Organizational Reputation as a Source of Sustainable Competitive Advantage and Above-Normal Performance: An Empirical Test among Local Authorities in Israel

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ABSTRACT

The role of organizational reputation (OR) was studied as a source of sustainable competitive advantage (SCA) and superior performance, theoretically and empirically, among local authorities in Israel. Using the LISREL VIII program, we proposed a mediation model that argued for a relationship between OR and financial performance, mediated by three tests for SCA: OR-value, OR-rareness and OR-inimitability. The effects of demographic and environmental variables on financial performance were also examined. Strong support was found for the resource-based view (RBV), maintaining that to achieve superior performance, organizations need to acquire SCA, which is dependent upon the core resources it possesses.

INTRODUCTION

Local governments in Western countries increase their volume of activities in accordance with the central government. The rate of local government expense out of total public expense has been continuously growing (*Goldsmith and Newton, 1988; Leach, Stewart, and Walsh1994; Sharpe, 1988*). Although local authority could be defined as a regional monopoly and political entity, it should be examined as an independent organizational unit aimed to meet well-defined purposes. The local authorities (LA) compete to build a solid organizational reputation (OR) in order to gain a sustainable competitive advantage (SCA) for achieving

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above-normal performance in diversified fields of activity. As it is diversified organization, the issue of measuring performance arises. The problem of measuring performance of public organizations, including local authorities, has not been resolved, even after much debate on the issue (*Ammons, 1995, 1997; Cunnigham, 1977; Martin and Kettner, 1996*).

The resource-based view (RBV) is predicated on the assumptions that gaining and preserving SCA is a function of the core resources and capabilities (e.g., know-how, culture, strategy, etc.) which each organization brings to the competition in a given environment (*Barney, 1995*), and that such resources and capabilities are the primary source of an organization's success (*Grant, 1991*). From the late 1980s, research efforts have been directed to examining the relationship between core resources and capabilities, SCA, and above-normal performance. These efforts have stemmed from the theoretical claim that heterogeneity of organizational resources leads to differences in competitive advantage and to variance in performance (*Prahalad and Hamel, 1990; Reed and DeFillippi, 1990*).

According to the demographic model of the open system approach, one can examine the effects of demographic traits (e.g., age, size) on the organizational life cycle: creation, growth, decline and mortality (*Morgan, 1986*). This approach can also be employed in the strategic analysis of gaining SCA, whereby demographic traits as well as tangible and intangible resources may create SCA and lead to superior performance (see *Ghemawat, 1986*).

The theoretical aspects of the RBV have not yet been empirically examined in LA. The study reported here concerned OR as a source of SCA and above-normal performance in LA in Israel. Drawing on theoretical insights from the RBV and the demographic model of the open system approach, it explored (a) the relationship between the OR and financial performance, as mediated by SCA, and (b) the competence of explanation of the variance in performance of the local authorities in Israel, by relating demographic traits and organizational environment to OR and SCA.

In this paper, we first briefly discuss the theoretical origins, assumptions, and constructs of the RBV, mainly core resources and SCA. We continue with a discussion of the concept of OR as a core resource. Next, the measurement of performance of public sector organizations is discussed, with specific focus on LA. Then the paper proposes a research model to be discussed and examined. It concludes with a discussion of the theoretical and practical implications of the findings.

THE RESOURCE-BASED VIEW: ORIGINS, CONCEPTS, AND ASSUMPTIONS

ORIGINS

The notions of the RBV notions were expressed by *Penrose (1959)* in her popular book, *The theory of the growth of the firm*. She argued that in order to evaluate which firms will grow successfully, we need to focus on the internal factors, since they are the real source for competitive advantage. Yet only with the appearance of the writings of *Wernerfelt (1984)* and *Barney (1986)* did the RBV become a widely researched field. The RBV is affected neither by the economy nor by science, but mostly by a strategic view of organizational research, which has begot two trends. One of these emphasizes the effects of the external environment (market) on the strategic decisions of the players (*Bourgeois, 1980a, 1980b; Porter, 1980*). This trend has little effect on the development of the RBV, compared with the other trend, which while not disregarding the external environment ascribes greater consideration to the internal side (*Andrews, 1971; Ansoff, 1965; Hitt and Ireland, 1985; Hofer and Schendel, 1978; Selznick, 1957*). The latter trend, as defined by the SWOT model, means that an organization aiming to gain competitive advantage should form a strategy based both on the state of the internal side (strengths and weaknesses) and the external side (opportunities and threats). Basically, the RBV concentrates on the internal side of the SWOT model as a platform for the formation of a competitive strategy (*Barney, 1991; Peteraf, 1993; Porter, 1991; Reed and DeFillippi, 1990*) and as a source of creation of SCA (*Barney, 1995; Conner, 1991; Grant, 1991; Peteraf, 1993*).

