

Applying the Miles and Snow's Business Strategy Typology to China's Real Estate Development Industry: A Research Framework

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Abstract

Strategy typologies have been widely employed to describe various business strategies within a given industry. However, few studies have applied this useful tool to China's real estate industry. In this paper we examine business strategies of Chinese developers based on the strategy typology developed by Miles and Snow (Prospector-Analyzer-Defender-Reactor). In light of the classic SWOT framework, we examine the external and internal influences/constraints to the firms' business strategy formulations by adopting two perspectives, i.e. the strategic choice and the resource-based view, in order to identify the antecedents of the business strategy types. Factors such as 'perceived political/regulatory environmental uncertainty', '*guanxi* with the local government' and 'market-linking and marketing capabilities' are suggested as significant predictors of business strategies of Chinese real estate developers and five research hypotheses are proposed. The paper aims to contribute to a better understanding on China's real estate market in general, and of the developers' strategy making behaviors in particular.

Key words: Business strategy; Real estate developer; China, Strategic choice, Resource-based view

1 Introduction

Since its publication in 1978, Miles and Snow's *Organizational Strategy, Structure, and Process* (Miles & Snow, 1978) has had considerable influence on the fields of strategic management and organization theory (Hambrick, 1983). Up to 2003, over 1100 scholarly works have cited the book, paying attention especially to the Miles and Snow strategy typology highlighted in the book (Ketchen, 2003). Based on field studies in four industries, Miles and Snow classify firms within a given industry into four groups, i.e. defenders, prospectors, analyzers and reactors, depending on how a firm responds to the three major problems facing the firm (entrepreneurial, engineering, and administrative problems). Defenders have a limited range of products and focus on efficiency and process improvement; Prospectors have a broad market/product domain and tend to lead change in the industry; Analyzers fall between the above two groups and are likely to follow a second-but-better strategy; Reactors have no consistent strategy and they merely respond passively to environment pressure. Compared with other classification schemes for generic strategies (e.g. Abell, 1980; Porter, 1980), the Miles and Snow one has been widely supported on account of its strong theoretical orientation and generalizability (Chrisman, Hofer, & Boulton, 1988; Doty, Glick, & Huber, 1993; Smith, Guthrie, & Chen, 1989; Zahra & Pearce, 1990).

However, in reality, firms' business strategic types may not be as 'pure' as Miles and Snow predict (Desarbo, Benedetto, Song, & Sinha, 2005) and the characteristics of each type may vary across industries (Hambrick, 1983). Based on the original description of the typology as well as the practices in China's real estate development industry, four derived business strategy types are suggested in this paper, embodying both commonalities with those from other industries as well as the uniqueness of the industry.

The classic SWOT (Strengths, Weaknesses, Opportunities, Threats) framework (Hofer & Schendel, 1978; Learned, Christensen, Andrews, & Guth, 1969) is revisited to identify the antecedents of the business strategy types within the industry. We adopt two perspectives, i.e. the strategic choice and the resource-based view, to examine the framework further. From the perspective of the strategic choice (Child, 1972, 1997) we believe that the ‘perceived environment’, i.e. the strategy makers’ perceptions and interpretations of the environment, are most relevant in examining the role of the ‘opportunities’ and the ‘threats’ playing in a strategy formulation process. From the resource-based view (Barney, 1991; Wernerfelt, 1984), we suspect that a developer’s business strategy type also largely depends on its ‘strengths’ and ‘weaknesses’ and therefore the strategic resources and capabilities the developer possesses. Particularly, factors such as ‘perceived political/regulatory environmental uncertainty’, ‘*guanxi*⁴ with the local government’ and ‘market-linking and marketing capabilities’ are suggested as significant predictors of business strategy types in Chinese real estate development industry. In brief, this research examines the relationships between the types of business strategies on the one hand, and a firm’s perceived environment and its strategic resources/capabilities on the other.

