a firm to the challenges and opportunities posed by the business environment (Knight, 2000). He is of the view that an organization may find itself in a stable environment for many years but a sudden change in environment can become so turbulent that even the very best planning techniques can fail to predict the kind of unstable environment for the firm. Thus importance of use of information regarding business environment in strategy formulation is seen as important by researchers being aware of the turbulent environmental situations and their impact on the firm. Inconsistency in the environment is a phenomenon which managers need to always consider while formulating strategies. Managers must develop a suitable strategy, which is a long term plan, to set out that how objective of the firm will be reached (Oxford university, 2011). Inter-relations amongst various factors in the environment make strategy formulation a more challenging task for the managers.

## **2.2 GLOBALIZATION AND FIRM'S STRATEGY**

Firm's strategy in a global context is discussed by many researchers (Levitt, 1983; Porter, 1986; Yip, 1989; Douglas and Wing, 1987; Zou and Cavusgil, 1995; Peng and Delios, 2006; Peng and Pleggenkuhle-Miles, 2009). It was Levitt (1983) to make the term 'global' mainstream in the 1980s as firms were encouraged to 'go global'.

Yip (1989) defines global strategy as a multidimensional construct which postulate that the degree of a firm's global strategy depends on the industry's globalization potential as defined by market, cost, governmental and competitive factors.

Zou and Cavusgil (1995) still find a great deal of ambiguity about real meaning of global strategy in the literature. However, they attempt to define it as the way a business competes in the global market. They point out that presence of important interdependencies among a business's competitive position in different countries requires a firm to have a global strategy.

Defining global strategy, Peng and Delios (2006) explain that firms' strategy around the globe is focused on how to compete successfully and this broader definition build on the argument that what is international and what is domestic may become increasingly blurred (Peng and Pleggenkuhle-Miles, 2009).

Miles et al. (1978) argue that SMEs' success in large part depends on the formulation and implementation of strategy under globalization. Porter

(1986) recognizes the interdependency among various country markets and contends that a global strategy has two basic dimensions viz. configuration of value-adding activities and co-ordination of the activities across markets. A global perspective may help in the identifying opportunities for products and brands in global markets and integrating strategy across national boundaries to exploit potential synergies (Douglas and Wind, 1987). He is of the view that such a strategy will help in planning strategy on the basis of worldwide markets instead of planning on a country by country basis. Knight (2000) also finds that globalization has increased interdependence of national economies which involves not only consumers in the global markets but also suppliers, producers and the governments in different countries. It allows firms to increase their international profiles and sell and distribute their products and brands in international markets. As per Makki (2010) business environment is becoming very competitive in WTO setting and corporations need to improve their performance to remain viable.

Under globalization the role and importance of technology is emphasized in literature. Researchers are convinced that technology is a powerful force now which is resulting into emergence of global markets and driving the world towards commonality (Douglas and Wind, 1987). They find that technological advancement is growing integration of international markets, and also increased competition on a worldwide scale. They argue that adaptation of a global perspective requires examining alternative international strategic options and to make an effective global strategy. With globalization of markets, advancements in the areas of communication and transportation SME are looking for more opportunities in international markets (Oviatt and McDougall, 1994).

Globalization is being seen both as a threat and opportunity and importance of developing strategies to navigate towards firms' objectives is highlighted by many researchers (Cavusgil and Zou, 1994; Hitt et al., 1998; Knight, 2000; Greenaway et al., 2006). Along with threats and severe competition international expansion also provides new potentially more profitable markets and gives access to latest technology, new product and ideas and innovation in manufacturing, which will ultimately increase competitiveness of the firms (Cavusgil and Zou, 1994). Moving into new markets provides many opportunities, but at the same times also multiple challenges (Hitt et al., 1998). Researchers give much importance to the responsiveness of the management to the globalization challenges. Brooks and Weatherston (2000) argue that matching internal and external critical success factors is very important for generating effective strategies to respond changing environment under globalization. Kalim and Lodhi (2002) are of the view that world economies are opening, new products are entering into

the world markets, number of environmental variables with which a company has to deal have increased, which has exposed firms to higher risk and management is left with lesser timeframe to make decisions. Knight (2000) gives very much importance to the firm's response arising from globalization challenges. He is of the view that globalization evokes both threats and opportunities and a firm's response describes the extent to which they respond accordingly. Greenaway et al. (2006) find that globalization offers opportunities to firms, but also poses threats. Koo (2007) is of the view that uncertainty is increasing for the organizations and it is becoming important that business strategists understand and predict the business environment systematically and structurally. World Trade Report (2008) also recognizes globalization phenomenon. Report takes inter-dependency of the nations in trade as a complex phenomenon which involves economic, political, and social interaction both at nation and international levels.

### **2.3 ENVIRONMENTAL SCANNING, STRATEGY AND FIRM PERFORMANCE**

Firms don't operate their business in a vacuum as they are influenced by, and are also at the same time able to influence, the environment (Oxford University, 2011). Importance of scanning external environment can be related to the *management belief* concept that how these factors would impact firm's performance.

Importance of environment is very much emphasized in the literature and researchers have been studying managing both internal and external environmental factors and their relationship with firm performance. Environment has both threats and opportunities for organizations. Choo (1993) observes that several studies have reported a positive correlation between environmental assessment and organizational performance, and that information about the market and competitors is often positively correlated with organizational performance. Sharma and Vredenburg (1998) argue that a better environmental performance can provide competitive advantage to the firms to improve their financial performance (such as low cost and differentiation). Ebrahimi (2000) emphasizes that adapting environmental conditions and their monitoring can improve a firm's competitiveness, success, and even survival depend.

Duncan (1972) takes environment in totality of physical and social factors which are directly considered in the decision making behavior of individuals in the organizations. The seminal study on environmental scanning, published by Aguilar in 1967, defines environmental scanning as

scanning for information in a company's outside environment which would help top management in planning future course of action for the firms (Choo, 1993). The environment affects decision making of the management in organizations (Duncan, 1972; Pfeffer and Salancik, 1978).

Environment is important for managers, specially for the top management, as it creates uncertainty for them from information processing perspective (Daft et al., 1988). Scanning provides external intelligence to policy makers which they use in decision making, planning and formulating strategy (Meyer, 1982). Chief Executives are responsible for the organization/environment alignment in the firms and environmental scanning is important for their decisions as they can acquire of information about the environment (Daft et al., 1988).

Auster and Choo (1993) are of the view that scanning helps in seeking information about specific questions for decision making and also to look for new opportunities. Learning about market trends, new events taking place and their relationships thus becomes a critical information activity of Chief Executive Officers for planning.

Rose et al. (2010) are of the opinion that management can be guided in strategic decision making process by having essential information about firm's relative internal weaknesses and strengths and their resources. Oxford University (2011) takes business environment very important for the performance of firms and urges that managers need to constantly look at the environment and identify changes that can either possibly harm or value them. Past studies on scanning environment found that uncertainty perceived by the managers' increases with the complexity and variability of the environment (Auster and Choo, 1993). They think that those managers who perceive greater uncertainty in the external environment tend to scan more than before. Scanning enables the company to adapt to a changing environment (Choo, 1993).

## **2.4 PESTEL ANALYSIS TO SCAN EXTERNAL ENVIRONMENT**

As external environmental factors (which provide opportunities and also pose threat to the organizations) are becoming more complex, organizations need to monitor both internal and external factors and to incorporate them in their strategies. PEST, PESTEL or STEEP technique (latest variants of PEST) are being used by the firms for scanning external environmental factors.

PEST technique is being used by many firms for identifying and evaluating political, economic, social, and technological external factors; and ultimately opportunities and threats for the organization (Brooks and Weatherston, 2000). Firms require a functional tool such as the PEST or the extended PESTEL analysis which distinguishes between Political, Economic, Social, Technological, Environmental, and Legal factors and assist decision makers in the analysis of the general environment (Oxford University, 2007). The PEST analysis is important for identifying and examining the key external factors and to evaluate their impact on operations and success of an organization (Wanjare, 2008). Bivolaru et al. (2009) find PESTEL analysis to be a more systematic and detailed framework employed in strategic management. To scan external environment various approaches are being used, and the evolutionary changes include simple brainstorming along Social, Technological, Economical, and Political factors (i.e. PEST) or brainstorming along Political, Economical, Social, Technological, Environmental, and Legal (i.e. PESTEL) factors (Koo and Koo, 2007). Koo et al. (2008) also refer to five broad aspects for scanning external factors affecting the organization which include social, technological, economic, environmental and political factors (known as STEEP). Bitelmal (2010) consider PESTEL to be a reliable business tool to identify impact of different environmental factors on an industry as well as on individual firms.

Factors favorable to the organization are ‘opportunities’ and those which are unfavorable are ‘threats’ (Koo et al., 2008). Al-Rousan et al. (2009) assert that organizations must be capable to diagnose all aspects of internal and external environment. In a study of airport’s general environment Bitelmal (2010) finds that unlike the political and economic factors involved in the PESTEL analysis, the social and cultural factors involved can impact not only on the attractiveness of the product but can also determine what challenges the firm will face during the current time in operations (for example, getting and keeping workers or branding challenges due to customer attitudes). He is of the view that the use of tools such as the PESTEL analysis requires the considerations of a wide range of factors that can change at any time and this is an influential tool that proves to be useful in anticipating competitive challenges and can help managers better understand their external and internal environment.

Very recently Oxford University (2011) has studied relation between external environmental factors and firm performance. Explaining micro and macro environments study articulates that the micro environment includes both individuals and/or the organizations that a firm deals with including customers and employees, competitors, suppliers and distributors. Macro environment includes factors outside direct control of the business such as

government policy and economy, social changes in the environment and these factors can significantly affect success. Factors in the macro environment can affect the decisions of the managers, and also firm's performance. Macro environmental factors can include exchange rate which can affect a firm's ability to sell their products abroad, an increase in the interest in healthy food (such as organic food), ageing population (may result into increasing demand for healthcare resources, for example in Japan), demographic changes, changes in tax or trade barriers, and government policies. The study gives examples of some of the indicators of PESTEL factors which are as follows:

- Political: such as enlargement of the European Union, international trade and taxation policy, the Euro
- Economic: including interest and exchange rates, stock market, national income, unemployment and inflation
- Social: For example country's ageing population, income distribution in the society, and attitudes to work
- Technological: new product development and rate of technological obsolescence, Innovation
- Environmental: including environmental issues, such as global warming
- Legal: health and safety laws, employment law, competition law

To further understand the relationship of PESTEL factors with firm's performance, each of the factors is discussed below in detail.

