

## **Strategic Innovation as an Antecedent of Firm Performance: A Critical Review of Literature**

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### **ABSTRACT**

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Amidst a dynamic business environment that is volatile, uncertain, complex and ambiguous, firms must determine ways of achieve their strategic objectives as well as and gain an edge over their competition. This must happen both in the short and the long term for sustainable competitive advantage. The general objective of the study is to review conceptual, theoretical as well as empirical literature on the relationship between strategic innovation and firm performance with the view of highlighting the knowledge gaps suitable to form basis for future research work. Specifically, the study aims to review the existing conceptual and theoretical literature on the construct of the strategic innovation and its connected phenomena, identify emerging conceptual theoretical and empirical gaps from the reviewed literature, review relevant empirical literature on the construct of firm performance and its connected phenomena and propose a suitable theoretical framework in respect to the identified gaps for guiding future research. To achieve these objectives, the study involved a critical review of conceptual, theoretical and empirical literature that provided valuable insights on the dimensions and indicators of the key constructs. This review also aided in identifying the link between key constructs, provided the theoretical underpinning and generated insights into the existing gaps that would require an empirical pursuit. The theoretical paper ultimately identified product innovation, process innovation, organizational innovation and business process innovation as integral dimensions of strategic innovation. In addition, the review proposed revenue growth, brand loyalty, market share and employee engagement as appropriate measures of firm performance. The recommendation deriving from this review is that the developed conceptual framework should be validated in diverse contexts so as to harness its practical, empirical and theoretical value.

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**Keywords: Strategic Innovation and Firm Performance**

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## 1.0 Introduction

Firm performance has been a key focus of research by both practitioners and academicians (Kumar & Saha, 2008). Further, Bergh and Lim (2008) posit that performance heterogeneity across firms is a central concern in strategic management research. Firm performance is the firm's ability to generate profits or economic value added over time. (Barney, 1991). Porter (1980) defines firm performance as the result of the successful interaction between a firm's strategy and its environment. There exists a large body of research that examines the factors that contribute to firm performance, suggesting that a range of factors, including strategy, innovation, human resources, and leadership, can impact firm performance (Barney, 1991, Chandler, 1962, Grant, 1991, Porter, 1985, Wernerfelt 1984). Firm performance is a dominant dependent variable in studies seek to identify variables that produce variations in firm performance. In this study, firm performance is the dependent variable.

Strategic innovation is important to a firm's success in today's dynamic competitive business environment. Lichtenthaler and Lichtenthaler (2009) define strategic innovation as the capability of a firm to align its innovation activities with its overall business strategy and thus, to achieve superior long-term performance. Further, strategic innovation involves more than just product or process innovation, but rather it involves a strategic reorientation of the organization towards new opportunities and markets (Lichtenthaler & Lichtenthaler 2009). Several studies have examined the relationship between strategic innovation and firm performance. In investigating how strategic innovation can contribute to firm performance, Barreto and Karia (2020) posit that firms with strategic innovation have a higher likelihood of experiencing growth and financial success. Similarly, Bower and Christensen (1995) argue that strategic innovation can enable firms to create new markets and transform existing ones, leading to a competitive advantage and that firms that engage in strategic innovation tend to have higher profits and market share. Strategic Innovation is the independent variable in this study.

## 2.0 Statement of the Problem

Strategic innovation contributes to creation of new products and new markets (Birkinshaw, Bouquet and Barsoux, 2011). However, despite acknowledgement of the benefits of strategic innovation, it is apparent that its impact on firm performance remains misunderstood (Juma, Zawdie, & Nyeko, 2014). One of the reasons for this situation is that the drivers of strategic innovation have not been agreed upon and tested. Successful firms know the significance of strategic innovation and as such it has become more entrenched globally among firms as they explore the unexplored positions in its industry (Markides, 1998).

Previous research has identified multiple factors that either hinder or promote strategic innovation. Those curtailing strategic innovation include: the tendency for firm managers to have a risk-averse attitude toward change (Delmas, 2002), firms' inadequate ability to acquire and absorb knowledge (Cohen & Levinthal, 1990), limited and un-optimized resources as well as firm rigidities (Delmas, 2002), technological challenges and advancement (Nelson & Winter, 1982; David, 1985). Some of the dynamics that seem to promote strategic innovation include: strategic leadership, creativity, imagination, supportive culture, entrepreneurship (Schumpeter, 1939; Drucker, 1985), capacity to learn and exploit both internal and external knowledge and collaborations (Cohen & Levinthal, 1990). Several authors have linked managerial capabilities and firm's innovation insisting that managerial competences, entrepreneurial capabilities and strategic risk orientation, are key to

strategic innovation (Penrose, 1959). The nature of a firm's strategic orientation, culture, structure, systems and processes are also key in facilitating or limiting strategic innovation.

