Regulatory Focus Enhancing Firm Performance through Strategic Change

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ABSTRACT

This study aims to analyze the effect of regulatory focus on firm performance mediated by strategic change. Novelty in this study provides knowledge on how regulatory focus affects firm performance when mediated by strategic change. This research was tested using Structural Equation Modeling (SEM). The research data used were manufacturing companies in the Riau Islands Province in Indonesia. The research results explained that regulatory focus can enhance firm performance through strategic change. This study provides theoretical implications for the development of the upper-echelon theory that regulatory focus theory is a theory in the field of psychology that can support strategic decision-making to survive dynamic conditions. The managerial implications in this study contribute to companies in determining the top management team. Companies can arrange a top management team with a regulatory focus theory approach in dealing with a dynamic environment. In addition, the top management team must implement strategic changes so that the company's performance is achieved.

Keywords: Firm Performance, Regulatory Focus, Strategic Change.

I. INTRODUCTION

Today's business environment is characterized by increased and dynamic uncertainty, requiring companies to make internal adjustments to cope with changes in the external environment. The business environment in our world today is characterized by dynamic changes as a result of developments in various economic, social, political, market, and technological aspects. So, it is necessary to make strategic changes to adapt to ensure the organization maintains short-term performance to deal with certain threats and in the long term is able to achieve success in various aspects by maintaining the quality of the products and services provided (Al-Hamdani & Kadhim, 2020). In particular, corporate strategic change refers to the reallocation of company resources to achieve long-term performance goals (Helfat & Martin, 2015). Strategic change has been considered an important source of achieving competitive advantage in a very complex macroeconomic environment that positively affects company performance. However, the greater the company's strategic changes, the company requires extra effort and brings greater complexity, causing a higher risk of failure. Given the importance of strategic change involving complex processes and uncertain results, the study of strategic change is interesting to study more deeply (McElroy, 1996).

The company's strategic decisions always return to the characteristics of upper-echelon managers in decision-making. Upper Echelons Theory (UET) research generally focuses on how the characteristics of top management influence the company's strategic decision making which will affect performance. UET states that organizational strategic choices and performance results reflect the characteristics of top executives (Hambrick & Mason, 1984). The substance of UET is that top management shapes and influences the results of planning and strategic activities because the decision-making process by top management always involves character and cognitive psychology (Liu et al., 2017). Regulatory Focus Theory (RFT) is a theory that is closest to behavior and cognitive psychology than the characteristics of other directors (Gamache et al., 2020). Regulatory focus is the main motivational characteristic of top management. This has to do with how top management sees their goals and what strategies will be adopted when they try to achieve them. Thus, regulatory focus has the potential to influence company actions (Higgins, 1997). RFT can help explain how executives influence strategic change, especially for companies in dynamic markets due to uncertain environments. Planning and implementing strategic change are an important aspect of the top management role. It is perceived that top management is specifically responsible for strategic change. It is assumed that RFT is also capable of influencing future company performance in facing a dynamic environment through a strategic change approach (Jiang et al., 2020).

A country's economy can be supported by several sectors, one of which is the manufacturing industry sector. The manufacturing industry sector is believed to be a sector that can lead other sectors in an economy toward progress. This is
because the manufacturing industry sector has a very diverse product variety and is able to provide high benefits to the wearer. The manufacturing industry is more complex, so the top management strategy greatly influences the company's performance. Manufacturing industry strategy influences business objectives and strategies as well as manufacturing functions to contribute and to increase company competitiveness in the long term (Kumar & Bhatia, 2021).