### **2.4.1 Political Factors**

Political factors are one of the major determinants of firm's performance as political decisions affect both economic policies and business environment in the country. According to Hitt et al. (1998) economic change often result into bringing political changes as economic development creates needs and desires for business products and forces politicians to agree on new rules to do business and encourage further economic development and growth. One example of these new rules is the development of free trade agreements (e.g. GATT and NAFTA). Researchers articulate that opening of boundaries free trade agreements will open opportunities for those who are competitive both domestically and globally. Knight (2000) is of the view that with globalization boundaries between domestic and international markets are becoming less relevant and it has provided firms opportunities to increase their profiles abroad.

Yoganandan (2010) observes impact of political instability in Africa, and finds this case to be true in case of Pakistan. End of Multi Fibre Agreement (MFA) affected textile and clothing globally and he finds that post quota regime looking very attractive for Pakistan. But, according to him, there is need to move up the value chain to face renewed competition from India, China, Thailand and Indonesia for sustaining growth in Textile exports.

Government interventions reducing the profitability of investments have become a key political concern for investors (Buthe and Milner, 2008). Bitelmal (2010) finds that Political forces can have a direct impact on firms and industries. Uncertainties in future political and regulatory conditions, according to Ebrahimi (2000), are a great challenge for strategic decision makers.

#### **2.4.2 Economic Factors**

Economic factors have a major impact on the business environment and cost of doing business in a country. Economic factors may directly and indirectly impact performance of the firms and decision makers need to critically evaluate these factors while developing strategies. According to Johnson (1999) economic factors that could impact on a firm's performance include inflation, business cycles, interest rates, economic growth, unemployment, money supply, disposable income, energy availability and general income. Auster and Choo (1993) also observe that such economic factors which indirectly affect performance of the firms include inflation and interest rates, stock markets, government budget, unemployment in the country, and rate of economic growth.

New economic development and political rules (such as Free Trade Agreements) are providing opportunities to firms to enter into international markets (Hitt et al., 1998). He also found that for many countries Free Trade Agreements are one of the important factors for economic development and growth. Daft et al. (1988) find that economic, competitor and customer factors have generated greater strategic uncertainty than regulatory, socio-cultural and technological factors.

According to Grewal (2001) sooner or later economic crises can have a direct or indirect effect on almost every firm globally. They are of the view that decision makers need to develop an understanding of firm's capabilities to help manage crisis. Report by World Bank and IFC (2010) identify that global economic and financial crisis has resulted into fiscal constraints for

many and throughout 2009/10 firms around the world felt the repercussions in mostly high income economies and then it was spread as an economic crisis to many more. Report also point out that 1.9 million construction workers in USA lost their jobs as a result of the global economic crisis between December 2007 and January 2010. Thus impact of global financial crisis on industry and firm level was devastating.

As per Oxford University (2011) economic factors include interest and exchange rates, inflation, changes in taxation and trade policy, government intervention in economy and all these factors are important for a firm's macro environment. Higher interest rates may affect investment as it cost to borrow increases, a strong currency may affect exports, inflation may result into increase in higher wage demand and ultimately a raise in costs, and higher growth in national income may boost products' demand.

### **2.4.3 Social Factors**

There are a number of social and cultural forces that need to be considered by decision makers while making business strategies. Daft et al. (1988) are of the view that social demographics may affect the organizations. Hinings and Greenwood (2002) believe that corporations (and firms) draw resources from society and their duty to society goes beyond simply maximizing the wealth of their equity holders. Bakshi and Chen (1994) find that demographic changes impact aggregate consumption, savings, labor supply and social programs. In Japan, for example, the problem of ageing population has become a serious issue. Governments globally are developing new policies as to how demographic changes can be effectively handled. With decrease in labor population, including children and youth, burden of pension and welfare cost is shifted to the government in Japan. Change in demographics situation has also changed demand for certain products in the local markets. Size of the market for children products has decreased. The ageing population has increased demand for sheltered accommodation, medicines etc. In case of Pakistan youth is one of the major chunks of the population.

With increasing awareness amongst people about their rights and role of the firms (especially corporations) pressures from the community, social organizations, buyers, suppliers and government is increasing day by day. Auster and Choo (1993) have emphasized importance of socio-cultural aspects which includes social values, ethic at work place, and demographic trends. They also believe that firms need to adapt to turbulent environments. Nadvi and Thoburn (2003) observe that standards for labor conditions,

environmental impact and social and ethical concerns in production are now part of either formal 'rules' or a necessary 'voluntary' requirement to access international trade markets.

Peng and Pleggenkuhle-Miles (2009) observe that globalization and trade liberalization has also affected labor market conditions all over the world. Movements of labor across borders has changed international social values, life style, habits and tastes, income distribution and a global labor market has been seen emerging all over the world.

Bitelmal (2010) argue that unlike the political and economic factors involved in the PESTEL analysis, the social and cultural factors involved can impact not only on the attractiveness of the products but can also determine what challenges the firm will face during the current time in operations (for example, getting and keeping workers or branding challenges due to customer attitudes).

Studying airport industry Bitelmal (2010) finds that while demographic factors are important, social and cultural differences, educational levels, lifestyles, and attitudes toward work as well as levels of consumerism are all factors that would play important role in the overall competitive environment. He also observes that demographic and population factors important for the airport industry as such factors drive consumer demand.

Managers need to take into account social factors while making strategies for product development, adopting procedures and developing marketing strategies, and more importantly while selecting target markets and segments (in domestic and international markets) as these social factors can pose threats to their performance as well as provide opportunities.

#### **2.4.4 Technological Factors**

Technology is seen as one of the important factors for the growth of the firm and researchers find it as a key determinant to face future challenges (Porter, 1990; Zahra, 1996). Douglas and Wind (1987) give great importance to technology and observe that globally standardized products are emerging in global markets. Hitt et al. (1998) give importance to technological revolution and globalization and argue that firms must develop new strategies to deal with new competitive landscape.

According to Porter (1990) technology acquisition enables the firms to compete more effectively. He has taken innovation as the firm's ability to be

competitive and viewed it as an advantage for companies in this globalization era. He takes advanced technology as a key factor for firms which enable them to innovate and respond to changing external environment conditions.

New technologies create new products and new processes. Technology and innovation enables firms to respond to changing external environmental conditions (e.g. Miles et al., 1978; Porter, 1990). Thanks to the technological advancements that everyone is aware of what is produced in other parts of the world and can have access to these products and services. Levitt (1983) argues that advances in communication, transportation technologies and worldwide travelling have homogenized world markets. People sitting in UK can buy any product from a US shop with a click of the mouse using e-commerce facilities.

Technology has reduced cost of transportation and time, improved product shelf life, aesthetic value and functional properties. Perishable goods are being transported to far-fetched areas using high speed transportation technologies. We can find fruits and vegetables being grown even in off seasons. Fruits and vegetables are available across the year due to modern storage facilities. We can talk to our families using mobiles, Skype and other telecom facilities. According to Zou and Cavusgil (1995) usage of new technologies has also provided opportunities to smaller companies to operate internationally.

More SMEs are pursuing opportunities globally due to advancements in communication and transportation technologies, globalization and other factors facilitating doing business (Oviatt and McDougall, 1994). Improvement in telecommunications and logistical systems has reduced the distances for everyone. Importance of improvement in telecommunications and logistical systems is studied in by many researchers (for example Douglas and Wind, 1987; Zou and Cavusgil, 1995). Advancements in telecommunication and information technologies have also helped in reducing physical and virtual distances between markets (Cairncross, 1997). Authors are writing much about importance of internet and the power of virtual space over physical distance (Zou and Cavusgil, 1995). As per Knight (2000), technology has increased automation and as a result flexibility and productivity of the firms has increased which has made them more globally competitive.

Winer (2001) believes that the information technology revolution and, in particular, the World Wide Web has enabled firms to respond more effectively to customer needs and requests and improved interaction.

R&D strategy is one of the important tools for a firm to respond to globalization challenges. Researchers emphasize on investing in R&D to face the challenges of globalization (e.g. Porter, 1990; Zahra, 1996; Knight, 2000). As per Porter (1990) companies need to invest on new technologies which require proper investment and R&D strategy to produce such goods which are competitive not only in domestic markets but also globally. Shrinking product life cycles are also forcing firms to invest in R&D, accelerate innovative work and capabilities and accordingly respond to challenges of globalization. Zahra (1996) emphasizes that investing in R&D is important for firms to improve their performance and to compete in globalization era. Oxford University (2011) states that new product development requires investing in R&D and innovation.

#### **2.4.5 Environmental Factors**

Compliance to social and environmental standards and regulations is very important to operate not only in domestic markets but also globally. Compliance concerns, especially with global ethical and labour standards is especially marked in the textiles and clothing industry (Nadvi and Thoburn, 2003). Nadvi and Thoburn (2003) find that compliance concerns, especially about global ethics and labour standards, are increasing in textile and clothing industry. According to them, international standards are being driven by not only governments at national and international levels but also by international private actors including consumer groups, corporate sector and also local and international NGOs. They believe that in textile and clothing, there are many trade related pressures on international supplier, either part of the formal 'rules' governing international trade or necessary 'voluntary' requirement, to comply with global process standards including standards for environmental impact or labor conditions etc.

Hart (1995) observe that awareness for environment friendly products and processes is increasing which not only affect global demand patterns but also creating new business opportunities for firms. People are now more concerned over issues that have a great impact on the environment and thereby on people's lives such as global warming, increase in pollution, waste disposal, conservation of energy, shortage of drinking water and other scarce resources.