Authors see strategic innovation as a fundamental change, a radical business plan innovation, breaking the rules, creating of new markets and the fundamental re-organization of the way the firm has serves its customers, therefore redefining the customer value proposition, strategic position and orientation of the firm (Kim & Mauborgne 2004; Charitou & Markides 2003). Strategic innovation is key to achieving competitive advantage and firm performance. Most firms are seen to be implementing at least some dimensions of strategic innovation (Markides, 2003), but often they do that in a very ad hoc manner and lack an all-encompassing structure. So how can a firm upscale its current innovation practices towards a more sustainable path?

Strategic innovation has been identified as a critical driver of firm performance, and that firms should effectively manage their strategic innovation capability to achieve sustained success, (Porter, 1985; Teece, Pisano, & Shuen, 1997; Baldwin, & Johnson 2015; Cameron & Quinn 2011). Though the connection between strategic innovation and firm performance is well-established, there is little understanding of the processes through which this relationship operates (Chang & Huang, 2015). By examining the relationship between the two constructs, this study aimed to fill these gap.

### **3.0 Conceptual Literature**

#### **3.1 Concept of Strategic Innovation**

Scholars have defined strategic innovation variously. Lichtenthaler and Lichtenthaler (2009) define strategic innovation as the capability of a firm to align its innovation activities with its overall business strategy and thus achieving superior long-term performance. Further, strategic innovation involves more than just product or process innovation, but rather it involves a strategic re-orientation of the firm towards new opportunities and markets (Lichtenthaler & Lichtenthaler 2009). Teece (2018) defines strategic innovation as the development and implementation of new business models, product-market strategies, and associated organizational architectures that permit the firm to achieve and sustain superior performance. Drnevich and Croson (2013) conceptualize strategic innovation as the ability to think creatively, take risks, collaborate effectively, and identify and capitalize on emerging opportunities in order to achieve strategic goals. Strategic innovation is seen as the deliberate and systematic attempt to recognize new opportunities and threats and to create new value propositions, business models, and organizational capabilities in order to address them (O'Regan & Ghobadian 2017). Chesbrough and Rosenbloom (2002) posit that strategic innovation as the ability to see opportunities where others do not, and to shape those opportunities to create economic value and capture a share of it. Henderson and Clark (1990) suggest that strategic innovation involves redefining the terms of competition in an industry, often through the introduction of new technology, business models, or other innovations. Hamel (2006) argues that strategic innovation is about creating new strategic options for the organization, rather than simply exploiting existing ones.

Strategic innovation has also been defined as the capacity to anticipate and respond proactively to discontinuities and changes in the environment by exploiting new technologies, resources to develop new business models, products, or services. (Salampasis, Birasnav, & Malindretos, 2017). Strategic innovation is about creating the future through making strategic choices, which technology developments to pursue and how to leverage and deploy these technologies (Dodgson, Gann, & Phillips, 2014). Strategic innovation is about breaking out of stagnant or declining markets, to pre-

empt competition, or to significantly increase the value that firms capture from existing markets (Lee, Lee, & Pennings, 2010). Strategic innovation involves the identification and proactive exploitation of opportunities that emerge from shifts in the external environment, such as changes in customer needs, technological breakthroughs, or regulatory changes (Schilling, 2013).

Strategic innovation is a multifaceted construct that encompasses several elements, including creativity, risk-taking, and collaboration (Drnevich & Croson, 2013). It involves generating novel ideas and approaches to addressing business challenges, and implementing these ideas in a systematic and coordinated manner (Ettlie & O'Keefe, 1982). Strategic innovation can be driven by various factors, such as changes in market conditions, advances in technology, or shifts in consumer behavior (O'Regan et al., 2019). One important aspect of strategic innovation is the ability to seize new opportunities. This requires an in-depth understanding of industry trends and customer needs, as well as the agility to adapt to changing conditions (Teece, 2018). Another important aspect of strategic innovation is the willingness to take risks and experiment with new ideas. This requires a culture of innovation that values experimentation and learning from failure (Gupta et al., 2021). Organizations that are too risk-averse may miss out on potential opportunities or miss out the opportunity to adapt to changing market conditions. Collaboration is also an essential component of strategic innovation. This involves working with external partners, such as suppliers, customers, or other organizations, to co-create and co-innovate (West et al., 2014). Collaborative innovation can help to leverage the strengths of different partners and bring new ideas and perspectives to the table. The concept of innovation has been used as an explanatory variable in different studies (Abdi & Kinyua, 2018; Mugambi & Kinyua, 2020; Moki, Ndung'u & Kinyua, 2019; Muithya, Muathe & Kinyua, 2021). Technology is important in driving strategic innovation with the rise of new technologies creating new possibilities for collaboration and value creation (Kagermann, Wahlster, & Helbig, 2013). Strategic innovation demands indepth understanding of the external environment, including trends, customer needs, and competitive forces, as well as a close understanding of the firm's strengths, weaknesses, and capabilities (Drnevich & Croson, 2013)..