2 Business Strategy, Miles and Snow Typology, and its Derived Version in China’s Real Estate Development Industry

2.1 Business strategy

There is a difficulty in finding a universally accepted definition for business strategy as people’s understanding on the concept has been greatly evolved since the term of

⁴ *Guanxi* is a popular term used in Chinese society, which is described as “the informal connections so essential to gaining approval for or access to just about everything in China” (Wall, 1990; Tsang, 1998, p.64). There are *guanxi* at individual level as well as at organizational level, between which the latter is based on the former (Tsang, 1998). This paper will focus on organizational *guanxi*.

'strategy' was introduced to business and management in the 1960s. A pioneering researcher (Chandler, 1962, p.13) on this subject defines strategy as "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". Similarly, another early scholar (Ansoff, 1965, p.103) views 'strategy' as "decision rules and guidelines" required by a firm for its "orderly and profitable growth". However, apart from this "design view of strategy", more recent works on strategy recognize that a strategy can be more than an explicit, formal planning (Johnson & Scholes, 2002, p.39-61). In other words, not only can a strategy be a plan, but also a ploy, a pattern, a position, or a perspective (Mintzberg, 1987), depending on the context of discussion.

For many organizations, especially for those who engage in multiple industries or businesses, a distinction can be made between a strategy at the corporate level and at the business level (Hofer et al., 1978, p.27-29; Walker, Boyd, Mullins, & Larreche, 2003, p. 9-11). At the corporate level, a strategy should focus on the selection of a set of businesses and on the resource deployment between them. At the business level however, a strategy is to deal with the question of "how to compete in a particular industry" (Hofer et al., 1978, p.29). As noted in Johnson (2002, p.11), the business strategy of a firm is primarily concerned about "how advantage over competitors can be achieved; what new opportunities can be identified or created in markets; which products or services should be developed in which markets; and the extent to which these meet customer needs in such a way as to achieve the objectives of the organization". Those questions are of this paper's interest.

2.2 Mile & Snow typology

Two typical approaches to business strategy can be identified in the literature (Mansfield, 2002). One approach examines a number of 'components' of strategy,

typically including scope, goals and objectives, resource deployment, identification of competitive advantages and synergy (Hofer et al., 1978; Walker et al., 2003). Another approach, called generic strategy or strategy typology, premises that each business strategy type is “internally consistent” (Porter, 1980, p.24) and develops classifications of business strategies. While the former approach is helpful for analyzing strategy at the firm level, we believe a strategy typology approach is more relevant if one’s interest is to examine business strategies at the industry level.

Among the influential strategy typologies are Porter’s (1980) typology, Abell’s (1980) typology and the Miles and Snow typology (Miles et al., 1978). Porter’s (1980) typology claims that a company can follow only three generic strategies, i.e. a cost leadership strategy, a differentiation strategy and a focus strategy. Built on the dimensions of a business’ scope and the segment differentiation, Abell (1980)’s classification also suggests three possible generic strategies, namely differentiated, undifferentiated and focus strategy.

Miles & Snow’s (1978) typology classifies firms into four distinct groups, i.e. defenders, prospectors, analyzers and reactors, based on how a firm responds to three major problems facing it, i.e. entrepreneurial, engineering, and administrative problems. According to them, the entrepreneurial problem defines an organization’s product-market domain; the engineering problem focuses on the choice of technologies and process for production and distribution; and the administrative problem involves the formulization, rationalization and innovation of an organization’s structure and policy processes (see Miles et al., 1978, p.20-23).

While each of these typologies has their merits, Miles & Snow’s approach is chosen in this paper as a theoretical framework. Porter’s (1980) scheme is criticized as it “is described in relatively general terms, and seems to be limited explaining the competitive market behavior of larger firms” (Smith et al., 1989, p.63). Abell’s (1980) typology is also challenged for its failure to differentiate the “‘strategyless’

stuck-in-the-middle venture and the ventures that used cost leadership strategies” (Chrisman et al., 1988, p.418). Compared with others, two important advantages of the Miles and Snow typology are its “extensive detailed theoretical orientation” and its strong generalizability across settings (Smith et al., 1989, p.63). Especially, the model has been testified by a number of researchers in the business setting in China, a transitional economy (Desarbo et al., 2005; Peng, Tan, & Tong, 2004), which provides confidence for the current research.

