

# The Relationships Between Environment, Strategy, Organizational Structure, and Business Performance

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# The Relationships Between Environment, Strategy, Organizational Structure, and Business Performance

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**Abstract-**This study will develop a model of relationship between the environment, strategy, organizational structures and business performance of the manufacturing industries in Yogyakarta and Central Java. The population of this study are all manufacturing industries in Yogyakarta and Central Java. The samples in this study are designed using Cluster Random Sampling technique, guided by Standard Classification of Indonesian Business Field [Klasifikasi Baku Lapangan Usaha Indonesia] (KBLUI) in category D at digit 2. 250 samples are taken and based on the result of the questionnaire distribution, 143 respondents answered the items completely, so this meets the requirement for Structural Equation Modelling (SEM). Six variables are considered: external environment, internal environment, competitive strategy, strategic orientation, organizational structure and business performance. Validity and reliability tests indicate that all variables are valid and reliable.

Based on the data analysis, the findings are: (1) external environments have positive influences to competitive strategies, (2) internal environments have positive influences to competitive strategies, (3) organizational structures don't have positive influences to competitive strategies, (4) competitive strategies have positive influences to strategic orientation, (5) competitive strategies have positive influence to the business performance, (6) competitive strategies have positive influence to organizational structures, (7) strategic orientation have positive influence to the business performance, and (8) organizational structures have influence to the business performance.

**Keywords-**environment, competitive strategy, strategic orientation, organizational structure, and business performance.

## I. INTRODUCTION

The government expects that the manufacturing industries could continuously improve their performance. Department of Industry in Indonesia has focused and will focus its support on the manufacturing industries until next year. The fact needing serious attention is that the performance of manufacturing industries has kept slowing down. In Indonesia, growing of manufacturing industry is very significant for manufacturing industry,

government and industry is very significant for manufacturing industry, government, and society in order to assist in achieving pro-growth, pro-job, and pro-poor.

## II. LITERATURE REVIEW

The Relationship between Environment, Competitive Strategy, Strategic Orientation, Organizational Structure and Business Performance

Since competition is a game, particularly for a company in the turbulent environment, the competing company is trying to find ways to sustain its success in the long term, which is difficult to copy by its competitors. This means that the company wants to gain its competitive advantage. It is therefore required that it have competitive strategies leading to a position of profitability and supporting capacity facing the powers which determine industrial competition.

In the opinion of Schuler and Jackson (1987), there are three strategies in an organization which can be used to gain competitive advantages; innovation, quality enhancement, and cost reduction. These strategies can be pure for single units or in the functional areas, but these may overlap, where business units or functional areas have two or more competitive strategies simultaneously (Schuler and Jackson, 1987). Kumar, et al. (1997) say that as a matter of fact, the type of Potter's generic strategy is similar to that of Miles dan Snow. Defender (Miles and Snow) is similar to Low Cost (Porter) and Efficiency. Prospector (Miles and Snow) is similar to Differentiation/Innovation (Porter/Miller and Friesen's). Porter explains that Cost Leadership and Differentiation are mutually exclusive (Kumar, et al., 1997). If both are combined they will get stuck in the middle. Cost leadership and differentiation is combined with the focus strategy, hybrid will take place. This does not necessarily mean that that getting stuck in the middle may not happen. In one of the researches conducted by Kumar, et al. (1997) indicated that Porter's generic strategies are not mutually exclusive and each strategy can be connected to another variation of strategy.

Competitive strategic variations could create competitive advantages. What needs to bear in mind is that the condition of getting stuck in the middle is unpredictable. As in the reactor strategy explained by Miles and Snow, stuck in the middle has never been proposed as a way to success (Robbins, 1994). The reason is that both types of strategy have a clear-cut characteristics, in extreme points and consistently adapting themselves with the variable contingency in the company.

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After considering the existing environmental aspect, the choice of appropriate strategy is closely related to the strategic orientation of the managers and the organizational structures, which will have impact on the business's performance (Covin and Slevin, 1989; Robertson and Chetty, 2000). The findings conclude that there is a causality between environment, organizational structure, and strategic orientation on the performance. If there is a synchronicity between environment and strategic orientation, organizational structure and strategic orientation, better performance can be made.