### **3.1.1 Perspectives of Strategic Innovation**

Key perspectives of strategic innovation include the type of innovation that a firm pursues which entails product, process, organizational, and marketing innovations (Damanpour & Aravind, 2012). A firm's innovation strategy is another perspective of strategic innovation and it entails the level of investment, the types of innovation a firm is inclined to, and the degree of risk-taking involved (Drnevich & Croson, 2013). Innovation capabilities including a firm's capacity to generate, select, and deploy ground-breaking ideas through various means, such as investments in R&D, partnerships with external stakeholders, and employee training and development. (Damanpour & Aravind, 2012). Innovation culture and its influence on the willingness of employees to take risks, share ideas, and collaborate (Hult, Ketchen & Slater 2004). Innovation performance that includes measures of financial performance, market share, customer satisfaction, and employee engagement depending on the organization's goals and priorities. (Damanpour & Aravind, 2012). Another key perspective is management capabilities. This entails the power to be able to seize market opportunities and trends, and arrive at an appropriate response, mobilize the resources and guide the firm effectively towards a successful future lies in the capability of the CEO and top management and further harnessed by the firm's values, culture and its ability to quickly adopt and adapt new business strategies and models (Teece, Pisano, & Shuen, 1997). This is the orchestration function of top management and their creative and entrepreneurial managerial decisions that they make as they steer a firm forward (Dosi, Faillo, & Marengo, 2008).

Learning and innovation are key as top managers of a firm ask themselves fundamental questions on customers, their current and future needs, the technology that the firm should deploy to serve those needs, interrogate the business models and question what business strategies are working or need to be confirmed to build superior performance. (O'Reilly & Tushman 2008). Technology as a resource, process and enabler is important to strategic innovation by providing the foundation for new products, services, and processes. (Chesbrough, 2003). Firms that possess technological knowledge, skills, resources, culture and capacity to invest in emerging technologies are better positioned to identify and exploit opportunities for innovative value creation (Teece 2012). However, technology alone is not sufficient, and firms must also have the capabilities to effectively develop and implement new innovations (Danneels, 2002). Factors influencing strategic innovation include its internal resources and capabilities, external market conditions, and organizational culture and leadership (Damanpour & Schneider, 2006).

Open innovation is a paradigm shift in strategic innovation that lays emphasis on the significance of collaboration and external knowledge sources in driving innovation in firms. Such collaborations could be strategic partnerships with customers, suppliers, and research institutions, to create new products, services, and processes (Chesbrough, 2003).

### **3.1.2 Dimensions of Strategic Innovation**

Research studies in strategic innovation have identified four key dimensions with specific indicators. These include product innovation which involves the generation of new and enhanced product or service portfolio that meets the ever changing needs of customers and prospective clients. The measures can be done by looking at the number of new products or services introduced, the percentage of sales from new products, and the rate of product development (Damanpour & Aravind, 2012). Process innovation dimension looks at the new or improved processes that increase efficiency, reduce costs, and improve quality with indicators such as cycle time, defect rate, and cost per unit (John & Storey, 1998). Another dimension is organizational or firm innovation which entails the creation of new structures, systems, and processes that enable the firm better leverage its resources and capabilities with measures such as the level of cross-functional collaboration, employee engagement, and the use of new communication technologies (Birkinshaw et al., 2008). Another dimension is that of business model innovation which is about creation of new ways of creating and capturing value, such as new revenue streams or cost structures with its indicators including the percentage of revenue from new business models, the number of patents or trademarks filed, and the level of investment in research and development (Zott, Amit & Massa, 2011).

There are various models and indicators used to measure strategic innovation including: The Strategic Innovation Index (SII) developed by Kessler and Chakrabarti (1999) and measures the speed and effectiveness of strategic innovation in organizations by assessing strategic orientation, organizational learning, market positioning, and speed of implementation. The Strategic Innovation Capacity (SIC) model developed by Subramanian and Nilakanta (1996) measures the capacity of an organization to innovate by assessing the organization's innovative resources, processes, and performance. The Innovation Climate Scale (ICS) is a model that was developed by Ekvall (1996) and it measures the organizational climate that supports or inhibits innovation by assessing the organization's culture, leadership, resources, and support for innovation. The Innovation Potential Index (IPI): This model was developed by Amabile et al. (1996) and measures the potential for innovation within an organization by assessing the organization's resources, motivation, and work environment. The Innovation Capability Assessment (ICA) model was developed by Phusavat and

Kanchana (2009) and measures the organization's capability to innovate by assessing three main components: strategic capability, innovation capability, and operational capability.

Further to these, various researchers have used various indicators for strategic innovation in their studies including: Technology Innovation, (Zahra & Covin, 1993), marketing innovation (Jansen, Van den Bosch, & Volberda, 2006), business model innovation (Teece, 2010), open innovation (Chesbrough, Vanhaverbeke, & West, 2006), product innovation, process innovation, knowledge management, strategic alliances: (Damanpour, 2014; Jansen et al., 2006; Subramanian & Nilakanta, 1996; Zahra & Covin, 1993) and entrepreneurship (Covin & Slevin, 1991). This independent paper adopts four main indicators and includes other indicators as measures based on their relationships as demonstrated in the proposed theoretical framework.

