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The effect of environment risk, corporate strategy, and capital structure on firm performance: An empirical investigation of restaurant firms

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Abstract

The co-alignment process has been used in hospitality strategy as a framework to explain strategic orientation of firms. In this study, using a sample from the US restaurant industry, the authors test the simultaneous impact of surrogates from constructs identified as part of the co-alignment model, i.e. environment, strategy, and structure, on firm performance. Results indicate that a significant variance in firm performance is explained by the variables from the foregoing constructs of the co-alignment model. The robustness of this study provides restaurant firms' managers a basis to evaluate their firms' strategic orientation vis-à-vis its impact on firm performance.

Keywords: Environment risk; Corporate strategy; Capital structure; Firm performance; Cash flow

1. Introduction

In the research domain that contains the study of firms from a strategic management perspective, firm strategy formulation and implementation decisions have been pointed out to be the key in explaining superior firm performance (Thompson et al., 2004; Hill and Jones, 1995). Conceptually, this relationship is purported to be within the paradigm that explains the effect of environment, strategy, and structure, on firm performance (Olsen

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et al., 1998). In this study, the authors use this underpinning to test surrogates from the corporate finance literature that represent the foregoing constructs in terms of their simultaneous effects on firm performance.

Inasmuch as incremental research is essential in building theory in a given field of study, it is essential that empirical tests are used as a basis to verify the underpinnings of theoretical models to confirm such ex ante conceptualizations. While prior studies in hospitality research have not tested the relationships among the constructs proposed in this effort, the justification to explore such relationships is based on the fact that it provides practitioners with a framework to view firm performance-related variables from a strategic perspective. Moreover, scholars in mainstream business research domains, i.e. strategic management and corporate finance, have not delved into testing such a model that confirms the empirical veracity of the constructs in being able to explain firm performance.

The authors make such an attempt in this paper while positing that the variance in firm performance can be better understood by using surrogates from the three constructs, i.e. environment risk, corporate strategy, and capital structure. The surrogates from these constructs are used to explain the proportion of variance in firm performance. Results indicate that a significant variance in firm performance is explained by the independent variables. In fact, the robustness of the empirical findings provides practitioners with a basis to evaluate their firms' strategic orientation from a financial perspective while lending support to the idea of organizational alignment or fit.

The following sections report a historical perspective on past efforts and theoretical underpinnings followed by a description of the constructs/variables and the interrelationships between them, hypothesis development and testing, and description of results, while concluding with the implications for practitioners and future research.

2. Historical perspectives and theoretical foundation

Several management researchers of the likes of Lawrence and Lorsch (1967), Jurkovich (1974), Porter (1980, 1985), Dess and Davis (1984), Kotha and Vadlamani (1995), and others have directly or indirectly made attempts to theorize the effects of single or multiple constructs, vis-à-vis the firm environment, strategy, and structure on firm performance. Research work in the management field had a significant impact on hospitality research (West and Olsen, 1988; Dev and Olsen, 1989). Although these empirically based research efforts could not confirm the relationship between the constructs purported by management theorists, these efforts were significant in that they incrementally added to the hospitality literature on strategy. This led to the emergence of the "Co-alignment Model" (Olsen et al., 1998), the theoretical underpinnings of which explicate the alignment between the firm's environment, its strategy, structure, and performance.

While it is important to underscore that the model has not been empirically verified in the hospitality industry setting, the efforts to test the model were based on management theory. The constructs and variables used to test the relationship among them were developed in tandem with concepts in strategic management. Although a few strategic management theorists (Barton and Gordon, 1987) have combined concepts in finance and strategic management to test models in business management, such an approach has been few and far between. This is an even more pressing issue given that both these domains have developed theories that relate to each other especially in the context of environment, strategy, structure (resource-based), and performance.