Since the publishing of 'Brundtland Commission Report' in 1987 by World Commission on Environment and Development, corporate managers and researchers are focusing more on environmental issues in strategic decision making (Sharma and Vredenburg, 1998). Several studies have found

that customer concerns motivated firms to adopt environmental management practices (Anderson et al., 1999). Christmann and Taylor (2001) believe that it was the pressure of customers in developed countries which influenced Chinese firms to improve their compliance to environmental standards and adopt ISO 14001 EMS standard. Delmas (2002) also finds that role of the governments is also very important in forcing firms' to adopt ISO 14001. With weather extremes globally people are focusing more on environmental compliance, and this concern is seen to be more dominant in developed countries.

Delmas and Toffel (2004) observe that amongst other stakeholders, local communities, non-government organizations, and various government bodies influence firms' for adoption of environmental standards and regulations. Several studies have found that industry's associations have motivated firms to adopt environmental management practices (Delmas and Toffel, 2004).

Borial (2006) reports that environmental intelligence tool provide information and resources related to new environmental policies concerning various sectors. He finds that commitments to environmental issues (e.g. global warming and greenhouse gas emissions) are important for firms and have also resulted in many innovative initiatives. In a study conducted in 2004 in top 500 companies in the world, Borial found that 80 per cent of respondents considered that global warming regulations will affect working of their firms. He observes that people in society do not want to have just the basic requirements of life; they also desire to achieve the highest standard of living and quality of life. He observes that buyers, especially in developed countries, demand strict environmental compliance which increases cost of doing business.

Compliance to global standards can raise cost of doing business. The need for regulations to protect the environment and make planet livable is getting widespread, but it can increase industrial cost and product prices and competitiveness of the firms can reduce (Porter and Linde, 1995). Cost concerns are important for the firms as these are detrimental to compete in a world where product price can affect sales. But according to Nadvi and Thoburn (2003), leading brands still consider compliance to environmental, social and labour standards for selecting suppliers.

Compliance to environmental standards and technical regulations are being strictly observed in many developed countries now and it is becoming a pre-requisite for firms to export their products to these markets. Oxford University (2011) also points out that interest of firms in Corporate Social

Responsibility (CSR) is still high and role of a business as a citizen within society is crucial.

#### **2.4.6 Legal Factors**

Legal factors are important for firms in both domestic and international markets. In international markets WTO laws govern international trade and policies. Laws and regulations help in protecting both firms and consumers and at the same time may also create hurdles in firm's growth. Bitelmal (2010) finds that a number of regulations may affect the performance and the profitability of firms in an industry. Zou and Cavusgil (1995) think that regulatory differences between countries are important for firms to sell their products. Report by World Bank and IFC (2010) also recognizes that doing business requires good rules for the firms.

Study by Claessens and Laeven (2003) found that countries having better legal systems are good for financial sector to perform and they find it easier to attract external financing. They also acknowledge importance of a good legal framework and property rights for economic growth of countries.

Looking at country-wide institutions Dabla-Norris and Inchaust (2007) investigate that higher regulatory burden reduces firm growth. World Bank and IFC report (2010) points out that good labor regulation can improve worker protection, increase productivity, help in promoting new businesses, help shift workers to the formal sector and also boosts economic growth.

Oxford University (2011) reports introduction of various laws in UK, such as age discrimination and disability discrimination legislation, minimum wage and recycle. Report also states affect of these recent laws on organization's action and costs. Some of the different categories of law as reported in Oxford University (2011) report include consumer laws (to protect customers against unfair practices), competition laws (aimed to protect small firms from larger firms), employment laws (such as working hours, minimum wages, dismissal of workers, protecting employees against the abuse by managers), health and safety legislation (to ensure a safe workplace). Whether to operate in domestic or international markets (across country border), firms need to understand the legal framework and those factors which are specifically related to their business environment.

## 2.5 BALANCED SCORECARD FOR MEASURING PERFORMANCE

Robert Kaplan and David P. Norton developed BSC in 1992 at Harvard Business School which provides four perspectives for strategy formulation and to measures performance. Kaplan and Norton (1992) gave much importance to vision and mission by explaining that organization's vision paints the picture of the future and mission tells that why organization exist. Kaplan and Norton (2005) recognize that company's strategy must keep up with the changing competition. They also argue that traditional financial performance measures don't fulfill requirements of the management today. They are of the view that no single measure can provide a clear performance target to the decision makers. They urge for a balanced presentation of both financial and operational measures for managers for developing a strategy. Following are four perspectives of BSC and attempt to answer the following questions:

Financial perspective:	How do we look to shareholders?
Customer perspective:	How do customers see us?
Internal perspective:	What must we excel at?
Innovation and Learning:	Can we continue to improve and create value?

Kaplan and Norton (1992) make the analogy between BSC and cockpit of a plane. To navigate and fly a plane, pilot needs information about many aspects such as altitude, fuel quantity in the airplane, speed of the air in atmosphere, predicting environment, and destination to keep flight on the right direction using navigation system. Kaplan and Norton (1996 b) introduce the concept of leading (or driving) indicators and lagging indicators as they are of the view that traditional financial measures tell the story of the past.

BSC is a strategic management tool and performance measurement system (Rodriguez, 2008). BSC is found to be well-known in the field of operations management (Bourne et al., 2000) and also in general strategy perspective (e.g. Mooraj et al., 1999; Hudson et al., 2001). BSC is being used in most of the Fortune 500 companies (Suleiman, 2006). He also points out 64 percent of U.S. companies also using some form of BSC framework as a performance measurement and strategic management tool.

Like other strategic frameworks, BSC has also received criticism from the researchers. While making strategy, scanning of the environmental factors are very important for which SWOT analysis is made by the strategy makers to find opportunities and threats. According to Neely et al. (1995) BSC didn't answer that "what are the competitors doing?" and fails to focus on competitors. Bourne (2002) also criticizes that BSC excludes people and suppliers and ignores competitors and regulators. Mooraj et al. (1999) point out that BSC fails to consider the extended value chain. They also find that BSC focuses primarily on top-down performance measurement and fails to identify performance measurement as a two-way process. According to some researchers environmental and community/ social issues are missing in BSC (e.g. Bourne, 2002; Marr and Adams, 2004). For example Mooraj et al. (1999) criticize BSC that the role of the community in defining the environment, within which the company works, is not defined. According to Marr and Adams (2004), learning and growth perspective of BSC has been considered its weakest aspect for a long time. They also report that authors admit this fact. An interview conducted by De Waal (2003) reports that Robert Kaplan acknowledges flaws in BSC framework and also weakness in knowledge of their measurement techniques. Researchers have also found concept of causality missing in BSC.

## **2.6 CUSTOMER RETENTION AS FIRM'S PERFORMANCE**

*Customer retention* is seen to be one of the important indicators for the firms' performance. Various international researchers have labored on issues associated with customer satisfaction, loyalty, retention and firm performance (e.g. Reichheld and Sasser, 1990; Fornell, 1992; Hallowell, 1996; Bolton et al., 2000; Winer, 2001; Hogan et al., 2003; Gustafsson et al., 2005). Johnson and Fornell (1991) take customer satisfaction as overall evaluation of the performance of an offering to date.

Daft et al., (1988) find that customers and competitors may affect performance on a day today basis. Rust et al. (1995) find link between *customer retention* (or repurchase intention) and overall satisfaction measures. Researchers also find mediating effects of customer satisfaction on loyalty (e.g. Bolton and Lemon, 1999; Fornell et al., 1996). Other studies also find moderating role of age, product usage, variety seeking, knowledge of the consumer, and socio-demographics characteristics between satisfaction and customer loyalty relationship (Capraro et al., 2003; Mittal and Kamakura, 2001). Su (2004) find service quality and customer satisfaction important for *customer retention* and firm's competitive performance.

How much funds companies spend and/or focus for the customers' acquisition versus retention activities, Winer (2001) takes it as an important consideration. According to him, there are more choices today for the customers and their retention must receive a high priority in service delivery.

Gustafsson et al., (2005) study telecommunications services and examine the effects of customer satisfaction, and effective and calculative commitment on customer retention. They emphasize to improve product or service quality or offer better prices and efforts for improving customer satisfaction, whether competitors are doing the same or not.

A large scale survey of telephone users in UK also find that perceptions of service quality have a direct linear relationship with *customer retention* (Ranaweera and Neely, 2003). Reichheld and Sasser (1990) find that as customer's relationship with the company grow longer, profit rises. They also find that longer relationships can boost profits by almost 100 percent by retaining just 5 percent more of their customer. They are of the view that companies don't know how much it costs to lose a customer. Capturing value of a loyal customer today is difficult using conventional accounting systems. They also find another advantage of long time retention of customers that companies can charge more for their products or services.

Anderson et al., (1994) find positive relationship between increasing customer satisfaction and future profitability. They give example of a restaurant to explain cumulative value of a loyal customer to a firm. Three colleagues take meal at a restaurant close to their workplace with average price of \$6 and give annual revenue around \$2700. They estimate that 100 similar loyal customers would be worth \$ 90,000 to the restaurant and it would be worth almost a half million dollar over next five years. Thus they conclude that customer satisfaction and long term retention of loyal customer improve profits of the firms.

Fornell (1992) enumerates several key benefits of high customer satisfaction. Anderson et al., (1994) finds that higher customer satisfaction should increase loyalty (Anderson et al., 1994). Many researchers find that customer satisfaction affects customer loyalty, and ultimately firms' profitability (e.g. Anderson et al., 1994; Rust et al., 1995). Customer satisfaction and service quality are found statistically related to *customer retention* and market share (Rust et al., 1995). Hallowell (1996) observes links between satisfaction, loyalty, and profitability. He observes relationship of customer satisfaction to profitability and retention in hospitals and retail banking. Customer satisfaction has a strong positive effect on customer loyalty (Fornell et al., 1996). Ittner and Larcker (2003) also find positive

relationship between customer loyalty measures, higher profits and shareholder value. Bolton et al. (2000) show that loyalty programs have a significant, positive effect on *customer retention* and/or service usage. Verhoef (2003) also find direct effects of affective commitment on both relationship maintenance (i.e. customer retention) and relationship development (share of a customer's business).

Customer defection is defined as a situation in which a customer switchover to another firm for their purchases which result losses to the first firm (Hogan et al., 2003). Customer defection is seen to be a big loss for the firm as profit making potential goes along with them (Reichheld and Sasser, 1990).