CONSTRUCTS

The literature suggests diversified terms, such as resources, capabilities, competencies, skills and assets, as the basic concept of the view. But this raises the question of the meaning of whichever term we use. This paper uses the term “resources.” *Amit and Schoemaker (1993, p. 35)* defined resources as “stocks of available factors that are owned or controlled by the firm (organization).” *Wernerfelt (1984, p. 172*) describes a resource as “anything which could be thought of as a strength or weakness of a given firm (organization).” By this term, we mean a strategic resource, namely one that creates SCA. This will occur only when a firm implements a value-creating strategy that is not simultaneously being implemented by any current or potential competitors, and when these other firms are unable to duplicate the benefits of this strategy (*Barney, 1991, p. 102*).

Every organization has diversified resources. The issue is to identify the strategic and the non-strategic resources. A strategic resource (know-how, human capital, etc.) is one that contributes significantly to the creation of SCA and organizational success, as opposed to a non-strategic resource (office furniture, etc.) whose contribution is insignificant. There are several suggested criteria for determining whether a given resource creates and preserves SCA. First, the resource should be valuable (*Barney, 1986, 1991, 1997*). Second, the resource should be rare (*Barney, 1986, 1991, 1997*). Third, the resource should be hard to imitate (*Barney, 1986, 1991, 1997; Collis and Montgomery, 1995; Dierickx and Cool, 1989; Reed and DeFillippi, 1990*). Fourth, there should not be an available substitute for the resource (*Barney, 1991, 1997; Collis and Montgomery, 1995; Dierickx and Cool, 1989*). Fifth, the resource should not be easily tradable (*Dierickx and Cool, 1989; Peteraf, 1993*). This research tested three of the terms above: the value, the rarity, and the difficulty of imitation of the resource, as suggested by *Barney (1986).* Furthermore, four conditions for SCA (e.g., value, rareness, inimitability, and substitutability) have received the most theoretical consideration. Yet only the three conditions examined in this study have received considerable empirical attention. According to *Barney (1997, p. 142*), an organization’s strength may be a resource, hence a potential source of competitive advantage if it meets the following conditions. First, the resource that an organization possesses is valuable in that it enables the organization to exploit opportunities or neutralize threats. Second, this resource is possessed by a small number of competing organizations. Third, this resource is costly to imitate. To our knowledge, no study has yet explored the conditions of substitutability or tradability of intangible resources such as organizational reputation. Accordingly, the present research covered only the extent to which the OR was valuable, rare, and inimitable.

In any case, we are in need of a deeper understanding of SCA. The concept of competitive advantage is well defined in the strategic respect. To have competitive advantage means to be in a distinct position, including strength points, in relation to the competitors (*Hofer and Schendel, 1978; Porter, 1985*). The competitive advantage can be addressed in several ways.

The RBV sees the competitive advantage in superior organizational resources, capabilities, and/or competencies, for instance, in financial, physical, human, and organizational terms, as well as in technological capabilities (*Hofer and Schendel, 1978*), the invisible assets of knowledge, skills, and experience of committed people (*Itami with Roehl, 1987*), and the four dimensions of core capability: skills and knowledge, technology, management, and values/norms (*Leonard-Barton, 1992*), among others.

BASIC ASSUMPTIONS

The RBV does not see firms in terms of their product market activities but of their resources (*Wernerfelt, 1984*). The underlying assumption of this concept is that the organization functions in a dynamic and competitive environment. Thus, the real source of competitive advantage is the ability consistently to adapt to environmental changes, accomplished only through identification, development, and preservation of strategic capabilities (*Bartmess and Cerny, 1993*). Acquiring and preserving SCA and superior performance are a function of the resources and capabilities brought to the competition (*Aaker, 1989; Barney, 1995; Conner, 1991; Grant, 1991*). These theoretical arguments, as established by the findings of *Hansen and Wernerfelt (1989)*, contend that while external market factors have the ability to explain variance in performance, internal factors can explain more than twice the variance in performance. Furthermore, *Rumelt (1991)* showed that the unique skills of a business unit could explain more than six times the variance in performance, in contrast to the earlier findings of *Schmalensee (1985)*.