2.3 Four business strategy types in China’s real estate development industry

To apply the Miles and Snow model to China’s real estate development industry is the focus of this paper. By comparing our observation on the practices in the industry and the original Miles and Snow typology, we propose characteristics of the four types of developers as follows, sharing commonalities with those from other industries while meantime presenting “sector-specific strategic recipe”(Spender 1989, cited in Child, 1997, p.56). For us, the defenders tend to stick to one or a few cities, enjoying their strong links with the local markets. While they seldom significantly differentiate their products from others’, the locations of their projects are often attractive. The prospectors seek opportunities in broad market domain and they are usually pioneers of ‘new ideas’ in the market. Thanks to newer designs, more aggressive promotions and better services, their properties can usually enjoy higher prices than their counterparts at similar locations. The analyzers are seen as ‘balanced players’ in the industry, often following a second-but-better strategy in both local markets and markets in other areas. Other developers in China, who have no consistent strategy, can be categorized as reactors. They are opportunists and are usually set up to pursue particular projects.

3 The Role of the Environment: A Strategic Choice Perspective

‘How are strategy outcomes affected by strategy process’ is a fundamental issue in business strategy research (Rumelt, Schendel, & Teece, 1994). Traditionally, this question is addressed within the classic SWOT (Strengths, Weaknesses, Opportunities, Threats) framework which considers both the external and internal influences/constraints to firms’ business strategy formulation (Hofer et al., 1978; Learned et al., 1969). In this paper, this framework is revisited and two perspectives are adopted to further examine the external and internal aspects respectively. Five hypotheses will be presented, which aims to establish links across the business strategy types and several key factors suggested in the context of China’s real estate development industry.

In the strategy literature, it is almost universally agreed that the environment ‘matters’ in firms’ business strategy formulation process (Johnson et al., 2002). However, given that the environment is such a ‘dustbin’ concept that “captures the whole world outside the organization” (Witteloostuijn, 2002, p.3227), in the following sector we discuss from the strategic choice perspective and propose a factor central to understanding on the environment of business strategy formulation processes in China’s real estate development industry.

3.1 The ‘perceived environment’ vs. the ‘objective environment’

First of all, a distinction needs to be drawn between the ‘perceived environment’ and the ‘objective environment’. In prior studies, ‘objective’ factors have been widely used to measure the environment. Typical factors of this kind include per capital gross national product (GNP), annual population growth rate, urbanization, interest rate, and

so on (Austin, 1990). However, from the strategic choice perspective (Child, 1972, 1997), we believe that top executives' perceptions on the environment can largely vary, which may cause the diversity of business strategies in a same industry/market.

Rooted from Weick (1979), the strategic choice perspective claims that decision makers 'enact' the environment in a strategy development process. On the one hand, it "allow[s] for the objective presence of environment" (Child, 1997, p.58). On the other hand, the strategic choice theory emphasizes "various possibilities allowing for choice on the part of organizational actors" (Child, 1997, p.56). According to the theory, decision makers, or the 'dominant coalition' members as called by Child (1972), have power as well as responsibilities to evaluate the environment and their organization's position, to set the goals and objectives for the organization, to allocate resources and sometimes to move into and out of an environment. They bring their 'prior ideology' into the strategic choice process. They also face limitations arose from action determinism, intra-organizational political process and informational deficiencies when making strategic choices.