### **3.1.3 Adoption of Strategic Innovation in Strategic Management and Outcomes**

Strategic innovation leverage can lead to significant outcomes for organizations, including improved performance, increased market share, and enhanced customer satisfaction. According to Teece (2018), strategic innovation creates new opportunities and markets through the development of new products, services, and business models. This innovation can be achieved through various means, including research and development, strategic partnerships, and acquisitions. Organizations that adopt strategic innovation as part of their strategic management approach are more likely to achieve sustainable competitive advantage (Helfat & Lieberman, 2016).

A key outcome of strategic innovation is improved firm performance. Strategic innovation can enable organizations to improve their products and services, leading to increased customer satisfaction and loyalty (Hitt, et al, 2017). Additionally, strategic innovation can lead to cost savings, increased efficiency, and improved resource allocation, all of which contribute to improved firm performance (Teece, 2018). Another outcome of strategic innovation is increased market share. Strategic innovation can enable a firm to differentiate itself from its competitors, gain competitive advantage and increase its markets share (Helfat & Lieberman, 2016). By developing innovative products and services, firm can attract new customers and retain existing ones, thereby increasing their market share. The adoption of strategic innovation can result in enhanced customer satisfaction. By developing customer-focused products and services, firms can enhance their customer satisfaction and loyalty which in turn, can lead to increased sales and revenue for the firm (Hitt, et al, 2017).

Strategic innovation can also help organizations to adapt to changing market conditions and emerging trends. By continually innovating and developing new products and services, organizations can remain competitive and responsive to customer needs (Hitt, et al, 2017). This agility can help organizations to overcome challenges and seize opportunities, leading to improved outcomes such as increased revenue and profitability. In addition, strategic innovation can enable organizations to expand into new markets and diversify their offerings. By developing innovative portfolios that appeal to a broader range of customers, firms can reduce their reliance on any single market or product category (Teece, 2018). This diversification can help organizations to mitigate risks and capitalize on new opportunities, resulting in improved outcomes such as increased market share and revenue growth.

However, the adoption of strategic innovation has its barriers. Firms must invest in research and development, talent acquisition, improve managerial capability, align culture and technology to

develop and implement innovative strategies (Helfat & Lieberman, 2016). This requires a significant commitment of resources, and there is no guarantee that the investments will result in successful outcomes. Additionally, organizations must be willing to take risks and embrace uncertainty, which can be difficult for some organizations. Having said this, firms that prioritize strategic innovation as part of their strategic management approach are more likely to achieve sustainable competitive advantage and long-term success (Teece, 2010).

### **3.2 The Concept of Firm Performance**

Firm performance refers to achievement of goals and objectives including, generating profits, and creating value for its stakeholders (Chandler, 1962). According to Barney and Arian (2001), firm performance can be assessed based on two dimensions: the financial performance and the strategic performance. Financial performance measures the company's profitability, liquidity, and solvency, while strategic performance measures the firm's ability to generate and sustain a competitive advantage (Barney & Arian 2001). Park and Jang (2019) suggest that firm performance can be measured by examining three dimensions: financial, operational, and market performance. Various methods are used to measure firm performance, including financial ratios, such as ROA, ROE, and NPM (Choi & Rainey, 2010). Non-financial measures include customer satisfaction, employee engagement, and corporate social responsibility (Chen & Mohamed, 2018). Internal and external factors have a bearing on firm performance including resources, capabilities, firm size, age, industry, resources, capabilities, strategy, corporate governance and strategy, as well as the macro-social economic factors (inflation, interest rates, and exchange rates), industry dynamics, economic factors, legal and political environment can also affect firm performance (Porter, 1990; Ozkan & Cakan, 2020).

Corporate governance, dynamics including board structure, CEO and top management characteristics, and ownership structure, also contribute to firm performance (Albuquerque, Crifo, & Reberioux, 2020). Human resource management (HRM) practices, such as recruitment, training, performance appraisal, and compensation, can also affect firm performance (Cappelli and Singh, 2017). Hill, Schilling & Jones (2001) argue that in the business world, competition is an endless process and only the most efficient, effective firms are able to gain an edge ahead of their competition. Therefore, in order to maximize sustainable shareholder value, managers need to deploy business strategies that drive firm performance, enhance sustainability and drive competitive advantage (Hill, et al, 2001).

#### **3.2.1 Measuring Firm Performance**

Financial performance is the most common indicator of firm performance. The financial measures as indicated in previous sections include sales and sales growth, ROI, ROA, ROE, cost per client, costs, profitability, and liquidity ratio (Kumar & Garg, 2018). These are drawn from lagging results that are maintained across firms compared to non-financial measures that must be defined and measures constructed (Lilly & Juma, 2014). Considered alone, financial indicators can only offer a skewed and narrow perspective of performance (Kaplan & Norton, 1992). Non-financial indicators on the other hand are low on qualitative measurability rendering them subjective yet they assist to give a total picture of firm performance.