Given the theoretical position that heterogeneity of organizational resources leads to differences in competitive advantage and to variance in performance (*Prahalad and Hamel, 1990; Reed and DeFillippi, 1990),* we can understand the argument that the best way to win in a competitive world is to buy core competencies for the long run. Perhaps, but not necessarily, competencies create competitive advantage (*Reed and DeFillippi, 1990*). In this context, the issue of the organizational reputation as a core resource should be further examined.

THE CONCEPT OF ORGANIZATIONAL REPUTATION

In this part we explore the nature of the concept of the OR. What is it? What facets does it comprise? How does it function as a core resource at both the theoretical and empirical levels?

WHAT IS ORGANIZATIONAL REPUTATION?

The precise definition of the concept of OR has become one of the most substantial issues requiring clarification, due the differential facets it contains. Some of the explanations as to why OR is slightly elusive are that reputation is a "fragile resource" (*Hall, 1993, p. 616*), which changes over time (*Ching, Holsapple and Whinston, 1992, p. 291*), yet it enjoys relative stability (*Barney, 1997, p. 226*), reflects cumulative investments (*Fombrun and Shanley, 1990, p. 254*), and exists as a concept distinct from other organizational behavior constructs (*Jones, 1996, p. 2*86).

The difficulty in finding a single explicit definition for the concept of organizational reputation inheres in the range of facets it embodies. This multifaceted aspect is addressed by *Fombrun (1996, p. 72)*, who suggests that corporate reputation consists of four interrelated characteristics: credibility, reliability, responsibility, and trustworthiness. *Petrick, Scherer, Brodzinski, Quinn, and Ainina (1999, p. 63)* extended this view, claiming that reputational capital is the initial part of social capital that solidifies credibility, reliability, responsibility, trustworthiness, and accountability. Thus, the definitional difficulty is understood in the argument raised by *Clark and Montgomery (1998, p. 65)* that reputation is determined through the observer's perceptions and interpretations. For instance, *Yoon, Guffey, and Kijewski (1993)* found that a purchaser's response to a service is consistent with his or her notion of the vendor's reputation.

Since reputation is a multifaceted construct, we must identify its key dimensions. In general, we may find two types of approaches, some with a more comprehensive view as against others with a narrower view of the concept of reputation. The following is an outline of the more comprehensive view. *Olins (1990)* refers to reputation as an organizational identity, which includes everything that the organization does and concerns itself with in four major areas of its activity: first, products/services - what it makes or sells; second, environments - where (the physical place) it makes or sells; third, information - how it describes and publicizes its activities; and fourth, behavior - how the organization members behave to each other and to non-members. A similar view is suggested by *Vergin and Qoronfleh*

(1998, p. 22), namely reputation reflects behavior exhibited every day through numerous small decisions. *Teece, Pisano, and Shuen (1997, p. 521)* refer to reputation as an intangible asset, representing a kind of summary statistic about the firm's current assets and position, and its likely future behavior. *Fombrun and Shanley (1990, p. 234)* argue that the construct of reputation concerns the multiple constituents that assess it; hence, the issue is not just economic effectiveness but also non-economic, that is, sociological significance. *Shrum and Wuthnow (1988)* claim that reputational status is not just a function of market position, but is more complex insofar as it is a function of past performance, structure, and network position of the organization. *Elsbach and Glynn (1996)* suggest three types of reputations that firms attempt to cultivate: toughness, high quality, and distinction.

The narrower view is grounded in the claim that past financial performance yields the core nature of the reputation construct. *McGuire, Sundgren, and Schneeweiss (1988)* showed that accounting-based measures, in particular return on assets (ROA), proved to be the significant predictor of a firm's reputation for social responsibility. According to another empirical work suggested by *Hammond and Slocum, Jr. (1996)*, two financial factors - standard deviation of the firm's market return and return on sales - are found to be an explanation of subsequent reputation. Other perceptions are less dominant and deal with different aspects, for instance, reputation as a way to signal quality (*Nachum, 1996*), and reputation of human resources and their determinants (*Jones, 1996*).

REPUTATION AS A CORE RESOURCE: THE THEORETICAL LEVEL

Strategic resources, as "core competencies" (*Prahalad and Hamel, 1990*), or "core capabilities" (*Leonard-Barton, 1992*), are those which create SCA and lead the organization to above-normal performance. This definition distinguishes strategic reputation from non-strategic reputation. The former refers to resources that make a significant contribution to gaining SCA and superior performance, while the latter refers to resources whose contribution is either insignificant or harmful, leading to a lack of SCA and inferior performance.