Positive word of mouth is taken as one of the important indicators of customer loyalty and satisfaction. Satisfied customers are likely to engage in positive word of mouth (Reichheld and Sasser, 1990) and as a result new customers are attracted, customer retention level increases and revenues and market share go up (Rust et al., 1995). Customer satisfaction results into increased loyalty which can be reflected in firm's financial performance (Bernhardt et al., 2000). Customer defection has not only directly affect on purchases but also has indirect affect in the form of word of mouth, imitation, and other social effects which influence even future customer acquisitions and loss to the firm (Hogan et al., 2003).

In context of export of clothing sector, *customer retention* is one of the major challenges for the exporters. Customers are well aware of various brands available in the markets. Competition from both domestic and international competitors is very high in this sector. Nadvi and Thoburn (2003) find the 'new' competition in global textiles and clothing sector shaped by phase out of the MFA and competition from China. There are large numbers of international suppliers in textiles and clothing sector offering variety of products and *customer retention* is a major challenge for a firm in such a scenario.

## **2.7 FIRM AGE AND PERFORMANCE**

Loderer and Waelchli (2010) take measures of *age* as the age of legal entities. They observe that most studies that look at firm's *age* measure age in the same way (including Fama and French, 2004; Chun et al., 2008).

Study by Evans (1986) find that firm's age is an important determinant of the growth of the firms. They find that the probability of firm's survival

increases with firm's size and age. They find positive relationship between survival and age, and observe that variability of firm's growth decreases with firm's age. One stream of research suggests that older firms have more experience and enjoy superior performance (Majumdar, 1997). He also finds another equivocal theory and stream of research which suggests that older firms are prone to inertia, bureaucratic, and thus unlikely to have the flexibility to make rapid adjustments to changing circumstances. He finds that larger firms in India are less productive, but more profitable. Conversely, in comparison with younger firms, he finds older firms to be more productive and less profitable.

According to Farinas and Moreno (2000) failure rates and the mean growth rate of successful firms decline with size and age. Relation between firm's age and profitability is found to be significantly inverse, in spite of how profitability is being measured (Loderer and Waelchli, 2010).

Huergo and Jaumandreu (2003) find somewhat lower probabilities of introducing innovations in oldest firms than entrants. They also find that firms above intermediate ages between 20 to 36 years are almost as active as entering firms and even more in product and process innovations.

To respond to the problems faced due to aging of the firms Lee (2006) observes that firm performance also tends to decline with age but improve with more investment in capital.

## **2.8 DEVELOPMENTAL INVESTMENT AND FIRM PERFORMANCE**

According to Douglas and Wind (1987) technology is resulting into emergence of global markets. Advancement especially in the fields of information technology and telecommunication has brought the world closer. To respond to globalization and external environmental challenges (which have opportunities and threats) firms need to make *developmental investment* (DI) (taken as investing in R&D, technology up-gradation and training & skill development).

Globalization is being seen as an opportunity in international expansion as it gives access to latest technology, new product ideas, helps in increasing competitiveness of the firms and provides new markets (Cavusgil and Zou, 1994). Investment in R&D can improve performance of the firms affected by globalization (Zahra 1996). Knight (2000) also emphasizes upon

technology acquisition and investing in R&D to improve their products and making them globally competitive.

In a globalized world, firms need to be competitive both domestically and globally. Along with technology, importance of skill development and training is also emphasized in the literature. A number of studies have estimated positive impact of training on organizational productivity (Bartel, 2000).

## 2.9 MANAGEMENT BELIEF AS A MEDIATOR

*Management belief*, a new concept used in this study, explains how management perceives the relationship between external environmental factors and their impact on firms' performance. The variable represents the 'belief of the management that the factors under PESTEL viz. political, economic, social, technological, environmental and legal can have a significant effect on the firm's performance which is reflected under four perspectives of the BSC viz. financial, customer, internal business process, and innovation and learning. Choo (1993) finds a growing awareness of the importance of the environmental information that external scanning increases with environmental uncertainty, information about the market and competitors are the most important, and that scanning is often positively correlated with organizational performance. Firms manufacturing and exporting readymade garments and competing globally can be affected by the PESTEL factors. This realization of uncertainty of external environmental factors requires management to take external events important for the performance of firms and this behavior may lead them to scanning behavior, as observed by Pfeffer and Salancik (1978).

*Management belief* concept emphasize upon investing in R&D and skill development to respond to the challenges in external environmental factors and their impact on the performance of the firms. Technology acquisition enables management to advance corporate objectives (Knight, 2000) and investing in R&D helps in facing globalization challenges and improve performance (Zahra, 1996). Bartel (2000) also find positive impact of training and development on organizational productivity.

Mediation of *management belief* in context of *age-performance relationship* is discussed in this study. Majumdar (1997) reports that older firms are more experienced and, therefore, enjoy superior performance. The *management belief* concept makes an argument that those older firms having better understanding of the external environmental factors can make better

strategy to respond to globalization challenges and improve their performance. *Management belief* concept explores relationship between age and firm's performance in a different context where management belief mediates between *age-performance* relationships.

# CHAPTER 3

## RESEARCH METHODOLOGY

The researchers use several methods to obtain relevant research material on the subject. Help is taken from different researchers from within the countries and abroad, libraries are visited, and publications from various research databases are obtained by using internet search engines. The researcher has also been able to enrich the study from cross discipline discussions. Survey is conducted using questionnaire to gather opinion from CEOs of the firms in RMG sector engaged in manufacturing-cum-export business. Industry visits are made before developing instrument and discussions are made with CEOs of some of the selected units. The questionnaire is finally tested before the final survey.

Research methodology involves efforts pertaining to theory and developing research measures. Empirical survey aims to validate proposed measures and investigate relationship between independent and dependent variables, and role of some mediating variables in this relationship. To develop measures and basis of theory, extensive literature review is made. Research involves searching on the search engines the key words like PESTEL, Balanced Scorecard, firm performance, customer retention, firm age, R&D, technology, skill development and firm strategy. Citations of the relevant published papers are also found to be very helpful for research.

### 3.1 RESEARCH DESIGN

#### 3.1.1 Purpose of the Study

An exploratory research is undertaken to ascertain and describe the characteristics of variables in the study. The study comprehends the relation between construct for *developmental Investment* and *management belief*, external environmental factors (PESTEL), firm strategy, firm *age* and *performance* of the firm. None of the studies has been conducted on Pakistan's textile and apparel in the past. The study explores the literature on combined used of BSC and PESTEL analysis to formulate firm's strategy and track performance.

Study engages in hypothesis testing to explain relationship between different independent variables (i.e. *management belief*, PESTEL factors,

*developmental investment, age*) of the study and dependent variable (firm performance – taken as *customer retention*). Mediating role of *management belief* and *developmental investment* on firm *performance* is also empirically investigated.

### **3.1.2 Unit of Analysis**

Unit of analysis in the study is individuals, i.e. CEOs of the firms, or any senior management officer designated by the CEO. Field visits to the firms during pilot studies reveal that the strategy in firms in RMG sector is made by the CEOs of the firms. In some of the cases, especially in case of medium and large size firms, top management is also consulted by CEOs during the process of strategy formulation, but ultimately it is CEO who finalizes the corporate strategy.

### **3.1.3 Study Setting and Interference of the Researcher**

The study is conducted in non-contrived setting. Correlation study is conducted in the natural environment with minimal interference and in the normal flow of the work in these firms. Two pager questionnaires is used for data collection from CEOs and there is minimal interference in routine functioning of the firm's operations as time given for filling the questionnaire is flexible.

### **3.1.4 Time Horizon**

Data is collected from the manufacturing-cum-export firms registered with PRGMEA, Lahore at one point in time which is sufficient based on the objectives and purpose of the study. Cross-sectional design is adopted for the study.

## **3.2 POPULATION AND SAMPLE**

### **3.2.1 Population**

Manufacturing-cum-export firms in RMG sector registered with Pakistan Readymade Garments Manufacturers & Exporters Association (PRGMEA), Lahore is the target population for the study. PRGMEA is the representative body of the manufacturers-cum-exporters in RMG sector in

Pakistan which is registered as an Association with the office of Director General Trade Organizations, Government of Pakistan. Member firms are engaged in manufacturing-cum-export of readymade garments (Woven, Denim and Knitted) mainly to United States of America (USA) and European countries.

A complete list of registered member firms is taken from PRGMEA, Lahore. Product-wise distribution of the population is presented in Table 3.1 below. There are 88 firms registered with PRGMEA, Lahore out of which 42 firms are engaged in manufacturing-cum-exports of Woven garments, 9 firms deal in Denim, 20 in Denim & Woven garments, 7 firms in Knitted garments and 10 firms deal in business of Woven and Knitted garments. Maximum firms in the study sample are engaged in manufacturing and exports of Woven garments.

**Table 3.1**  
**Product-wise Population Distribution**

<b>Product Type</b>	<b>Frequency</b>
Woven	42
Denim	9
Denim and Woven	20
Knits	7
Woven & Knits	10
<b>Total</b>	<b>88</b>

### 3.2.2 Sample

Sampling is not done for the study and all 88 firms are targeted in the survey. Out of total respondents, 34 firms returned filled questionnaires after continuous follow up and reminders through e-mails and phone calls.

### 3.3 DATA COLLECTION

A survey questionnaire (at annexure- A) designed carefully for this purpose has been used for data collection. Data collection involves designing of the questionnaire which is validated through a pilot study and careful administration in collecting data with reliability.

### 3.3.1 Pilot Survey

Before launching a full-scale study on the subject it deems necessary to conduct a pilot survey to testify the effectiveness of the instrument, measures and statistical methods. It also deems fit to identify actual problems before hand and make necessary amendments in the instrument and methodology to be adopted.

Selected firms in the population are visited and discussion made with the CEOs and top management to take help in designing the questionnaire. It has become clear during the discussions that in most of the firms CEOs of the firms are the final authority to take decisions on the firms' strategies.