Related to competitive strategies, Steers (1984) empirically find that environment could influence strategies and performance/organizational effectiveness, and environment could influence organizational structures. This could happen because different environments require different organizational structures, and this will influence the business performance. Steers (1984) highlights that new strategies require new structures, so strategies will influence organizational structures. This finding is supported by Miner (1982) and Hammond (1994) by adding a debate whether structure follows strategy or strategy follows structure. In later development, there is a consensus that both could be implemented (Hammond, 1994). Therefore, there will be reciprocal influence between strategy and structure.

In general, environments can be categorized into external environments and internal environments. Boyd et al. (1993) explain how to measure environmental variables which can be viewed from two approaches: objective and perceptual. Based on the approach of E-S-P (environment-strategy-performance) paradigm model, environmental variables could play an important role affecting the business' strategies and performance. Even the research of Adu (1999) finds that there is a direct influence of environment on the business performance.

Steers (1980) explains that environment could influence the roles of the managers which will influence the effectiveness of the organization. The management will find it hard to understand the complexity of the environment. The capacity of information processing management will be overloaded and it will also implicate the decision made (Robbins, 1994). Researches dealing with the influence of environment on the management attitudes/roles/styles, particularly with managerial convictions and performance have been conducted by Coltman et al. (2003). Based on the model and measurement, it is found that organizational condition (feasible limitations, organizational condition) and external environment (market/technology and environmental pressure) could directly influence e-business performance, and it could also indirectly influence e-business performance mediated by the managerial convictions/attitudes/management styles. The general findings of several empirical researches also indicate that strategy influences performance (Bou and Beltran, 2005); Edelman et al. (2005); Carmeli (2004); Priyono (2003, 2004); Heijltjes (2003); Weinsten and Obloj (2002); Dyer and Reeves (1995), strategy influences strategic orientations (Offstein et al., 2005); Edelman, et al., (2005),

Alleyne, et al. (2005), Carmeli, (2004), Hoogervorst, et al. (2002), Schuler and Jackson (1987). Therefore we propose hypothesis. This literature has been used to develop the conceptual framework for this study as shown in Figure 1.

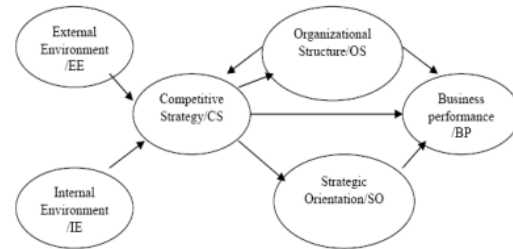


Figure 1. The relationships between Environment, Strategy, Organizational Structure, and Business Performance

#### A. Hypothesis

Based on the research model, this study hypothesizes that:

- H1. There is positive influence of external environment (EE) to competitive strategies (CS).
- H2. There is positive influence of internal environment (IE) to competitive strategies (CS).
- H3. There is positive influence of organizational structures (OS) to competitive strategies (CS).
- H4. There is positive influence of competitive strategies (CS) to organizational structure (OS).
- H5. There is positive influence of competitive strategies (CS) to the business performance (BP).
- H6. There is positive influence of competitive strategies (CS) to organizational structures (OS).
- H7. There is positive influence of strategic orientation (SO) to the business performance (BP).
- H8. There is positive influence of organizational structures (OS) to the business performance (BP)

### III. RESEARCH METHODOLOGY

There are six variables which are used in this research; external environment, internal environment, competitive strategy, strategic orientation, organizational structure and business performance. Validity and reliability tests indicate that all variables are valid and reliable. The population of this study are all manufacturing industries in Yogyakarta and Central Java. The samples in this study are designed using Cluster Random Sampling technique, guided by Standard Classification of Indonesian Business Field [Klasifikasi Baku Lapangan Usaha Indonesia] (KBLUI) in category D at digit 2. 250 samples are taken and based on the result of the questionnaire distribution, 143 respondents answered the items completely, so this meets the requirement for Structural Equation Modelling (SEM).

### IV. EMPIRICAL RESULTS AND DISCUSSION

#### A. Descriptive Analysis

The number of questionnaires distributed is 250, with the response rate 57.2%. The following is the description of the respondents. Table 1 shows the research data used, based on

The number of questionnaires distributed is 250, with the response rate 57.2%. The following is the description of the respondents. Table 1 shows the research data used, based on the sample target, realization for each area and industrial groups.