II. LITERATURE REVIEW

A. Regulatory Focus

Upper Echelons Theory (UET) was first proposed by Hambrick and Mason (1984) which concluded that the chosen strategy and level of performance of an organization reflect the characteristics of top management. UET articulates a model in which top executives play an important role in shaping the majority of the results of an organization. The theory suggests that executives act on the basis of their understanding of the circumstances they face and that this personal interpretation is a function of the executive's personality and past experience. In other words, the organization is a reflection of top management which directs the actions in which the organization is involved. Top management occupies a key decision-making position, which provides opportunities for their personal characteristics to have significant consequences on determining organizational strategy, structure, and subsequent performance (Henderson et al., 2006). However, UET only uses demographic data from top management. This theory is not based on the results of a comprehensive test of individuals. To find out the relationship between individuals, organizations and their environment requires research with approaches from various disciplines such as psychology, society, and economics. UET rules out approaches such as the psychological processes of top management. This is a weakness of this theory (Hambrick & Mason, 1984).

Higgins (1997) proposed a theory of tendencies or motivations that influence how a person approaches and tries to achieve the desired goals. Regulatory Focus Theory (RFT) is a key motivational characteristic of top management. It has to do with the psychological process of how top management sees their goals and what strategies will be adopted when they try to achieve them. RFT includes two motivational dispositions that differently influence behavior; promotion focus and prevention focus (Higgins, 1997). Supporting this view, the characteristics of top management need to be investigated further regarding their relationship with strategic decision-making because there is not enough research on regulatory focus on corporate strategic implementation. The study on regulatory focus has not been extended to other firm-level outcomes, such as the decision to change the company's strategy. While strategic change is influenced by how sensitive top management is in gaining profits or experiencing losses, studies on its impact on strategic change have not been explored. Strategic changes in a company are influenced by decisions from top management to achieve company performance (Liu & Atinc, 2021).

Regulatory Focus Theory (RFT) is a theory formulated by psychology professor and Columbia University researcher, E. Tory Higgins regarding people's perceptions in the decision-making process. RFT suggests two orientations: promotion focus and prevention focus. Promotion focus is focused on hope and performance, concerned with "profit" and higher achievement. Promotion focus fits perfectly with behavior to achieve goals by focusing on achieving positive results without regard to possible negative consequences. Prevention focuses on safety and responsibility, emphasizing “no loss” and safety by following guidelines and rules. Prevention focus encourages individuals to be careful not to make negligent mistakes, and as such, they are usually more efficient in decision-making and decision execution (Higgins, 1997). Promotion focus is concerned with progress, growth, and achievement with the strategic tendency to make progress to a close match to a desired end state. Whereas prevention focuses with regard to security, safety, and responsibility with the strategic tendency being to exercise caution and avoid nonconformance with the desired end state (Higgins & Crowe, 1997).

B. Strategic Change

Strategic change is a topic that stands out at this time because it has received attention from many scientific studies (Al-Hamdani & Kadhim, 2020). Strategic change is an important effort for companies to achieve proper alignment in adapting to a dynamic environment to achieve performance. Strategic change describes changes regarding decisions regarding the allocation of company resources in the main strategic dimensions (Marta Dominguez et al., 2015). There are two approaches to strategic change which consist of causation strategic change and effectuation strategic change. Causation strategic change to accelerate strategic change, rational leader, prioritizing implementation, first-mover advantage. Effectuation strategic change is more to repeated learning, trial and error, and minimizing losses. (Wei & Zhang, 2020).

Companies must increase the speed of adaptation to a dynamic environment with strategic changes. Causation strategic change places priority on the speed of strategy implementation to gain a first-mover advantage (Rajagopalan & Spreitzer, 1997). Cause strategic change may have a positive effect on company performance. Cause strategic change can accelerate strategic change. Top managers directly disseminate the intended strategy in relation to established goals to other members after analysis. This process allows all stakeholders to become aware of changes, and thus, generates strong signals within the organization as a whole (Lundgren-Henriksson & Kock, 2016). Strong signals compel employees to engage in strategic change activities throughout the organization so that they achieve their intended strategy with high efficiency. In addition, the process not only reduces the number of experiments and out-of-control costs but also increases the adaptive speed. Therefore, the company can gain benefits as a first-mover and thereby boost company performance (Chandler et al., 2011). Conversely, effectuation strategic change can result in more appropriate adaptations through repeated learning and continuous experimentation, and thus, drive higher performance. Effective strategic change can reduce the cost of strategic change. Companies need to increase the number of experiments and adaptations to explain strategic issues.
In-depth insights from experimentation and repeated learning can deepen understanding of the strategy in question and improve the quality of the strategy. Therefore, repeated learning during the strategic change process can reduce the costs that stem from the incompatibility of strategies and inconsistent investment of resources (Dew et al., 2009). The effectuation of strategic change can increase the suitability of the new strategy and the external environment with high flexibility. This strategy not only keeps the company free from unexpected losses but produces the most appropriate effect (Arend et al., 2015).