Questionnaire is designed very carefully after visits to the selected firms and discussions with their top management. A great amount of time and energy is invested to reach the final draft. The questionnaire is developed by going through a three phase process. The first phase involves visits of the randomly selected units to observe type of work, production processes and type of products being produced for exports to the target markets. All the firms registered with PRGMEA, Lahore are manufacturing and exporting garments to international brands mainly in USA and European countries. In the second phase, interviews of selected CEOs and top management are made to take input on the subject for designing questionnaire. In the third phase, a questionnaire is developed for pilot testing so that necessary adjustments may be incorporated before circulating the questionnaire.

Pilot survey is conducted to identify structural, sequential and linguistic problems of the questionnaire. Six member firms from the target population are randomly selected and CEOs/ top management of these firms are asked to fill the questionnaires. Questions from 11 to 14 are used to measure the impact of PESTEL factors on firms' performance under four Balanced Scorecard perspectives. Feedback from the CEOs and top management of the firms helped in identifying performance indicators for the survey. One of the senior research members of the PRGMEA suggested including type of the products being exported by the firms, which was duly incorporated in the final questionnaire.

Two senior academicians also checked the questionnaire and suggested modifications. The study helped in understanding certain practical problems in advance which are likely to be faced. The study helped in knowing the problems faced by respondents about verbal explanation, use of terminology and rephrasing some of the questions. One of the head of the department of

management sciences in a reputed educational institution in Islamabad was also requested to fill the questionnaire and give feedback.

On the basis of feedback from the respondents of the pilot study necessary sequencing is changed, questionnaire is reworded, rephrased, combined or otherwise eliminated. On the basis of this pilot study it is found that the methodology is quite effective. The data collected for this pilot study is not used in the final analysis.

### **3.3.2 The Questionnaire**

The final questionnaire (at annexure -A) is developed by incorporating the information collected during the earlier phases of literature review, visits of the firms, observation, semi-structured interviews and pilot testing. To help readers understand the sequencing of the questions and relation of various variables all the questions are grouped under following three sections.

#### **Section one (item number 1 to 5):**

This section takes into account the basic organizational characteristics. Questions in order of occurrence in the questionnaire covered in item number 1 to 3 are listed below:

1. Name of the firm
2. Year of establishment of firm
3. Number of employees (i.e. size of the firm)

Year of establishment of firm is one of the important variables of the study which determine the age of the firm, taken from the day of the establishment of the firm or listing/registration with the concerned government agency.

Size of the firm is measured in terms of number of employees a firm has. In order to categorize the firms as per their size (i.e. number of employees) we have divided them in four main age classes. Using the definition of European Commission (2005) following four categorizes are adopted to explain size of the firm on the basis of number of employees, which is as follows:

- i) 'Micro Firms' which employ fewer than 10 persons

- ii) 'Small Firms' which employ more than 10 and less than 50 persons
- iii) 'Medium Firms' which employ more than 50 and less than 250 persons
- iv) 'Large Firms' which employ more than 250 persons

In this study only permanent employees are taken to measure the size of the firm. Employees hired/recruited for short term service contracts or on daily wage basis are also excluded. In actual reporting by the firms same measurement methods is being adopted in which only permanent employees are taken as the actual size (employee strength) of the firm.

Questions covered in item number 4 to 5 in order of occurrence in the questionnaire are listed below:

- 4. Type(s) of product(s) being exported
- 5. a) Presence of formal strategy  
b) Main emphasis of firm's strategy

Type(s) of product(s) manufactured and exported by the sample firms are inquired in the survey. Firms in RMG sector are engaged in manufacturing and export of three major product types which are as follows:

- 1. Woven garments
- 2. Denim garments
- 3. Knitted garments

Types of products manufactured and exported pertain to the basic characteristics of the business domain. There are many such firms which are also manufacturing and exporting more than one type of products to international markets. It is found during field visits and during discussion with the representatives of the association that all PRGMEA member firms deal in any one of the following product types/line, or a combination of two products:

- 1. Manufacturer-cum-exporter of Woven garments
- 2. Manufacturer-cum-exporter of Denim garments
- 3. Manufacturer-cum-exporter of Knitted garments
- 4. Manufacturer-cum-exporter of Denim and Woven garments
- 5. Manufacturer-cum-exporter of Woven and Knitted garments

Presence of a formal or informal strategy is also inquired in the survey (item number 5 of the questionnaire). There are many such firms which don't

have a formal strategy, but all of them follow an informal strategy to make corporate decisions.

An emphasis on firm's strategy is linked with the *developmental investment* made by the firms. It may be argued that a firm focusing on *growth strategy* will have higher *developmental investment* than the firm following *downsizing strategy*.

### **Section two (item number 6 to 7):**

Item '6 a' is about the exports made by the firms in last four years i.e. 2007 to 2010. In data collection most of the firms didn't report export data as they are reluctant to share their export value and quantity. Moreover, some of the firms provided export figures, but is not verifiable from some authentic source.

Item '6 b' is about the percentage of profit spent by the firm as *developmental investment*. It includes profits spent on technology up-gradation, R&D and training & skill development.

Item number '7' in the questionnaire pertains to the *customer retention* by the firms in percentage value in last three years.

### **Section three (item 8 to 14):**

This section can be grouped into two different sets of items.

First set is grouped as "PESTEL Consideration" which consists of items 9 and 10. PESTEL consideration explains the importance of external environmental factors for firm and consideration by management in firm's strategy formulation. Item number 8 of the questionnaire inquires that how external environmental factors (PESTEL) are important to the firm's performance?

Second set of variables include item number 11 to 14 which are grouped under the variable *management belief*. All the 16 items of *management belief* are grouped together against each of the four perspectives of BSC. Table No. 3.2 below shows each of the sub-items under item number 11 to 14 showing grouping against all the four perspective of the Balanced Scorecard.

**Table 3.2**  
**Sub-items under Item Number 11 to 14 grouped**

<b>Sr. No.</b>	<b>Item # in the questionnaire</b>	<b>Sub-items under question 11 to 14</b>	<b>Group for each of sub-items (i.e. four groups under BSC)</b>
1	11	a. Financial Perspective	Financial perspective
		b. Customer Perspective	Customer perspective
		c. Internal Business Process Perspective	Internal Business Process Perspective
		d. Innovation & Learning Perspective	Innovation & Learning Perspective
2	12	a. Return on Investment	Financial perspective
		b. Customer Retention	Customer perspective
		c. Product Development Cycle	Internal Business Process Perspective
		d. Time to develop next generation products	Innovation & Learning Perspective
3	13	a. Revenue Growth	Financial perspective
		b. Share of segment	Customer perspective
		c. Engineering efficiency	Internal Business Process Perspective
		d. Human capital readiness	Innovation & Learning Perspective
4	14	a. Sales Margin	Financial perspective
		b. On-time delivery	Customer perspective
		c. Supply chain cycle efficiency	Internal Business Process Perspective
		d. Performance trajectories of competing technologies	Innovation & Learning Perspective

### **3.3.3 Administration of the Instrument**

Questionnaires are sent to all the firms registered with PRGMEA, Lahore through postal services and/or e-mails. Sampling is not done for the study and all 88 firms have been targeted in the survey. After follow-up efforts 34 respondents (with a 39 % response rate) returned the completed questionnaires.

### **3.4 MEASURES AND METHODS**

Measures and scales are carefully established to measure the study variables as explained below. We could not find any old measures suitable to this study dealing in manufacturing and exports of readymade garments. No study has been conducted on RMG sector in the past to assess relationship of external environmental factors and firm's performance. Measures are developed based on literature review, discussions and input taken from the industry professionals and researchers. Variables of the study are measured using method as explained in next paras.

Validity, the absence of systematic errors, is essential aspect of the study to be considered. Care is made in designing the questionnaire before and after the pilot study. To ensure the content validity, special care is taken in selecting the words, terminology and phrases, and simplicity is emphasized in designing the questionnaire. As all the firms in the population are engaged in manufacturing-cum-export of garments to the international markets they understand the English language and terminologies used in the questionnaire, which is further improved through pilot study.

Reliability, the absence of random errors, is also considered in the study. The instrument and design of study are stable and consistent, hence able to eliminate influences of unsystematic bias measures.

#### **3.4.1 Firm's Performance**

To measure firm's performance, the percentage of *customer retained* successfully during the last three years by a firm is taken as a proxy in this study. To measure *customer retention*, firms are asked to report the percentage of customer they could successfully retain in last three years. The value in percentage gives the mean of all the buyers retained successfully by the firm.

#### **3.4.2 Age of the Firm**

Age of the firm is measured in number of years. The firms reported their year of establishment, or listing/registration with the concerned government agency. The similar approach has been used by Loderer and Waelchli (2010). The age of the firm is computed as the difference between the year of study and the year a firm is registered/listed with concerned

government agency. Firms are divided in following five age classes as per the categorization used by Farinas and Moreno (2000).

- i) less than or equal to 5 years,
- ii) 6 –10 years,
- iii) 11–25 years,
- iv) 26 –50 years and
- v) more than 50 years.

### **3.4.3 Developmental Investment**

*Developmental investment* is taken as the investment made by the firms on *technology up-gradation, R&D and training & skill development*. Firms are asked to report percentage of total profit they spent on all the three sub-items during the last three years. The mean of these percentages is used to measure the *developmental investment*.

### **3.4.4 Management Belief**

*Management belief* is measured using 16 items scale. The firms are required to rate their extent of agreement with the belief that PESTEL factors can significantly influence the firm's performance against all the 4 perspectives/dimensions of the balanced score card (BSC) i.e. financial, customer, internal business process and innovation & learning. These items are arranged in a 4 set of questions. Each of the introductory pieces is followed by four options representing the four dimensions of BSC. Respondents are required to rate their belief about the impact of PESTEL factors against each of the perspective of BSC.