The description of research variables depicts that external and internal environments tend to be perceived as hostile,

conservative strategic orientation, efficient competitive strategies, and mechanical organizational structure. The descriptive approach indicate that the managers of the manufacturing companies in Yogyakarta and Central Java still have different perceptions about competitive strategies, strategic orientation, organizational structure, and environment to improve the business's performance.

**Tabel 1.**  
**Description of Research Respondents**

Code	Industry	CENTRAL JAVA		YOGYAKARTA		Realization
		Sample Target	Realization	Sample Target	Realization	
15	Makanan dan Minuman	30	15	16	20	35
16	Tembakau	18	16	2	1	17
17	Tekstil	10	8	6	2	10
18	Pakaian Jadi	5	2	5	5	7
19	Kulit dan Barang dari Kulit	3	2	17	14	16
20	Kayu dan Barang dari Kayu dan barang Anyaman	2	1	10	15	16
21	Kertas dan Barang dari Kertas	3	1	-	-	1
22	Penerbitan, Percetakan dan Reproduksi Media Rekaman	2	1	15	6	7
24	Kimia dan Barangbarang dari Bahan Kimia	2	1	2	-	1
25	Karet dan Barang dari Karet	6	3	2	-	3
26	Barang galian Bukan Logam	2	-	8	-	0
27	Logam Dasar	2	-	-	-	0
28	Barang-barang dari Logam kecuali Mesin dan Peralatannya	2	1	1	-	1
29	Mesin dan Perlengkapannya	3	3	1	-	3
31	Mesin Listrik lainnya dan Perlengkapannya	1	-	0	-	0
32	Radio, Televisi, dan peralatan Komunikasi perlengkapannya	1	-	-	-	0
33	Peralatan Kedokteran, alat-alat ukurperalatan optik, jam, dan lonceng	2	-	-	-	0
34	Kendaraan Bermotor	2	-	-	-	0
35	Alat Angkutan Selain Kendaraan Bermotor Roda Empat atau Lebih	3	3	0	-	3
36	Furnitur dan Pengolahan lainnya	50	20	15	3	23
37	Daur Ulang	1	-	0	-	0
		150	77	100	48	143

See Table 2 for the evaluation of the test result of that model.

**Table 2.**  
**Criteria Evaluation of Goodness of Fit Indices**

Criteria	Result	Critical Value *)	Model Evaluation
Chi-Square	1905.080	Relatively Small	Not Good
Probability	0.000	$\geq 0,05$	Marginal
RMSEA	0.076	$\leq 0,08$	Good
CMIN/DF	1,719	$\leq 2,00$	Good
GFI	0,665	$\geq 0,90$	Marginal
CFI	0,579	$\geq 0,90$	Marginal
TLI	0,544	$\geq 0,95$	Marginal

Sumber : \*) Hair (1992), Arbuckle (1997), Muller (1996)

From the evaluation of proposed models, of all criteria used, almost all are good, except probability. GFI, CFI and TLI have marginal criteria. Based on the available explanation referring to parsimony principle (Arbukle and Worthke,



1999), if there is one or two criteria of goodness of fit which meet the expected value, the model on the whole is good, or the development of hypothesis model conceptually and theoretically is said to be supported by empirical data.

### B. Hypothesis Test

To test the hypothesis of causal relationship between external environment, internal environment, strategy, strategic posture, organizational structure and business performance, the result of path coefficient could indicate this causal relationship between those variables. See Table 3 for that relationship.

Table 3.  
Path Coefficient (Standardize dan Unstandardize Regression)

Inter variable relationship	Estimate (Unstandardize)	Estimate (standardize)	C.R	p	Note
CS ← EE	0,648	0,304	1,874	0,061**	Significant (H1 supported)
CS ← IE	1,225	0,591	2,257	0,024*	Significant (H2 supported)
CS ← OS	-1,185	-0,171	-8,27	0,408	Non Significant (H3 rejected)
OS ← CS	0,269	0,590	2,404	0,016*	Significant (H4 supported)
BP ← CS	0,455	0,433	2,863	0,004*	Significant (H5 supported)
OS ← CS	0,583	0,628	3,037	0,002*	Significant (H6 supported)
BP ← SO	0,297	0,263	2,143	0,032*	Significant (H7 supported)
BP ← OS	0,956	0,415	2,201	0,028*	Significant (H8 supported)