C. Firm Performance

Company performance is defined as an indicator of the success of a company from the perspective of shareholders and stakeholders in the business model and the achievement of strategic goals. The company's performance is influenced by the company's strategic change which is an important process because it is difficult to achieve in an environment that is full of uncertainty. Failure to cope with environmental changes can have a negative impact on company performance. Strategic change is considered an aid to improve better performance (Gorondutse et al., 2021).

The aim to pursue corporate firm performance cannot be separated from the involvement of individuals in the organization. The values and cognition of influential individuals in the organization, namely top managers, play a major role in determining the results of firm performance (Mohammad, 2019).

III. HYPOTHESIS DEVELOPMENT

A. Regulatory Focus and Firm Performance

When making decisions and setting organizational goals, the decisions of top management (e.g., founders, owners, directors) can vary widely. Hence, they incorporate some aspects of themselves into the decision. Thus, to understand organizational results, one must consider the personality, disposition, and behavior of top management. Regulatory focus covers it all so that the nature of top management motivation has an impact on company performance. Top management that focuses on promotion will use cognitive, emotional, and financial resources to be allocated to aspects of achievement and profit for the organization because such tendencies lead to the manifestation of behavior eager to seek new methods to increase efficiency and ultimately effectiveness. In terms of top management is focused on prevention, resources are allocated to simply taking responsibility and seeking safety.

The prevention focus may miss some opportunities because it is overly vigilant (Liberman et al., 1999). Promotion focus will lead to higher company performance, leading to more achievements and profits for the whole company because top management is looking for new methods to help the company succeed.

However, promotion focus is no guarantee for success as it may lead to more mistakes being made in the process of striving for additional profits. Likewise, prevention focus will also improve company performance because top management who has this motivation will continue to engage and invest resources into aspects of the business that have been successful and are likely to continue to lead to success but do so in a more vigilant and compliant style to ensure financial security and avoiding possible mistakes (Higgins, 2018).

Based on this description, the first hypothesis in this study is: From the description above, the hypothesis will be used in study this are:

**H₁a:** Promotion focus has a positive effect on firm performance.

**H₁b:** Prevention focus has a positive effect on firm performance.

B. Regulatory Focus and Strategic Change

Strategic change has a very close relationship with the company's opportunity to succeed or fail. Planning and implementing strategic change is an important aspect of the role of the CEO. Therefore, the top-level management or CEO is specifically responsible for strategic changes. Promotion focus makes top management active and eager to try various paths and mechanisms, such as changing the company's resource allocation strategy, to find the most effective option for achieving goals. Top management whose motivation is more on promotion focuses on choosing riskier strategies when making decisions. Management that focuses on promotions is more likely to evaluate the results of strategic changes because profit potential carries greater importance compared to possible losses. Prevention focus tends to stick to the current resource allocation strategy if the strategy has led to success for the company in the past. Top management with a prevention focus is more likely to comply with conventional rules and routines. Although prevention-focused directors seek to avoid the risks that accompany strategic change, they will become more risk-seeking when the viability of the company is challenged. The poor performance serves as a negative stimulus, this will reduce the tendency of top management to strengthen the current strategy (Enke, 2017). Based on description above, the hypothesis is formed in study This is as following:

**H₂a:** Promotion focus has a positive effect on strategic change.

**H₂b:** Prevention focus has a positive effect on strategic change.

C. Strategic Change and Firm Performance

Most of the strategic change literature assumes a positive effect on performance. Strategic change refers to strategic decisions in managing available resources to deal with unpredictable conditions. Strategic change can expand the existing literature by identifying new approaches that have a close relationship with achieving company performance in the face of uncertain conditions (Wei & Zhang, 2020). Strategic change is considered an aid to improve better performance and can play a role in changing the organization. Strategic change is an important effort for companies to achieve proper alignment with a dynamic environment to improve performance (Kraatz & Zajac, 2001).

Strategic change is about allocating resources in a way that deviates from company experience and industry trends. Regulatory focus is considered strategically important because it can differently influence top management's approach to filtering, processing, and adopting information. Promotion focus and prevention focus also affect how top management determines strategies to achieve goals (Jiang et
The dimensions of strategic change are causation strategic change and effectuation strategic change. Causation strategic change to accelerate strategic change, rational leader, prioritizing implementation, first-mover advantage. Effectuation strategic change is more to repeated learning, trial-error, and minimizing losses. (Wei & Zhang, 2020).

From the description above, the hypothesis is formed as following:

H3: Strategic change has a positive effect on firm performance.

D. The Mediating Effect of Strategic Change for Regulatory Focus and Firm Performance

Many studies have found that a promotion focus is more creative and generates more thought ideas than a prevention focus. In certain situations, promotion-oriented are able to produce more solutions than those who tend to be prevention-oriented. The situation in question is a dynamic environment that influences how upper management levels make decisions. In general, promotion focus is associated with higher levels of strategic change characterized by a desire to try multiple paths, a preference for riskier strategies, and a positive evaluation of the uncertain outcome of strategic change. In contrast, prevention focus is associated with lower levels of strategic change because it involves concerns about safety and responsibility and a negative evaluation of the results of strategic change (Kirtley & O’Mahony, 2020).

Regulatory focus is the main motivational characteristic of CEOs (Higgins et al., 2001). The regulatory focus has implications for cognition, emotion, goal orientation, and performance which will lead directly to strategic decision-making (Tumasjan & Braun, 2012). Regulatory focus theory can help explain how executives influence company performance, especially for companies in dynamic markets because the uncertain environment and time constraints affect managerial decisions (J. Tan & Peng, 2003). Regulatory focus states that in regulating so that behavior can achieve the expected goals, individuals often adopt one of two different perspectives or motivations. This relates to how top management sees their goals and what strategies will be adopted when they try to achieve company performance (Roundy et al., 2016). The hypothesis is formulated as follows:

H4a: Strategic change mediates the effect of promotion focus on firm performance.
H4b: Strategic change mediates the effect of prevention focus on firm performance.

IV. METHODOLOGY

Data were collected from directors and managers of medium and large categories of industrial companies for the processing (manufacturing) of metal goods, computers, electronic goods, optics, and electrical equipment in the Riau Islands Province in 2021. A total of 222 respondents voluntarily participated in this study, and among them are represented by the directors or managers through questionnaires distributed online using Google-form. The questionnaires were designed using a Likert scale 1 to 5 point (strongly disagree to strongly agree). Data analysis was performed using SEM-PLS.

V. RESEARCH RESULT

Based on Table 1, the results of the H1a hypothesis test show coefficients positive and P-Value less than 0.05. This figure concludes that promotion focus has a positive significant effect on firm performance so hypothesis H1a in this study is supported. While H1b shows coefficients positive and P-Value more than 0.05 which means the influence of prevention focus to firm performance is not significant. Thus, the H1b hypothesis is not supported. The results of hypothesis testing H2a and H2b, the effect of promotion focus, and prevention focus on strategic change both produce positive coefficients and a p-value of less than 0.05. This concludes that the promotion focuses, and prevention focus has a significant positive effect on strategic change. So that the hypotheses H3a and H3b in this study are supported. Effect of strategic change on firm performance can be concluded that the H3 hypothesis is not supported because it has no significant effect with positive coefficients and a P-Value of more than 0.05. The strategic change variable is not able to mediate the influence of promotion focus on firm performance, because the effect is not significant with positive coefficients and a P-Value of more than 0.05, hypothesis H4a is not supported. Meanwhile, the strategic change variable is able to mediate the effect of prevention focus on firm performance with positive coefficients and a P-Value of less than 0.05, so the H4b hypothesis is supported.