In the case of Chinese real estate industry, it is arguable that developers may develop diverse perceptions and interpretations when they face the 'same' environment events across the country such as the housing reform (see e.g. Ho & Kwong, 2002; Wang & Murie, 1996; Zhao & Bourassa, 2003) and the urban land reform (see e.g. Li, 2003; Xie, Parsa, & Redding, 2002; Zhu, 1999). From the strategic choice perspective, we therefore argue that the business strategy types among the developers have partly resulted from their different 'perceived environments' during the business strategy formulation processes.

3.2 Perceived environmental uncertainty and its impact on the business strategies

Organizational environment is usually conceptualized as a multidimensional construct with dimensions such as uncertainty, threat level, dependency, homogeneity, dynamism, rate of change, routineness, domain consensus, turbulence, complexity and capacity (see Clark, Varadarajan, & Pride, 1994 for a summary of environmental dimensions). Perceived environmental uncertainty has been especially emphasized in previous studies on environment-strategy making relationship (e.g. Desarbo et al., 2005; Hrebiniak & Snow, 1980; Mintzberg, 1983). According to Milliken (1987, p.136), ‘uncertainty’ refers to “an individual’s perceived inability to predict something accurately”. Compared with other two types of environmental uncertainty (i.e. effect uncertainty and response uncertainty), perceived environmental uncertainty occur when managers perceive an organization’s environment to be unpredictable (Milliken, 1987).

Most studies in this regard support a positive link between a perceived environment uncertainty and a ‘proactive strategic orientation’ (Miles et al., 1978; Miller & Friesen, 1983; Walker et al., 2003). It is argued that “managers try to anticipate events and adopt preventive measures rather than merely react to events that have already occurred” (Chan, 2005, p.633). When perceiving a high uncertain environment, firms tend to pursue business strategies featured with innovative, proactive, and risk-taking behaviors (Buchko, 1994; Tan, 1996). For example, increasing diversification is a likely response for firms perceiving high environment uncertainty to buffer the effects (Milliken, 1987). Thus, a prospector strategy is likely to be driven by high perceived uncertainty due to “unstable, rapidly changing environments” (Walker et al., 2003, p.73). In contrast, a defender “enact[s] an environment of greater stability than do their counterparts” (Miles et al., 1978, p.47).

3.3 The perceived political/regulatory environmental uncertainty: A further note

Some perceived environmental uncertainties appear to be more relevant and important than others to different groups of managers. Country and industry factors would affect greatly how managers perceive and weigh different types of environmental uncertainties, such as political and macroeconomic uncertainties at the country level; and supply, product market, and competitive uncertainties at the industry level (Miller, 1993). Many researchers suggest that in a transition economy such as China the institutional environment, which is strongly related to the transition of government's regulation and rules, has the most considerable impact on enterprises' strategic choices (Child & Lu, 1996; Peng, 2003). Echoing this claim, Tan and Litschert's (1994, p.13) empirical study reports that "among eight environment segments surveyed, the regulatory segment was...the most influential, least predictable and most complex". In China's real estate sector, the housing reform (Ho et al., 2002; Wang et al., 1996) and the urban land reform (Xie et al., 2002; Zhu, 1999), both aiming to change the 'welfare/administrative system' to a 'market-oriented system', have been reportedly significant factors to the industry during the past two decades.

Based on the discussion above, we present two following hypotheses.

H1a Among China's real estate developers, a developer with a higher level of perceived political/regulatory environmental uncertainty is more likely to develop a 'prospector' business strategy;

H1b Among China's real estate developers, a developer with a lower level of perceived political/regulatory environmental uncertainty is more likely to develop a 'defender' business strategy;

4 The Role of the Resources/Capabilities: A Resource-based View

4.1 Strategic resources/capabilities

While some scholars distinguish the terms of ‘resource’, ‘competence’, ‘capacity’, ‘capability’ and so forth (Grant, 1991; Johnson et al., 2002), following Barney (1991; 1995) this paper refers to a firm’s internal attributes generally as ‘resources and capabilities’ which “include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness”. These resources and capabilities can be categorized into four groups-financial, physical, human, and organizational (Barney, 1995). Financial resources include equity, debt and retained earning. Physical resources include both tangible and intangible assets such as land, building, brands, copyrights, patents, and so forth. Human resources involve the resources/capabilities related to individuals, such as the experience, skill, knowledge of employees. According to Barney (1991; 1995), a firm’s organizational resources include its formal and informal management mechanism such as structure, planning, control, coordination and conflict resolution, and performance appraisal systems etc.; the organizational culture; its reputation; its relations with external institutions, and so on.