\* significant at alpha 5%; \*\* significant at alpha 6%

Based on the data analysis, the findings are: (1) external environments (EE) have positive influences to competitive strategies (CS) (H1 supported), (2) internal environments (IE) have positive influences to competitive strategies (CS) (H1 supported), (3) organizational structure (OS) don't have positive influences to competitive strategies (CS) (H3 rejected), (4) competitive strategies (CS) have positive influences to strategic orientation (SO) (H4 supported), (5) competitive strategies (CS) have positive influence to the business performance (BP) (H5 supported), (6) competitive strategies (CS) have positive influence to organizational structure (OS) (H6 supported), (7) strategic orientation (SO) have influence to the business performance (BP) (H7 supported), (8) organizational structures (OS) have positive influence to the business performance (BP) (H8 supported).

### C. Discussion

In general, this research indicates findings that environment-strategy-performance (E-S-P) model can be accepted or well implemented in the manufacturing industries in Yogyakarta and Central Java. This supports the previous researches which have confirmed the truth of his paradigm (Lukas, et.al., 2001; Badri, et al., 2000; Li, 1991; Luo, 1999). The findings of this research indicate that in the framework of environment-strategy-performance (E-S-P) paradigm, this paradigm could be integrated by studying other variables apart from competitive strategies which play a role of

mediation: strategic orientations and organizational structures. This supports the previous researches and confirms the truth of that integration model (Steers, 1980; Robbins, 1994: 254; Covin and Slevin, 1989) and other researchers. The researchers conclude that the paradigm of environment-competitive strategy-business performance could be integrated by considering other variables: strategic orientation and organizational structure. Next, we are going to discuss the most interesting finding of this research; Competitive strategies influences the organizational structures but organizational structures do not influences the competitive strategies.

Competitive strategies influences organizational structures. This confirms the theory and research conducted by Chandler (1962 in Steers, 1984) which highlights that a new strategy will require a new structure, so strategies will influence organizational structure. Nonetheless, organizational structures do not influence competitive strategies. What Miner (1982) and Hammond (1994) indicate seems to take place in this case. A debate whether *structure follows strategy* or *strategy follow structure* has been resolved. In its development, a consensus has been made that both could be implemented (Hammond., 1994). Findings by Covin and Slevin, (1989; Robertson and Chetty, 2000) explains that the choice of appropriate strategy will be closely linked with the organizational structure, which will influence the company's performance. Environment, organizational structure, and strategic orientations have a causal relationship with business performance. There is also a relationship between environment and strategic orientation, organizational structure and strategic orientation which could improve performance.

In this case, organizational structure does not significantly influence the competitive strategies. The manufacturing companies used as samples in this research do not have full organic organizational structures yet. In general, they still have mechanical organizational structures, for example, communication channel, very structured important operational and financial information access, limited information access, uniformed managerial styles, decision making responsibility of a formal manager, proven principles despite changing circumstances, employees are required to follow formal procedures, formal control through information system and strict control and complying formal job descriptions. This condition should not happen considering the manufacturing company leaders in Yogyakarta and Central Java perceive that the external and internal environments faced by the company are hostile. This will influence the strategies implemented by the company. If so, there is a discrepancy in the implementation of competitive strategies and organizational structure which may influence the company's performance. If nothing is done, this will predictably slow down the business performance.

Therefore, in today's competitive era, the companies are recommended to emphasize on marketing activities as a development support of production process, superior quality product creation with premium price, brand image building and focusing on continuous service, aggressively searching

for new market opportunities. Manufacturing companies in Yogyakarta and Central Java need to highlight the loose cost control system by focusing on the above standard product creation, flexible operational activities with strong inter-functional coordination, and excellence in research and development and high quality new products.

This condition happens because the companies are expected to implement innovative competitive strategies. This may be caused by the pressure of hostile external and internal environments. The characteristics of the environment condition are vulnerable industrial setting, tight competition intensity, tough and tight business climate, lack of exploitable opportunities, full of risks, pressure and domination. The company needs to be careful about implementing that innovation strategy since costs need to be taken into consideration. Loose cost control focusing on above standard product creation, flexible operational activities with strong inter-functional coordination, and excellence in research and development and high quality new products will require relatively high costs. This should be compensated by continuous performance improvement.