VI. DISCUSSION

A. Effect of Regulatory Focus on Firm Performance

Resources are allocated based on the aspect of achievement and achieving profits for the company by those who focus on promotion focus because it tends to lead to behavioral manifestations by eagerly seeking new methods to increase efficiency and ultimately effectiveness.

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Coefficients</th>
<th>p-Values</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1a: Promotion focus has a positive effect on firm performance.</td>
<td>0.412</td>
<td>0.000</td>
<td>supported</td>
</tr>
<tr>
<td>H1b: Prevention focus has a positive effect on firm performance.</td>
<td>0.112</td>
<td>0.224</td>
<td>not supported</td>
</tr>
<tr>
<td>H2a: Promotion focus has a positive effect on strategic change.</td>
<td>0.325</td>
<td>0.000</td>
<td>supported</td>
</tr>
<tr>
<td>H2b: Prevention focus has a positive effect on strategic change.</td>
<td>0.385</td>
<td>0.000</td>
<td>supported</td>
</tr>
<tr>
<td>H3: Strategic change has a positive effect on firm performance.</td>
<td>0.162</td>
<td>0.197</td>
<td>not supported</td>
</tr>
<tr>
<td>H4a: Strategic change mediates the effect of promotion focus on firm performance.</td>
<td>0.053</td>
<td>0.221</td>
<td>not supported</td>
</tr>
<tr>
<td>H4b: Strategic change mediates the effect of prevention focus on firm performance.</td>
<td>0.062</td>
<td>0.017</td>
<td>supported</td>
</tr>
</tbody>
</table>

Source: Data processed in 2023
With regard to the prevention focus, resources are allocated to fulfill responsibilities and seek security because the prevention focus pays more attention to and identifies potential obstacles that might cause the loss of some opportunities due to its highly vigilant nature (Wallace et al., 2010). Top management that adheres to a promotion focus often thinks of human figures as role models in the future. They usually focus on the success they want to achieve in the future and often imagine themselves experiencing good things that are expected to happen. Their goal is to achieve ambitions and strive to fulfill their hopes, desires, and aspirations. The promotion focus figure is more oriented towards achieving success than preventing failure. Achieving firm performance requires decision-makers motivated by promotion focus who are sensitive to profit and desire for progress and growth. Whereas decision-makers motivated by prevention focus are sensitive to losses and desire stability and security, making companies not achieve the expected performance (Baas Matthijs et al., 2011).

B. Effect of Regulatory Focus on Strategic Change

The dimensions of strategic change are causation strategic change and effectuation strategic change. Causation strategic change to accelerate strategic change, rational leader, prioritizing implementation, first-mover advantage. Effectuation strategic change is more to repeated learning, trial-error, and minimizing losses. The strategy used causation strategic change or effectuation strategic change can be reflected through the regulatory focus trend adhered to by top management (Wei & Zhang, 2020).

Promotion focus makes directors active and eager to try various paths and mechanisms such as changing the company's resource allocation strategy to find the most effective option to achieve goals. Directors who focus on promotion focus prefer riskier strategies when making decisions (Higgins & Crowe, 1997). Promotion focus reflects bold thinking but has a greater risk of failure (Zhang & Rajagopalan, 2010). Prevention focus makes directors focus on prevention, preferring defensive and security-oriented goals (Higgins, 1998). They are highly alert and have a low tolerance for error. Prevention focus prefers conservative strategies that raise awareness that has resulted in success in the past (Zhang & Rajagopalan, 2010).