The grouping of these 16 items scales measuring impact of PESTEL factors against each of the perspective of BSC is given as follows:

1. Financial Perspective (include sub-items 'a' under the grouped items)
2. Customer Perspective (include sub-items 'b' under the grouped items)
3. Internal Business Process Perspective (include sub-items 'c' under the grouped items)
4. Innovation & Learning Perspective (include sub-items 'd' under the grouped items)

All of the survey items are responded on four-point Likert scale (1 = Strongly Disagree, 2 = Disagree, 3 = Agree, 4 = Strongly Agree). All the 16 items have been averaged to create an overall variable score of *management belief*. Items were coded so that higher values represent higher levels of constructs. Four- point Likert scale is used in the study to avoid neutral point. The neutral point is one that is neither ‘agree’ nor ‘disagree’ has been intentionally avoided to account for a possible method baise. In case of a five-point Likert scale a midpoint is seen to be taken as undecided or neutral and no concrete conclusion is drawn based on the results. The Inter item consistency of the 16 items has high reliability with Cronbach's Alpha 0.978.

## CHAPTER 4

### ANALYSIS AND INTERPRETATION

This chapter reports general interpretations of the study. Statistical analysis of the results of the study are also reported and discussed here. Descriptive and bi-variate analysis has been performed for different data categories. Descriptive statistics are given to have an overview of the sample and the response to form an opinion in general about the adequacy, validity, reliability, and scope of the study.

#### 4.1 DESCRIPTIVE STATISTICS

##### 4.1.1 Sample Respondents

All 88 firms are targeted in the survey and only 34 firms responded. Out of 34 respondents, 13 firms are manufacturer-cum-exporter of Woven Garments, which is 38.2 % of the total responses received in the survey. 14.7 % of the firms deal in Denim Garments, 17.6% in Denim & Woven Garments, 17.6 % in Knitted Garments and there are only 4 firms which are engaged in manufacturing and exports of both Woven & Knits (11.8%). Product-wise distribution of the respondents is presented below in Table 4.1.

**Table 4.1**  
**Distribution of the Sample based on Product Type**

<b>Product Type</b>	<b>Freq</b>	<b>%</b>
Woven	13	38.2
Denim	5	14.7
Denim & Woven	6	17.6
Knits	6	17.6
Woven & Knits	4	11.8
<b>Total</b>	<b>34</b>	<b>100</b>

### 4.1.2 Size of the Firms

Firm's size is measured by number of employees in the firm in this study. Distribution of firms based on their size is presented under four categories and shown in Table 4.2.

**Table 4.2**  
**Size-wise Distribution of the Firms (Number of Employees)**

<b>Firm Size</b>	<b>Freq</b>	<b>%</b>
< 10 persons	1	3%
>10 and < 50 persons	18	53%
>50 and < 250 persons	8	24%
>250 persons	7	21%
<b>Total</b>	<b>34</b>	<b>100%</b>

Out of total 34 respondents, there is only 1 firm which has less than 10 employees (3%), called a micro firm as defined in chapter 3 above. There are 18 respondent firms which fall in small firm category, and found to be the largest category of the respondent firms (53%). There are 8 firms which are found to be of medium size, which is 24 % of the total respondents. 7 firms fall under large firm category, which is 21 % of the total respondents.

### 4.1.3 Age-wise Distribution

Age-wise distribution of the population is presented in Table 4.3. Data shows that 29.4% of the respondent firms are of age between 1 to 5 years, 35.3% are between the age of 6 to 10 years, 20.6% in age range of 11 to 25 years, 14.7% in age 26 to 50, and none of the firm is above age of 50 years. Most of the firms are in age of 6 to 10 years.

**Table 4.3**  
**Age-wise Distribution of Population**

<b>Age of the firm</b>	<b>Freq</b>	<b>%</b>
less than or equal to 5 years	10	29.4
6 to 10 years	12	35.3
11 to 25 years	7	20.6
26 – 50 years	5	14.7
more than 50 years	0	0.0
<b>Total</b>	<b>34</b>	<b>100</b>

#### 4.1.4 Distribution based on “Main Emphasis of the Firm’s Strategy”

Distribution of the firms based on *Emphasis of the Firm’s Strategy* is presented in Table 4.4. Data shows that 47.1 % of the firms in the population have emphasis on *Growth* strategy. There are 29.4 % firms which have an emphasis on *Stability* strategy whereas firms following *Downsize* strategy are 23.5 %.

**Table 4.4**  
**Distribution based on “Main Emphasis of the Firm’s Strategy”**

<b>Main Emphasis of the Firm’s Strategy</b>	<b>Freq</b>	<b>%</b>
Growth	16	47.1
Stability	10	29.4
Downsize	8	23.5
<b>Total</b>	<b>34</b>	<b>100</b>

#### 4.1.5 Distribution based on Formal or Informal Strategy

Distribution of the firms based on presence of a formal strategy (Formal or Informal) is presented in Table 4.5. Data shows that out of total 34 firms, 76 % of the firms have a *Formal* Strategy. 24 % of the firms in the population don’t have any *Formal* Strategy.

**Table 4.5**  
**Distribution of the Firms based on Strategy Type (Formal or Informal)**

<b>Strategy Type</b>	<b>Freq</b>	<b>%</b>
No	8	24
Yes	26	76
<b>Total</b>	<b>34</b>	<b>100</b>

## 4.2 CROSS TABULATION

### 4.2.1 Cross tabulation data based on “Type of Products Exported” and “Main Emphasis of the Firm’s Strategy”

Cross tabulation statistics in Table 4.6 below show distribution of 34 respondent firms based on *Type of Products Exported* and *Main Emphasis of the Firm’s Strategy*.

Data shows that for the firms having emphasis on Growth strategy, there are 38 % firms which manufacture and export Woven garments, 19 % deal in Denim garment, 19 % in Denim and Woven, 13 % in Knits and 13 % of the firms are manufacturer-cum-exporter of Woven and Knit garments.

For the firms having emphasis on *Stability*, 50 % of the firms deal in Woven garments, 20 % are in Denim, 10 % in Denim and Woven, 10 % in Knits and 10 % of the firms are manufacturer-cum-exporters of Woven and Knit garments.

For the firms having emphasis on *downsize* strategy, 25 % of the firms deal in Woven garments and none of the firm is exporting Denim garment. Firms dealing in Denim & Woven garments are 25 %. 38 % of the firms are in business of Knits and 13 % deal in Woven & Knit garments.

**Table 4.6**  
**Distribution based on “Type of Products Exported”**  
**and “Main Emphasis of the Firm’s Strategy”**

Type(s) of product being exported	Main emphasis of the firm’s strategy is on						Total	
	Growth		Stability		Downsize			
	Freq.	%	Freq.	%	Freq.	%	Freq.	%
Woven	6	38	5	50	2	25	13	38
Denim	3	19	2	20	0	0	5	15
Denim & Woven	3	19	1	10	2	25	6	18
Knits	2	13	1	10	3	38	6	18
Woven & Knit	2	13	1	10	1	13	4	12
<b>Total</b>	<b>16</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>8</b>	<b>100</b>	<b>34</b>	<b>100</b>

#### 4.2.2 Cross tabulation data on “Main Emphasis of the Firm Strategy” and “Strategy Type”

Cross tabulation statistics in Table 4.7 show distribution of firms based on *Main Emphasis of the Firm’s Strategy* and *Strategy Type*. Out of 8 firms having “No” formal strategy, 25 % of the firms have main emphasis on *growth* strategy, 25 % follow *stability* strategy and 50 % of the firms are following *downsize* strategy.

Data distribution further explains that there are 26 firms which have a formal strategy. Amongst these, 54 % of the firms have main emphasis on “Growth” strategy, 31 % follow “Stability” strategy and 15 % of the firms have “Downsize” strategy.

**Table 4.7**  
**Distribution of the Firms based on**  
**“Main Emphasis of the Firm’s Strategy” and “Strategy Type”**

Main Emphasis of the Firm’s Strategy	We have a formal corporate strategy				Total	
	No		Yes			
	Freq.	%	Freq.	%	Freq.	%
Growth	2	25	14	54	16	47
Stability	2	25	8	31	10	29
Downsize	4	50	4	15	8	24
<b>Total</b>	<b>8</b>	<b>100</b>	<b>26</b>	<b>100</b>	<b>34</b>	<b>100</b>

#### 4.3 DATA NORMALITY AND SCALE RELIABILITY

The basic descriptive statistics is applied to all the data. Independent variables used in this study are *management belief*, *developmental investment*, and *age* of the firm. *Customer retention*, one of the major indicators of a firm’s performance, is taken as the dependent variable to empirically test the impact of independent variable in this study. Table 4.8 shows reliability of scales.

To ensure the reliability of all the scales Cronbach’s alpha test is applied to all the scales, including independent variables, mediating variables, and dependent variable. All of the scales exhibited satisfactory Cronbach’s coefficient alphas that are larger than the acceptable threshold of 0.60 (Nunnally, 1978).

**Table 4.8**  
**Reliability of the Scales**

Scale	No of Items	Cronbach's Alpha
Importance of PESTEL for Performance	6	0.934
Consideration of PESTEL for strategy formulation	6	0.923
Management Belief that PESTEL factors impacts Firms Performance	16	0.978

Kolmogorov-Smirnov test is applied to test the normality of the five study variables which are shown in the Table 4.9.

**Table 4.9**  
**Normality of Study Variables using Kolmogorov-Smirnov**

Variable	Kolmogorov-Smirnov Z	Sig. (2-tailed)
Developmental Investment	.75	.631
Importance of PESTEL	.84	.475
PESTEL consideration for strategy	.67	.757
Management Belief	.57	.900
Performance	1.18	.124

#### **4.4 HYPOTHESIS RESULTS**

The research hypotheses presented in section 1.5 of the first chapter are analyzed and explained in the following sections. Results of hypothesis 1 to 3 are explained under 4.4.1. For hypothesis 4 and 5 (mediation analysis), results are explained separately under 4.4.2.

#### 4.4.1 Correlation Matrix

**Table 4.10**  
**Correlation Matrix**

Variables	Mean	S.D	1	2	3	4	5	6
1 Age (Years)	13.4	12.3						
2 Size (No of employees)	511.8	1530.7	0.162					
3 Developmental Investment	2.9	1.8	0.006	0.059				
4 Importance of PESTEL	2.5	0.73	0.323*	0.236	0.647***			
5 PESTEL consideration for strategy	2.5	0.73	0.29	0.197	0.577***	0.942***		
6 Management Belief	2.6	0.72	0.343*	0.07	0.611***	0.919***	.934***	
7 Performance	74.9	21.5	0.339*	0.104	0.319*	0.453***	0.469***	0.455***

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

Table 4.10 shows correlation and its significance between various constructs.