It should also be noted that along with the growth and growing organization due to the improving company performance, centralization or authority and power in the echelons of top management will also grow. There is distance between relevant information resources and decision making. Also, the more decentralization in an organization often produces improvement in some areas and in effectiveness. Decentralization is related with the more management efficiency, open feedback communication, work satisfaction and more loyal employees. In some cases, organizational decentralization produces performance and innovation improvement and creativity in organization, so organizational performance will also improve, although this is not a guarantee.

The study of organizational structures cannot be separated from specialization and formalization. Specialization can be measured in various ways, for example, the number of divisions in an organization and the number of special sections under each division, the number of different positions and the number of different sub units in an organization, and the number of jobs and positions in an organization. Specialization will boost performance because specialization enables every employee to have expertise in a certain field so that they could maximally contribute to the goal. Despite its benefits, specialization has also its drawbacks on the part of the employees regarding the mental health, work attitude, and the tendency to stay in an organization. Formalization usually indicates the work scope and regulation of employees through formal procedures, rules and regulation. The bigger the influence of rules, regulation, and work obligations, the bigger the formalization is. This formalization very often puts the company at disadvantage because this will discourage creative behaviors, innovations and adaptations. One of the advantages, however, is that the company becomes more effective and efficient. This organizational structure will have a close link with the business performance. Therefore, the appropriate strategic implementation should be followed

by appropriate design and organizational structure, and vice versa, because both will influences the business performance.

## V. CONCLUSION AND IMPLICATION OF THIS STUDY

### A. Conclusion

External and internal environments faced by manufacturing companies in Yogyakarta and Central Java are perceived hostile, efficient competitive strategies, conservative strategic orientation, and mechanical organizational structure. This perception will influences the main result of the research such as; (1) external environments have positive influences to competitive strategies, (2) internal environments have positive influences to competitive strategies, (3) organizational structure don't have positive influences to competitive strategies (CS), (4) strategic orientation have positive influences to competitive strategies, (5) competitive strategies have positive influence to the business performance, (6) competitive strategies have positive influence to organizational structure, (7) strategic orientation have influence to the business performance, (8) organizational structures have positive influence to the business performance.

The recommendations proposed by this research are; (1) manufacturing companies in Yogyakarta and Central Java need to analyze and pay attention to the strategies concerning the aspects of marketing mix. Aspects of marketing mix include marketing activities conducted by the company which cover; products and services, price competition, distribution and promotion channels. Besides, manufacturing companies in Yogyakarta and Central Java need to pay attention to the level of product innovation, industrial growth and development, the toughness of marketing environment of the main competition, impacts of competition, various production methods and marketing tactics to different consumers. When business faces tight competition, the situation is complex and uncertain. To respond this challenge, continuous innovations, based on the organizational knowledge, are required. The companies which continuously innovate (*act creative destruction*) have the competitive advantage based on knowledge. Accurate and appropriate identification of company's resources also functions as core competency to produce business performance, (2) competitive strategies are directed toward a position of profitability and competitive capability facing the power determining the industrial competition. It should also be noted that the choice of appropriate strategies will be closely linked with the managers' strategic orientation, which will influences the business performance, (3) structure is a good way to place people as part of an organization in relatively stable relationship, which determines patterns of interaction, coordination and task-oriented behaviors. Some of the things which need to be taken into consideration and to be further studied in organizational structure of a company is the span of control, decentralization or relative centralization of the authority and power, level of formalization, degree of functional specialization, (4) it should also be noted that experience,



expertise and the personality of the CEO tend to correlate with one type of strategy or a combination of various strategies. Strategies need to be appropriately formulated and implemented because they will influence business performance in the short term and in the long term

#### B. Implication Of This Study

only evaluates aspects related to environment, organizational structure, strategic orientation, all of which influence the business performance. It is recommended that the implementation of competitive strategies is linked to contingency variables faced by the company such as environment, organizational structure, strategic orientation from its configuration and contingency. This is important considering if manufacturing companies could adjust to appropriate level, these manufacturing companies in Yogyakarta and Central Java could improve their business performance.

Apart from competitive strategies, other aspects need to be taken into consideration; strategic orientation, and organizational structures in bridging the influence of environment on business performance like organizational culture, human resource practices, management practices, managerial styles and so on. By doing so, a holistic model which integrates other variables to improve business performance in a comprehensive model can be achieved.

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