The bundle of a firm’s resources/capabilities has long been viewed as a major input to the firm’s competitive strategies (Grant, 1991; Johnson et al., 2002). In fact, according to the resource-based view of the firm (Barney, 1991; Wernerfelt, 1984), the firm can be seen as a unique set of resources; thus the ‘strategic position’ of the firm depends largely on its ‘sustainable competitive advantage’, which is in turn due to its ‘resource position’. Consequently, the strategic orientations established by Miles and Snow (1978) have been linked to different sets of resources and capabilities. Snow and

Hrebiniak (1980) suggest that firms labeled as defenders, prospectors, and analyzers would have distinctive patterns of their resources and capabilities. For example, defenders are likely to be competent at production, applied engineering and financial management while prospectors' competent functions are market research, R&D and basic engineering. Meantime, they claim that the 'reactor' type of organizations do not have a consistent pattern of distinct competence. Camelo-Ordaz and colleagues' (2003) empirical study also establishes the relationships across the Miles and Snow strategy types and a variety of resources/capabilities. They found that a firm with a 'prospector' strategy tends to value the resources that enable innovation; a firm with an 'analyzer' strategy tends to possess the resources that strengthen both efficiency and markets/products development; and a 'defender' organization tends to base its strategy on the resources towards specialization and efficiency.

It should be noted that according to the resource-based view, a firm's resources and capabilities must meet four conditions- valuable, rare, inimitable and nonsubstitutable- to be the sources of the firm's 'sustained competitive advantage', which in turn leads to its competitive business strategies (Barney, 1991; 1992). It is also argued that these critical or 'strategic' resources and capabilities are not tradeable (Dierickx & Cool, 1989). Rather, they are accumulated by a firm through its 'time path of flows' (Dierickx et al., 1989). From this point of view, we concentrate particularly on two sorts of strategic resources and capabilities associated with real estate developers in the context of China, namely 'a developer's good relationship, or *guanxi*, with the local government (cf. Tsang, 1998); and the 'market-linking and marketing capabilities' (Desarbo et al., 2005). While the latter could involve a large number of issues, in this paper it is mainly based on the description of "out-in" capabilities by Day (1994, p.41) and refers to the resources/capabilities of a firm in knowing its customers and competitors; anticipating market requirements; creating and maintaining good relationships with customers, channel members, and suppliers; and effectively conducting marketing activities such as segmentation, pricing and promotion (Day, 1994; Desarbo et al., 2005).

4.2 *Guanxi*, market-linking and marketing capabilities and the business strategies

It has been proved that *guanxi*, or ‘good connection’, is an important issue to Chinese business people and can be a source of competitive advantage (Tsang, 1998). It appears that *guanxi* with the local government is perhaps even more critical for doing business in the real estate industry in China. Until recently, urban land in China had primarily been allocated to users through administration channels (Zhu, 1999). Even after nearly two decades of the urban land reform, a ‘dual-track land market’ can be seen in China where land users can still acquire land by administrative allocation or from existing land occupiers in the ‘black land market’ despite the increasing proportion of market allocation (Xie et al., 2002; Zhu, 1994). Moreover, among the market-based allocations considerable price differences are found, for example, between those sold by private treaty and those by open tender (Chinese and Foreign Real Estate Times 1992, cited in Xie et al., 2002). In such a circumstance, a good *guanxi* with the local government would significantly result in the developer’s competitive advantage and its profitability. These developers are usually state-owned enterprises or those privatized/reformed companies who can enjoy a strong link with their former state ‘owner’ (Peng, 2000). However, given the fact that land allocations are often decided by a government at the municipal level, a developer with such an advantage would hardly be able to benefit from the advantage in other areas. As such, the developer tends to limit its developments within a particular city/area and adopt a ‘defender’ strategy per se.