Non-financial measures include customer satisfaction which measures metrics such as customer retention rate, net promoter score, and customer feedback ratings (Anderson et al., 2004, Kanyurhi, 2017), Employee engagement which concerns itself with employee's commitment to the firm's mission and strategic objectives and motivation to perform with metrics such as employee

satisfaction surveys, turnover rates, and productivity levels (Saks, 2006) and internal business perspective (Eklof, Podkorytova & Malova, 2018) Social responsibility measures the extent to which the company is contributing to the well-being of society and the environment. Indicators of social responsibility may include measures such as carbon footprint, charitable donations, and employee volunteer hours (Murray & Vogel, 1997). The indicators for firm performance used in this study have been informed by the four perspectives of the BSC. The Balanced Scorecard (BSC) which was developed in 1992 by Kaplan and Norton has been used as an integrated and holistic model to measure firm performance combining both financial and non-financial perspectives (Kaplan & Norton, 1992). The perspectives include customers, internal business, financial, learning, social and environmental measures, linking strategic objectives and firm performance using pre-set goals (Kaplan & Norton, 1992, Ghosh, 2006).

The Balanced Scorecard (BSC) Model with its four perspectives is a good model that has been used to describe and measure firm performance. The financial perspective of BSC focuses on the firm's financial performance, such as its profitability, revenue growth, and ROI. Financial measures are important for organizations because they are often used by investors and analysts to evaluate the financial health of the organization and its ability to create value for shareholders (Kaplan and Norton, 1996). Financial measures can also help firms to identify areas where they can enhance their financial performance and increase their profitability in the long run.

The customer perspective of BSC looks on the firm's ability to create value for its customers amidst changes in demands and preferences over time. Measures for this perspective are customer satisfaction and loyalty as well as market share. These measures are important because they reflect the organization's ability to meet the needs of its customers and create a strong customer base (Kaplan and Norton, 1996). By focusing on customer measures, firms can improve their customer service and product quality, which can lead to enhanced customer loyalty and an increase in market share.

The internal business processes perspective of BCS focuses on the firm's internal processes and operations. Measures can include cycle time, quality, and cost. By focusing on these measures, organizations can identify areas where they can improve their efficiency and effectiveness, which can lead to improved performance and profitability (Kaplan & Norton, 1996). Improving internal business processes can also help firms to respond with agility to changes in the market and improve their competitiveness.

The learning and growth perspective focuses on the firm's ability to learn and innovate. Indicators of this perspective include employee satisfaction, employee turnover, and training and development. By investing in learning and growth initiatives, organizations can improve their employees' skills and knowledge, which can lead to improved performance and innovation (Kaplan and Norton, 1996). Improving learning and growth initiatives can also help organizations to attract and retain top talent, which can lead to improved organizational performance and profitability.

#### **4.0 Literature Review**

An extensive review of the vast body of relevant theoretical and empirical literature was carried out as guided by the key construct in this conceptual review. This section therefore, presents the theories that underpin the construct of strategic innovation and firm performance as well as related empirical literature.

#### **4.1 Theoretical Review**

Two theories namely, contingency and expectation confirmation theory were reviewed as presented in the preceding section.

##### **4.1.1 Resource Based View**

The Resource Based View (RBV) was first suggested by Edith Penrose who emphasizes the role of resources and capabilities in a firm's strategic success. Penrose posits that a firm's resources and capabilities are the main determinants of its long-term competitive advantage (Penrose, 1959; Wernerfelt, 1984). The scholar further claim that firms with superior resources and capabilities are more likely to achieve long-term success. Furthermore, Penrose notes that resources and capabilities in a firm are not fixed, meaning that they are dynamic and can be developed over time through investment in R&D, training, and other initiatives (Penrose, 1959).

Other key proponents of RBV are Birger Wernerfelt who contends that key to sustained competitive advantage for firms lies in their unique resources and capabilities (Wernerfelt, 1984) and Jay B. Barney who adds the importance of external factors such as industry structure and competition (Barney, 1991). RBV suggest that firms utilize their internal resources, both tangible and intangible, that are valuable, rare, inimitable, and non-substitutable (VRIN), to generate competitive advantage, outperform their rivals and achieve superior firm performance. According to Barney (1991), resources include all assets, capabilities, processes, attributes, information, knowledge that enables the firm to devise and implement strategies for improvement of efficiency and effectiveness. Intangible assets such as knowledge, innovation, and intellectual properties have been identified as performance drivers and sources of firm's competitive advantage (Barney, 1991). The RBV theory stipulates that it is the effect of key attributes being valuable and costly-to-copy (Barney, 1986, 1991) that really gives the firms an edge. Therefore, for RBV proponents, the firms that deploy their resources and capabilities efficiently to create a synergistic effect perform better than those who do not (Grant, 1991).

Indicators for RBV could be categorized into four areas: Valuable resources and capabilities which are essential for firms to achieve competitive advantage (Barney, 1991). In the context of strategic innovation, valuable resources and capabilities include technological expertise, skilled human resources, and strong brand reputation. (Alvarez-Garcia et al., 2018). Rare resources and capabilities are those that are not widely available in the industry (Barney, 1991). Inimitable resources and capabilities are those that are difficult for competitors to replicate (Barney, 1991). Non-substitutable resources and capabilities are those that cannot be easily replaced by competitors (Barney, 1991). In the context this study, VRIN resources and capabilities include strategic innovation capability, firm culture, technology, strategic orientation, brand reputation, customer loyalty and managerial capabilities.