C. Effect of Strategic Change on Firm Performance

The strategic change consists of dimensions of effectuation strategic change and causation strategic change cannot significantly influence company performance because it does not involve internal factors (decision makers) or external factors (environmental uncertainty) that exist in manufacturing companies in Riau Islands Province. Connection strategic change with firm performance has excellent potential if other influencing factors can be explored and studied before the strategic change is used by companies to assess performance (Vithessonthi & Thoumrungroje, 2011).

D. Effect of Regulatory Focus on Firm Performance

The conclusion is that the motivation of the top leaders of manufacturing companies in Riau Islands Province in Indonesia, which is dominant in prevention focus, cannot improve performance positively if they do not make changes when the company is faced with dynamic environmental conditions. Although top management that adheres to prevention focus is considered too vigilant and focuses more on preventing losses than achieving profits, strategic changes made by those who adhere to prevention focus are able to achieve company performance. Directors and managers implementing strategic change through the dimensions of effectuation strategic change or causation strategic change are careful to develop strategies to deal with technological uncertainties. Worries about failure and often thinking about how to prevent failure instead encourage them to make changes through strategic changes that are ultimately able to make companies phase in during a pandemic.

In contrast, the strategic changes made by top management with promotion focus motivation did not have a significant impact on company performance even though the company faced dynamic environmental factors. In other words, strategic change is not suitable for top management who adheres to a promotion focus to achieve company performance in dynamic environmental conditions for manufacturing companies in Riau Islands Province. Promotion focus is more ambitious, focusing on achieving success through this research is not suitable for carrying out strategic changes to achieve the performance of manufacturing companies in Riau Islands Province because bold thinking has a greater risk of failure while implementing strategic change requires large efforts and costs (Zhang & Rajagopalan, 2010).

VII. CONCLUSIONS, IMPLICATIONS, AND SUGGESTIONS

A. Conclusions

This study aims to analyze the influence of regulatory focus on firm performance directly or indirectly through strategic change as a mediator and environmental dynamism as a moderator in manufacturing companies in the Riau Islands Province concluded that:

1. Regulatory focus is a theory in the field of psychology that can contribute to the development of UET science. Regulatory focus through the dimensions of promotion focus and prevention focus on this study is able to enrich and play an important role in explaining its influence on the strategy used by the company and explaining its effect on company performance, and furthermore being able to explain its influence on company strategy to achieve performance when the company is faced with the environment, dynamic. Promotion focus and prevention focus are not just the characteristics of the leader but are the leader's motivation and outlook on life in leading the company.

2. Strategic change is a strategy that can be used by top management to support the achievement of company performance when faced with external factors. Strategic change is able to explain the indirect influence of top management characteristics on company performance. Companies can take a strategic change approach through the dimensions of effectuation strategic change or causation strategic change to achieve their performance.
3. Although said to be an alert motivation, vigilance from prevention focus is a suitable top management motivation to improve company performance through strategic change when the company is facing external environmental uncertainties.

B. Implications

This research is expected to have implications for the company in terms of management selection or the arrangement of the board of directors. Decision-making and setting organizational goals require directors' decisions which vary greatly; therefore, they involve several aspects of themselves in these decisions. Thus, to understand organizational goals, one must consider the top executives' personalities, dispositions, and biases. Regulatory focus is a major consideration because motivation and impact on performance and individual behavior influence many aspects. The effect of regulatory focus on firm performance must be considered if a firm sees the need to select directors, i.e. it is necessary to ensure the appropriateness of motivation and psychological processes. Individually, this research can provide understanding and knowledge about the motivation and outlook on life of each top management in running their company.

C. Suggestions

This study can be done in other kind of industry such as services and trading company in many types of business. Also, the location can be expanding to other countries by considering external factor the significant face by that country such as technology uncertainty, market uncertainty, war, or hyperinflation.

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