*Age* is found to be positively correlated with *performance* of the firm and data shows results to be significant with correlation coefficient 0.339 ( $p < 0.10$ ). This shows a support for the first hypothesis.

The table also shows that *developmental investment* and *performance* of the firm are positively related to each other. The correlation coefficient in this case is 0.319 ( $p < 0.10$ ). Therefore the second hypothesis is also supported.

Similarly, correlation between *management belief* and firm's *performance* is also found to be highly significant with coefficient 0.455 ( $p < 0.01$ ). Thus the third hypothesis also finds support.

We can also notice positive and significant relationships between performance and some other variables in Table 4.10. For example, the Pearson Coefficient for the relationship between *importance of PESTEL* and *performance* is significant and positive with correlation coefficient 0.453 ( $p < 0.01$ ). Relationship between *PESTEL consideration for strategy* and *performance* is also found significant and positive with correlation coefficient

0.469 ( $p < 0.01$ ). The relationship between *PESTEL consideration for strategy* and *management belief* is also found to be very strong and positive with correlation coefficient 0.934 ( $p < 0.01$ ). In the same manner significantly strong and positive relationship between *importance of PESTEL* and *management belief* is also found (correlation coefficient 0.919,  $p < 0.01$ ). Relationship between *developmental investment* and *management belief* is also found to be significant with positive correlation coefficient 0.611 ( $p < 0.01$ ).

#### 4.4.2 Mediation Analysis

According to Baron and Kenny (1986), to establish mediation, three conditions must hold. First, the independent variable (X) must affect the mediator (M) in the first equation. Second, X must be shown to affect the dependent variable (Y) in the second equation and third, M must affect Y in the third equation. The extent of mediation depends upon the behavior of the beta value of X before and after inclusion of the M in the model.

**Table 4.11**  
**Regression Results for Mediation of**  
**Management Belief in Age-Performance Relationship**

<i>Dependent variable</i>	Management Belief	Performance	
		Step 1	Step 2
Constant	2.332	66.841	37.205
<i>Independent</i>			
Age	0.343*	0.339*	0.194
<i>Mediator</i>			
Management Belief			.421**
R <sup>2</sup>	0.117	0.115	0.271
$\Delta R^2$			0.156

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

For testing of the forth hypothesis, the regression results have been presented in Table 4.12. In our hypothesis, age is X, *management belief* is M and firm's performance is Y. First condition is satisfied, because, *age* of the firm significantly impacts *management belief*. The value of beta is 0.343,  $p < 0.10$  and that of R-square is 0.117 for this equation (Table 4.12). Second

condition is satisfied, because, age of the firm significantly impacts firm's *performance*. The value of beta in this case is 0.339,  $p < 0.10$  and that of R-square is 0.115 (Table 4.12, Step 1). Third condition is also satisfied, because, *management belief* significantly impacts firm's performance. The value of beta in this case is 0.421,  $p < 0.05$  and that of R-square is 0.271 (Table 4.12, Step 2).

This may be further noted from the Table 4.12 that the beta value for the independent variable (i.e. age) dropped from 0.339 to 0.194 after the inclusion of the mediator (i.e. *management belief*) in the model. *Age* of the firm in equation (Step 2) has no longer shown a significant association with the dependant variable (i.e. firm's performance). The value of R-square has also shown an improvement of 15.6 percent. In total, the results from the three-step process (Baron and Kenny, 1986) show that *management belief* fully mediates the relationship between *age* and performance. Thus there is strong support for the fourth hypothesis.

**Table 4.12**  
**Regression Results for Mediation of Management Belief in Developmental Investment-Performance Relationship**

<i>Dependent variable</i>	Management Belief	Performance	
		Step 1	Step 2
Constant	1.858	63.657	40.749
<i>Independent</i>			
Developmental Investment	0.611***	0.319*	0.066
<i>Mediator</i>			
Management Belief			0.415**
R <sup>2</sup>	0.373	0.102	0.210
ΔR <sup>2</sup>			0.108

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

For testing of the fifth hypothesis, the regression results have been presented in Table 4.13. In this hypothesis, *developmental investment* is X, *management belief* is M and firm's *performance* is Y. First condition is satisfied, because, *developmental investment* significantly impacts *management belief*. The value of beta is 0.611,  $p < 0.01$  and that of R-square is 0.373 for this equation (Table 4.12). Second condition is satisfied, because, *developmental investment* significantly impacts firm's performance. The value of beta in this case is 0.319,  $p < 0.10$  and that of R-square is 0.102

(Table 4.13, Step 1). Third condition is also satisfied, because, *management belief* significantly impacts firm's *performance*. The value of beta in this case is 0.415,  $p < 0.05$  and that of R-square is 0.210 (Table 4.13, Step 2)

This may be further noted from the Table 4.13 that the beta value for the independent variable (i.e. *developmental investment*) dropped from 0.319 to 0.066 after the inclusion of the mediator (i.e. *management belief*) in the model. *Developmental investment* in the equation (Step 2) has no longer shown a significant association with the dependant variable (i.e. firm's *performance*). The value of R-square has also shown an improvement of 10.8 percent. In total, the results show that *management belief* fully mediates the relationship between *developmental investment* and *performance*. Thus there is strong support for the fifth hypothesis as well.

#### 4.4.3 Summary of the Results of the Hypothesis

**Table 4.13**  
**Results of the Hypothesis**

<b>S#</b>	<b>Description</b>	<b>Inference</b>
1	<i>Age of the firm positively relates to firm's Performance</i>	Accepted
2	<i>Developmental investment made by a firm positively relates to firm's performance</i>	Accepted
3	<i>Management's belief (that PESTEL factors influence the firm's performance in all of the four perspectives of BSC) positively relates to firm's performance</i>	Accepted
4	<i>Management belief mediates the relationship between age and a firm's performance</i>	Accepted
5	<i>Management belief mediates the relationship between developmental investment and firm's performance</i>	Accepted

## CHAPTER 5

### CONCLUSION AND DISCUSSION

#### 5.1 CONCLUSION

##### 5.1.1 Firms' Age and Performance

The study hypothesizes that *age* of the firm is positively related to the *performance*. The study concludes that *age* in terms of number of years in operation for the manufacturing cum export industry is positively related to the firm's *performance* (Correlation = 0.339,  $p < 0.10$ ). *Age* of the firm shows a significant regression coefficient and can explain variation in the firm's *performance* to the extent of about 12 percent.

The results of this study that *age* of the firms of the readymade garment (RMG) sector show a positive impact on *performance* are consistent with the previous findings. Majumdar (1997) observes that older firms enjoy superior performance. He finds that coefficient for *age* is positive in the productivity equation, but negative in the profitability equation. Evans (1986) studies the relationship between firm's *age* and *performance* and found that failure, growth, and the variability of firm's growth decreases as firm ages.

One of the important factors of the positive correlation between firm *age* and *performance*, as reported by one of CEOs among the respondents, is the orientation of manufacturing-cum-export RMG firms to the international markets and exposure to higher competition. More these firms interact with international buyers (which are international well recognized brands in developed countries) more they improve their internal business process and bring innovation and learning. It was found during discussions that in last few years many RMG firms, registered with PRGMEA, have closed their businesses due to their inability to compete with other international suppliers. The firms in study population are those which are comparatively more competitive than those firms which closed their business due to their failure to compete in the international market. This argument is further established by looking at the results of other hypothesis of the study which show that mediating role of *management belief* in *age-performance* relationship is found to be significant and positive.

### 5.1.2 Developmental Investment and Firms' Performance

As hypothesized in the study, the results of this study show that *developmental investment* and *performance* of the firm are positively correlated and, therefore, second hypothesis of the study is supported (Correlation = 0.319,  $p < 0.10$ ).

*Development investment* enables firms to respond to the globalization challenges and avail the opportunities in external environment. The results of the study are found to be consistent with the previous research which emphasize upon investing in R&D, technology acquisition (such as Porter, 1990; Douglas and Wind, 1987) and skill development and training (Bartel, 2000) to face the challenges of the globalization and improve firm's performance and achieve objectives (e.g. Zahra, 1996; Knight. 2000). Thus, study results conclude a positive and significant relationship between *developmental investment* and *performance*.

### 5.1.3 Management's Belief and Firm's Performance

*Management belief* is one of the important variables of the study which is hypothesized to be positively correlated with the firm's performance. The study results conclude that *management belief* is positively related to the firm's performance (Correlation = 0.455,  $p < 0.01$ ).

Importance of the awareness of environmental information and management's scanning behavior is discussed in this study, which is highlighted by many research scholars as well (e.g. Choo, 1993; Pfeffer and Salancik, 1978). Study hypothesizes that PESTEL factors impact firm's performance which is reflected under four perspectives of the BSC viz. financial, customer, internal business process, and innovation and learning. Previous research also highlights the similar approach that the uncertainty in external environmental requires scanning behavior and external events perceived by management as important (Pfeffer and Salancik, 1978).

The firms in study population are engaged in manufacturing cum export business and compete with other international brands in various countries. Political, economic, social, technological, environmental and legal system of target countries poses many threats to the performance of the firm. Firms having longer experience of working in many countries are more familiar with this fact that how PESTEL forces affect their performance and how to make use of these challenges as a competitive advantage. Thus with more experience and international exposure this *management belief* can be

more effectively used in strategic decisions and performance of the firms can be improved. Results of this study explain the same variation in firms' performance due to management belief and study hypothesis is supported.

#### **5.1.4 Management Belief as a Mediator**

This type of mediation has been tested for the first time in this study. It hypothesizes that *management's belief* mediates the relation between *age* and firm's *performance* and also between *development investment* and firm's *performance*. *Management belief* (MB) is a new construct in this study which explains that how management perceives the relationship between external environmental factors and their impact on the performance of the firm.

Results from the three-step process (Baron and Kenny, 1986) show that *management belief* fully mediates relationship between *age* and *performance* which provides strong support for the fourth hypothesis. In addition to direct relationship hypothesized between *developmental investment* and *performance*, the study empirically tests the role of *management belief* as a mediator in *development investment-performance* relationship. Results show that *management belief* fully mediates the relationship between *developmental investment* and *performance* and strongly support the fifth hypothesis of this study.