The theory assumes stable resource heterogeneity across firms and the propensity for those resources to generate sustained competitive advantage reside in their attributes - valuable, rareness, inimitability, and non-substitutability (Barney (991). According to Barney (1991), a firm is said to have a competitive advantage when it implements value creating strategies that are not simultaneously implemented by the rivals or the benefits of their strategy being duplicated (Barney, 1991). In this case, a firm's resources have the ability to generated competitive advantage if they are valuable; can exploit opportunities and by doing so neutralize the threats in a firm's environment, are rare among a firm's rivals, non- imitable and lacking in equivalent substitutes. Firms must

continually develop and upgrade their resources and capabilities to maintain their competitive advantage (Peteraf 1993).

Jones and Hill (1988) proposes a linear model of the RBV that focuses on identifying the key resources and capabilities that a firm possesses to achieve competitive advantage. The model emphasizes on the VRIN characteristics of resources and capabilities, which are difficult for competitors to replicate and can generate sustained competitive advantage for the firm. According to Jones and Hill (1988), the first step in applying the RBV is to identify the resources and capabilities that a firm possesses. These resources can be either tangible or intangible, and can include things like patents, brand equity, skillsets, and unique technologies. The next step is to assess the value, rarity, inimitability, and non-substitutability of these resources. If a resource possesses all four of these attributes, it is considered a VRIN resource and is likely to provide sustained competitive advantage for the firm (Jones & Hill 1988).

RBV has received its fair share of criticism. One of the criticisms of the linear model of the RBV is that it oversimplifies the complexity of how resources and capabilities interact with one another and the external factors to create competitive advantage. The model also does not seem to account for the role of dynamic capabilities in maintaining competitive advantage over time (Sirmon, Hitt, & Ireland, 2007). Pfeffer and Salancik, (2003) critique RBV theory and argue that it is too internally focused on firm's resource endowment neglecting the role of external factors such as relationships with external stakeholders - customers, suppliers, and regulators - in shaping firm performance. They propose a complementary model called the resource dependence model which incorporates both internal and external factors in explaining firm performance and suggests that firms are dependent on these external stakeholders for the resources they need to operate effectively. Therefore, the behavior and decisions of external stakeholders can have a significant influence on a firm's ability to create value and achieve its objectives (Pfeffer & Salancik, 2003).

In this study, RBV is the main theory that underpins all the four constructs including strategic innovation as a strategic resource and capability, competitive advantage, firm culture and firm performance.

#### **4.1.2 Market-Based View**

Market-based view (MBV) is a perspective that links a firm's performance to its ability to satisfy customers' needs and wants, as well as the effectiveness of the firm's marketing efforts (Amit & Shoemaker, 1993). The theory suggests that a firm's profitability and long-term success depend on its ability to generate value for customers increase its share of the market (Baines & Page, 2009; Barney, 1991). According to MBV, firms achieve superior performance by exploiting market imperfections and developing unique capabilities to respond to customer needs and preferences (Amit & Shoemaker, 1993). This view proposes that a firm's performance can be predicted by analyzing its market position, its competitive advantage, and its marketing strategy (Barney, 1991). It assumes that customer needs and wants are the primary driver of firm's performance and thus a firm's marketing activities can directly influence its financial outcomes (Amit & Shoemaker, 1993).

The main proponent of the Market-Based View is Shelby D. Hunt, a marketing scholar and professor at Texas Tech University. Hunt's influential work in the 1980s and 1990s laid the foundation for the Market-Based View, emphasizing the importance of market orientation and customer focus in creating sustainable competitive advantage (Hunt, 1991). Other key proponents

of market-based theory include Peter Drucker who emphasized the importance of understanding customer needs and behaviors to achieve long-term success in the marketplace (Drucker, 1954), Theodore Levitt who stressed the need for firms to focus on customer needs and demands rather than specific products to remain competitive (Levitt, 1960), and Philip Kotler who included the concept of the marketing mix which puts premium on the importance of product, price, promotion, and place in a firm's marketing strategy (Kotler, 1967).

The evolution of market-based theory can be traced back to the emergence of the marketing concept in the 1950s and 1960s (Drucker, 1954). This theory stresses on the prominence of customer orientation and the creation of customer value as the basis for long-term success in the market (Barney, 1991). Other proponents of market-based theory include Michael Porter (1980), who argued that a firm can achieve a sustainable competitive advantage cost leadership or market differentiation. Another prominent figure in the field is Clayton Christensen (2015), who developed the concept of disruptive innovation, which suggests that new entrants can disrupt established firms by offering low-cost, simplified solutions that appeal to underserved customer segments.

It is worth noting that the evolution of market-based theory has been influenced by advances in technology, changes in customer behavior, and globalization (Porter, 1980; Day, 1994). The rise of e-commerce, social media, and big data analytics has enabled firms to gain greater insights into the ever-changing customer preferences and behavior, leading to more targeted marketing and product development efforts (Porter, 1980; 1985; 1990). The emergence of new markets and the growth of international trade has also created opportunities for firms to expand their operations and reach new customers (Barney, 1991). The theory has advanced over time to bring into play concepts such as dynamic capabilities, which refer to a firm's ability to adapt and innovate in response to changing market conditions (Teece et al., 1997).