Another type of resources/capabilities can usually be observed from the Chinese developers who do not have a strong *guanxi* with the local government. Those developers have to primarily rely on their ‘market sensing’ to catch every opportunity from the market instead. Thanks to the housing reform during the last two decades, “a

brand new housing market” has been generated in China (Ho et al., 2002, p.229), which seems to bring larger opportunities to this type of developers than before (see e.g. Han & Wang, 2003). In many cases, in order to survive and grow in the competition with the developers who have *guanxi*, other developers tend to respond more quickly to the market, look after the customers more closely, and seek opportunities in much wider areas. As an illustration, a recent survey (China Real Estate Top 10 Research Team, 2004) reports that most development firms whose brands are appreciated by customers country-wide are the private-sector and foreign developers rather than those from public-sector with a ‘strong government background’, implying the distinct advantages between developers. In brief, it is suggested that those developers with a ‘prosper’ strategy are more likely to take advantage of their ‘market-linking and marketing capabilities’ than their ‘defender’ counterparts.

The discussion so far has focused on those developers who do have ‘competitive advantages’ due to their strategic resources/capabilities, whether their *guanxi* with local governments or their ‘marketing and market-linking’ capabilities. However, for those developers who have not had any strategic resources/capabilities, it appears reasonable to say that it is not easy for them to develop a certain pattern of business strategies as “the essence of strategy formulation...is to design a strategy that makes the most effective use of these core resources and capabilities”(Grant, 1991, p.129). In this case, they fall into the category of ‘reactor’. Based on the discussion in this section, three more hypotheses are presented as following.

H2a Among China’s real estate developers, a developer with a higher level of resources/capabilities in building *guanxi* with the local government is more likely to develop a ‘defender’ business strategy;

H2b Among China’s real estate developers, a developer with a higher level of ‘marketing and market-linking’ resources/capabilities is more likely to develop a

‘prospector’ business strategy;

H2c Among China’s real estate developers, a developer with a lower level of strategic resources/capabilities is likely to be a ‘reactor’;

5 Summary and Implications

The Miles and Snow typology has been influential and helpful in enriching our understanding on firms’ business strategies in a given industry. However, we are not aware of any application of the typology to China’s real estate development industry. In the paper, we firstly propose four business strategy types in the industry derived from the original Miles and Snow strategic typology. By adopting two theoretical perspectives, i.e. the strategic choice perspective and the resource-based view, we then have been able to examine the external and internal influents/constraints of the developers’ business strategy development process. Three factors are suggested as antecedents of the business strategies and five hypotheses are presented.

The current script merely deals with the task of developing logic theoretical linkages between the business strategy types and their antecedents and it has limitations. Before conclusions can be drawn, empirical studies are needed to testify the hypotheses. In addition, although the three antecedents to the developers’ business strategy making behaviors have gained a theoretical support, we have not intended to identify *all* possible antecedent factors. For example, researchers may wish to investigate whether additional factors such as strategy makers’ characteristics facilitate particular business strategies. Nevertheless, this study can be seen as the first step towards systematically examining business strategies of real estate developers in China, and thus adding knowledge to this important area of research and holding implication for the practice. For example, it helps us understand better the competition behaviors in the market such as why the developers choose their particular product

lines/market areas; and how they achieve their advantages in those product/market domains. Moreover, it is possible for future studies to consider the association between the business strategies and developers' performances if such a classification of the business strategies proves valid. In sum, this article aims to contribute to a better understanding on China's real estate market in general, and the developers' strategy making behavior in particular.

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