This study concludes that older firms are more likely to develop the *management belief* and through this process the performance of the firm improves. Similarly, improved performance due to development investment transforms into management belief and may further lead to improve performance in terms of retention of the international customers. Therefore, older firms even investing for developmental purpose are not likely to succeed, if they fail to sustain the *management belief* about influence of PESTEL on all of the four perspectives of the BSC. Study also notices positive and significant relationships between *importance of PESTEL* and *performance*. Relationship between *PESTEL consideration for strategy* and *performance* is also found significant and positive.

Performance of the firms manufacturing and exporting readymade garments and competing internationally is more affected by PESTEL factors and considering environmental scanning can improve organizational performance. Choo (1993) finds growing awareness of the importance of the environmental information and results of this study empirically find that considering environmental scanning for manufacturing cum export firms can improve organizational performance.

## 5.2 LIMITATIONS

RMG sector is one of the sub sectors of Textile & Clothing industry. From cotton to manufacturing of yarn and fabric to garment stitching, all the sub sectors are vertically and horizontally integrated with each other in the value chain. For example a change in duties or taxes in Pakistan for *yarn* can affect the whole vertical value added chain i.e. cost and price of the garments and their competitive position in international markets. Similarly, bad crop globally can affect demand-supply mechanism for the cotton and ultimately prices of the yarn can go up. As target population in this study is readymade garment firms registered with PRGMEA, Lahore, we need to also empirically assess the impact of PESTEL factors on other sub sectors so that relationship between the sub sectors in value chain can also be determined.

In a global perspective performance of the firms in RMG sector in other countries also determine level of global competition. How PESTEL factors affect the performance of the firms in other countries, a comparison need to be made especially with the countries in the region exporting readymade garments. For example an increase in wages in developed countries has resulted into shift of the garment manufacturing to the developing countries (Morris and Barnes, 2008) as cost of doing business is increased.

As most of the firms are reluctant to share their export data, study didn't empirically investigate export performance of the firms in terms of actual export size (exports in terms of numbers of garments or their dollar value) and /or profitability. Data can be taken for future research from other secondary sources such as State Bank of Pakistan (SBP) and Federal Board of Revenue (FBR) of the government of Pakistan so that export performance of the firms can be quantitatively investigated. Since the data related to the firms in readymade garment sector is not publically available, proxy variable of *customer retention* is taken to assess their performance. In case we have correct exports figures, the study may be replicated in future. Scarcity of financial resources and time shortage has also limited the scope of the survey as other main textile cities like Karachi and Faisalabad are also not included in the study.

The diagnosis of *developmental investment* in a particular firm requires in depth analysis of the strategic decisions made by the management and their understanding of the impact of the PESTEL factors on firm's performance. Impact of firm's vision and mission on management belief and firm's performance also needs to be empirically investigated.

### 5.3 CONTRIBUTION

This dissertation has contributed both theoretically and empirically to assess relationship between PESTEL factors and performance of the firms. RMG sector is one of the important sectors for Pakistan in terms of investment, export earnings and employment opportunities. No such study has been made in past on the subject on RMG sector in Pakistan which examines the external environmental factors (PESTEL) and their relationship with firm's performance. This dissertation theoretically and empirically finds relationship between firm *performance*, *developmental investment*, *management belief* and firm's *age*.

The study proposes items for assessing impact of PESTEL factors on firm's performance. Results of this study show significant relationship between firm's performance and PESTEL factors. Study also rates mediating role of *management belief* in *age-performance* and *developmental investment-performance* relationship. Results show a significant relationship between *management belief* and *performance* of the firm, thus enhancing the validity of previous studies which give importance to external environmental factors for firms' performance (Choo, 1993; Knight, 2000; Brooks and Weatherston 2000; Adepoju and Famade, 2010). Results of this study also empirically validate association between considerations of PESTEL for strategy and firm performance.

*Customer retention* is discussed as one of the important indicators for the performance of manufacturing cum export firms. Various researchers have found association between customer satisfaction, loyalty, retention and firm performance (e.g. Reichheld and Sasser, 1990; Fornell, 1992; Bolton et al., 2000; Winer, 2001; Gustafsson et al., 2005) and result of this study also validate the previous research.

A strong criticism is found on usage of BSC in previous literature. Researchers have found that BSC is missing environmental and community or social issues/aspects (e.g. Bourne, 2002; Marr and Adams, 2004) and fails to answer fundamental questions about competitors (Neely et al., 1995). Previous literature also emphasize upon using various tools and techniques together for tracking performance. This study on RMG sector is a contribution to the old literature as data results empirically show importance of combined use of PESTEL and BSC to assess impact on firm's performance.

## 5.4 PRACTICAL IMPLICATIONS

The study is based on strong theoretical foundations and proven BSC model to assess impact of PESTEL factors on performance of the firm. The firms in RMG sector face many challenges from external environment (domestic and international) and results show importance of scanning external environmental factors for the performance of the firms, thus highlighting consideration of PESTEL in strategy formulation. The study further advances the analysis to determine that how *developmental investment* can enable the firms face challenges of globalization and improve their performance, as is also empathized in old research work (Cavusgil and Zou, 1994; Zahra, 1996; Knight, 2000).

Keeping in view the significant role of external environmental factors in firm's performance, the study emphasizes that management need to understand that which of the PESTEL factors affect performance of their firms, and up to what extent. Firms can find information on how good we are performing financially (financial perspective), how do customers see us (customer perspective), what must we excel at to (internal business process perspective) face future challenges and avail opportunities and how can we continue to improve and create value (innovation and learning perspective). To compete in international markets, if information about external environmental factors is made available, management can effectively formulate their strategies which match with organizational strengths and weaknesses.

## 5.5 FUTURE DIRECTION

Pakistan's textile sector is affected by the end of quota regime in 2005 and global financial crises in 2008. But no studies are conducted on RMG sector, or any of the sectors of the economy, to assess that how PESTEL factors affected performance of the firms as well as overall sectors. It is an era of trade liberalization, especially Free Trade Agreements (FTAs), which is changing trade flows between the countries, ultimately affecting the performance of the firms. Using Balanced Scorecard approach, which is a widely accepted tool by many firms in the developed countries (including Fortune 500 companies), we need to explore the impact of PESTEL factors on performance of the firms. For future research the constructs for *management belief* needs to be tested in other sectors. The researcher may also try to further rationalize the number of items for the construct *management belief* and minimize the gap in number of items.

Mediation of *management belief* in *age-performance* and *development investment-performance* relationship is another stream which requires extensive sector specific research work, especially for the firms which are competing globally and/or are more technologically driven.

Study includes *age* and *developmental investment* as independent variables. Impact of *development investment* will be different on various types of firms and need to be assessed by the researchers. For example product based industry versus services sector; firms doing business in domestic markets versus those which compete globally; product involving high level of technology in design, production, handling/packaging, and distribution etc. are all different business modes and need different approaches to assess the performance relationship with PESTEL factors and various strategies to respond to environmental threats and avail opportunities. Future research may discover more avenues and more independent variables may be studied in context of PESTEL factors and their impact on firm's performance. However, the independent variables and items used in this study can be used as starting point for future research.

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## QUESTIONNAIRE

This survey is part of research for M.Phil. thesis. Aim of the study is to evaluate the influences of external environmental factors (PESTEL) on the strategy and performance of manufacturing-cum-export firms' in Readymade Garment sector. Your valued input will be a great contribution in this research work. Survey questionnaire will be used for research purpose only. The responses will be used collectively without mentioning name of any individual or firm. Your cooperation is highly appreciated.

### Section-1

1. Name of the firm: \_\_\_\_\_
2. Years of establishment of firm (firm age): \_\_\_\_\_
3. Number of employees (permanent) in the firm: \_\_\_\_\_
4. Type(s) of product being exported: \_\_\_\_\_
5. a. We have a formal corporate strategy:                      Yes                       No
- b. Main emphasis of the firm's strategy is on:  
 Growth                       Stability                       Downsizing
6. a. Total exports/sales of the firm is (Calendar year):
 

2007		(Rs. Million)
2008		(Rs. Million)
2009		(Rs. Million)
2010		(Rs. Million)
- b. Approximate percentage of total profit spent on:
 

i)	Technology up-gradation		(%)
ii)	R&D		(%)
iii)	Training and skill development		(%)
7. Percentage of customers retained successfully by the firm in last three years \_\_\_\_ (%)

## Section-2

Please encircle only one of the number at a scale of 1-4 that indicates your disagreement or agreement with following statements (1= strongly disagree ; 4 = Strongly agree)

8	The following external environmental factors (PESTEL) are important to the firm's <u>performance</u> :	Strongly Disagree	Disagree	Agree	Strongly Agree
	a. Political				
	b. Economic				
	c. Social				
	d. Technological				
	e. Environmental				
	f. Legal				

9	It is important to consider external environmental factors in making firm strategy:				
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10	The following PESTEL factors should be considered while formulating the firm's <u>strategy</u> :				
	a. Political				
	b. Economic				
	c. Social				
	d. Technological				
	e. Environmental				
	f. Legal				

11	PESTEL factors significantly influence the firm's performance under:				
	a. Financial Perspective				
	b. Customer Perspective				
	c. Internal Business Process Perspective				
	d. Innovation & Learning Perspective				

12	PESTEL factors significantly impact the firm's:				
	a. Return on Investment				
	b. Customer Retention				
	c. Product Development Cycle				
	d. Time to develop next generation products				

13	PESTEL factors can significantly change the firm's:				
	a. Revenue Growth				
	b. Share of segment				
	c. Engineering efficiency				
	d. Human capital readiness				

14	Focusing on the PESTEL factors makes the firm more competitive in terms of:				
	a. Sales Margin				
	b. On-time delivery				
	c. Supply chain cycle efficiency				
	d. Performance trajectories of competing technologies				

Personal information:

- a. Filled by (Optional): \_\_\_\_\_
- b. Mobile No: \_\_\_\_\_
- c. Email address: \_\_\_\_\_