Critics of market-based theory argue that it places too much emphasis on customers and short-term financial performance and neglects other important aspects of a firm's performance, such as social and environmental impact (Hillman, & Keim, 2001). They also argue that market-based theory can lead firms to prioritize the interests of shareholders over other stakeholders, such as employees, customers, and the community. Critics of the MBV argue that it places too much emphasis on the external environment as well as customers therefore ignoring the importance of internal resources and capabilities in achieving sustained competitive advantage (Makadok, 2001). Some studies have found support for the market-based theory's predictions about the relationship between a firm's market position, competitive advantage, and financial performance. For example, a study by Baines, Fill, & Page, (2009) found that firms with superior market-based assets, such as brand reputation and customer loyalty, tended to have higher financial performance than firms without these assets. However, other studies have found mixed results, suggesting that the interplay between market-based assets and financial performance is not always straightforward and can be influenced by other factors, such as industry characteristics and competitive dynamics (Slater & Olson, 2000). MBV underpins the construct of firm performance in this study

#### **4.2 Empirical Literature Review**

Uyar and Kilic (2017) investigated the relationship between product innovation and firm performance in the context of Turkey. The indicators used for product innovation were new product development, product design, and product performance, however, firm performance was measured by return on assets and sales growth. The study used quantitative research using survey data from 240 manufacturing firms and the findings include: Product innovation was found to have a positive

impact on firm performance, and this relationship was partially mediated by market orientation and knowledge management. The study only focuses on firms in Turkey, which may limit the generalizability of the findings to other countries and contexts. The study uses a cross-sectional design, which makes it difficult to establish causality between product innovation and firm performance.

A study by Li, Liu, & Li (2018) that examined the impact of product innovation on the financial performance of Chinese firms in the manufacturing industry in this empirical study, 259 Chinese manufacturing firms were sampled and examined using structural equation modeling as the empirical model. The findings indicated that product innovation positively affected the financial performance of Chinese manufacturing firms, and this relationship is mediated by market share and customer satisfaction. The study focuses only on the manufacturing industry in China, and the sample size used may not be representative of the entire industry.

A study by Sousa *et al.* (2019) sought to unearth the effect of process innovation on firm performance. Quantitative research approach using survey data from 239 Portuguese manufacturing firms was done and structural equation modeling was used to test the research hypotheses. The study found that both process innovation has a positive and significant effect on firm performance. The study also suggested that quality management practices partially mediates the relationship between process innovation and firm performance. The study only focused on manufacturing firms in Portugal, and future research could replicate the study in other context in order to ascertain the universality of the findings of the study.

In a study carried out in Pakistan by Mahmood *et al.* (2018), the relationship between process innovation and firm performance was examined. Quantitative research approach was used with survey data from 154 Pakistani manufacturing firms. Multiple linear regression analysis is used to test the research hypotheses. The study found a positive and significant relationship between process innovation and firm performance. The results also suggest that the relationship between process innovation and firm performance is stronger for small and medium-sized enterprises compared to large firms. The study only focused on manufacturing firms in Pakistan, and future research could explore the relationship between process innovation and firm performance in other industries and countries.

Zhou *et al.* (2018) sought to avail an empirical evidence from the Chinese context of the effect business model innovation on firm performance. The study found a positive relationship between business model innovation and firm performance. In addition, Lindman (2020) conducted a study in the Swedish context on the relationship between business model innovation and financial performance. Data extracted from annual reports and the websites the sampled firms. Performance as a key construct in the study was measured using return on assets, return on equity, and Tobin's q). Quantitative approach was used with panel data analysis. The study found that business model innovation has a significant positive effect on financial performance, and that this relationship was further moderated by firm size and industry.

Boon-itt and Wongwanich (2018) investigated the relationship between strategic innovation and firm performance in the Thai food industry. The study was based on a quantitative research design and involved a sample of 175 Thai food firms. The study used a survey questionnaire to collect data on strategic innovation and firm performance. The study found that strategic innovation has a

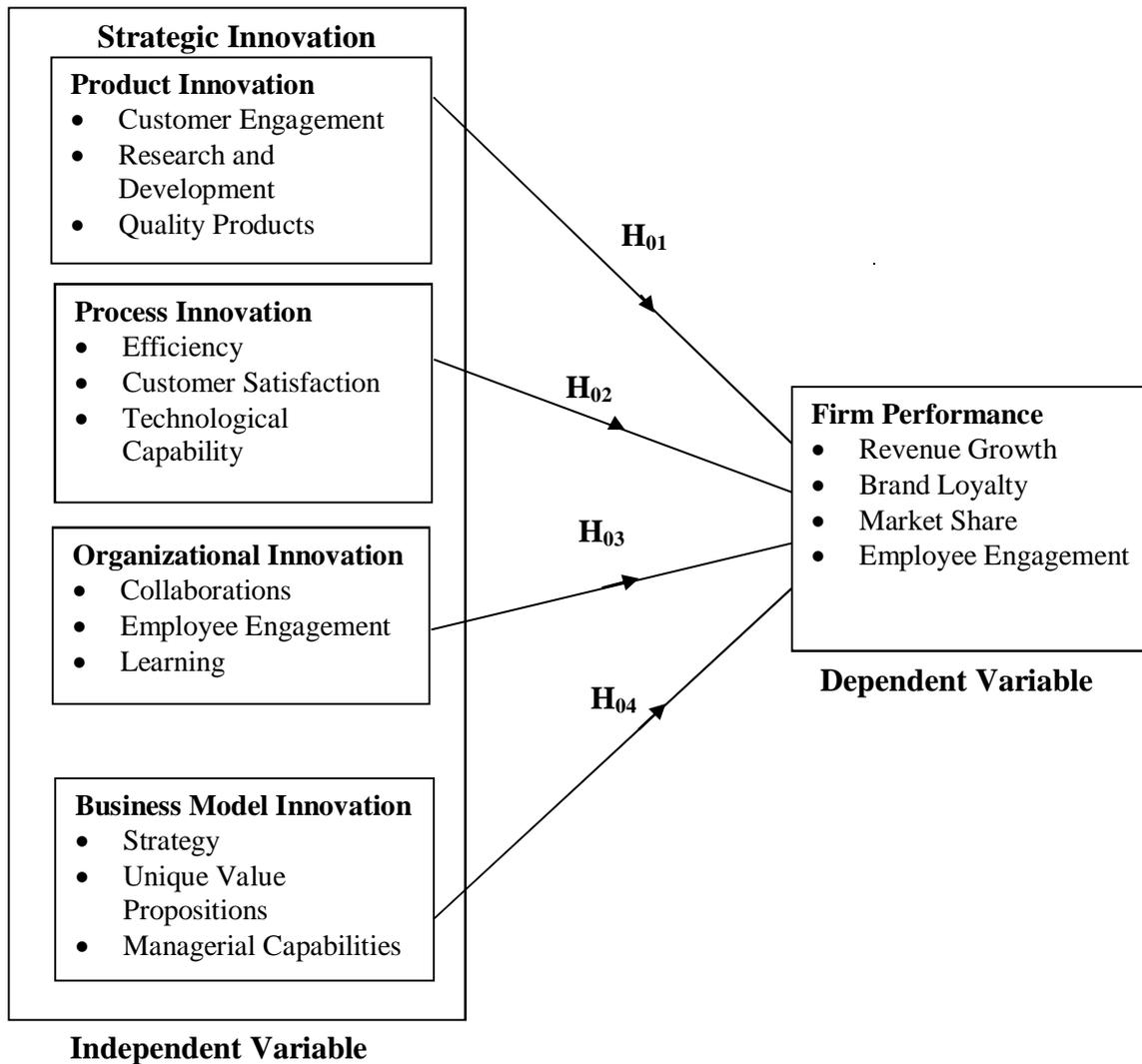
positive effect on firm performance, which is partially mediated by competitive advantage. The study further showed that market orientation, technological innovation, and knowledge management were significant predictors of strategic innovation. However, the study did not explore the specific factors that influence the mediation effect. Additionally, the study relied on self-reported data, which may be subject to response bias and social desirability bias.

A research by Alqahtani & Srinivasan (2019) investigated the effect of strategic innovation on firm performance in the Saudi Arabian construction industry. The study employed a quantitative research method and used a structured questionnaire to collect data from 217 construction firms in Saudi Arabia. The study used structural equation modeling to analyze the data and test the hypothesized relationships between the variables. The study found that strategic innovation has a significant positive effect on firm performance. The study underscored the importance of fostering a supportive organizational culture to enhance the benefits of strategic innovation on firm performance in the Saudi Arabian construction industry. However, the study used self-reported data which may render biases in the findings.

### **4.3 Proposed Theoretical Model**

Theoretical model is imperative in helping to reveal the relationship among independent variables, moderating variables, mediating variables and dependent variable. In the case of this independent study, a theoretical model was proposed that illustrated the relationship between strategic innovation and firm performance. This relationship is demonstrated in a chart below marked as Figure1.

### 4.3 Proposed Theoretical Model



**Figure 1: Proposed Theoretical Model**

**Source: Author (2023)**

The proposed model shows that strategic innovation as the independent variable and firm performance as the dependent variable were the constructs of the study. In this study, product innovation, process innovation, organizational innovation and business model innovation have been identified as the most widely analyzed dimensions of strategic innovation. Product innovation involves the creation of new or improved products or services that meet the evolving needs of customers. Process innovation fosters efficiency, reduces costs, and improves quality of products or services whereas organizational innovation creates new structures, systems, and processes that enable an organization to better leverage its resources and capabilities. Additionally, business model innovation entrenches new ways of creating value for the customers. On the other hand, firm performance can be effectively measured using brand loyalty, revenue growth, market share and employee engagement so as to cater for the diverse needs of organizational stakeholders.

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