The literature leans toward the argument of reputation acting as a core resource. *Weigelt and Camerer (1988, p. 452*) elucidate this point with illustrations from a wide range of corporate situations, where behavioral forms of reputation affect strategic choice by generating future rents. *Fombrun (1996)* gives a further demonstration of why reputation is a core resource. When we enter into a contract with any product or service supplier (travel agent, contractor, lawyer, accountant, etc.), our decision to choose one over the others will most likely be based on recommendations or information, namely on their reputation. *Shrum and Wuthnow (1988, p. 909)* argue that "reputational status becomes a critical resource for organizational managers." *Fombrun and Shanley (1990, p. 234)* depict reputation as the outcome of a competitive process in which firms signal their key characteristics to constituents in order to maximize their economic and non-economic (social) status.

Hall (1992, p. 138) claims that reputation can be a major factor in gaining competitive advantage and fortifying the firm's position insofar as competitors have difficulty matching the kind of fame and esteem created by reputation. In his studies, *Hall (1992, 1993)* identified reputation as the major source for success among firms in Britain. By contrast, non-strategic reputation can lead to a lack of SCA and, therefore, inferior performance. For instance, opportunistic behavior could be perceived as an unfavorable reputation indicated in the firm's profit performance (*Collis and Montgomery, 1998*).

REPUTATION AS A CORE RESOURCE: THE EMPIRICAL LEVEL

The notion of reputation serving as a core resource is well rooted on the theoretical level, but it still remains to determine how this accords with empirical evidence. Two major trends are evident in the research literature, one focusing on the sources of the reputation, the other on the effect of the reputation on organizational behavior. In line with the focus of this paper, the brief discussion below centers on the effects of the reputation on organizational behavior and performance.

A favorable quality-based reputation of a product was shown to act as a strategic resource, since it made possible a premium expressed in flow of profits, which in turn facilitated investment for building this kind of reputation (*Shapiro, 1983*). Other similar evidence, as presented by *Yoon et al. (1993)*, showed that the intention to buy an insurance program depends on the company's reputation. *Nachum (1996)* found that reputation was a significant factor and was positively related to both the performance and the survival of advertising firms. Likewise, *Vergin and Qoronfleh (1998)* found that future stock performance was directly related to reputation. *Dollinger, Golden, and Saxton (1997)* found that a firm's reputation was an important resource in terms of being targeted for joint venture. The work of *Clark and Montgomery (1998)* revealed that the more successful the firm, the more it would be perceived as a firm with a credible reputation. However, a credible reputation was found to deter only those who considered the defender a minor competitor, not a major competitor. Conversely, the mediocre social status (conservative, unattractive, and unchallenging) of the National Aeronautics and Space Administration (NASA) in 1980s made it almost impossible for this body to meet its goals (*see McCurdy, 1991*).

Theoretical as well as empirical arguments support the concept of OR acting as a core resource that creates SCA and leads to above-normal performance. In the next section, we briefly discuss the issue of measuring the performance of local authorities.

THE MEASUREMENT OF LOCAL AUTHORITIES' PERFORMANCE

The measurement of organizational performance or effectiveness is not easy for business organizations, but it is even more difficult for non-profit organizations, which have multiple and diversified goals (see *Oster, 1995*). Further, measuring the performance of business organizations is well defined by the economic view that the economic rent is the major goal (see *Mahoney and Pandian, 1992; Tirole, 1988*). Accordingly, these organizations use financial ratio measures, such as return on assets (ROA), return on investment (ROI), sales growth, and profit margin. But in public sector organizations, particularly in LA, the situation is far from satisfactory, as widely used, relatively established measures still do not exist.

In the literature we explored broad theoretical perspectives and models, in search of concepts for ways of measuring performance. The following are some of the major approaches among them (for a detailed discussion, see *Daft, 1995*). The goal model suggests measuring performance by examining the real goals versus those that have been achieved (*Etzioni, 1964; Mohr, 1973; Perrow, 1970*). The system resource approach suggests that the performance measure should be the degree of winning critical resources (*Yuchtman and Seashore, 1967*). By the constituency approach, performance is determined by the assessment of the organization's beneficiaries (*Connolly, Conlon, and Deutsch, 1980*). The competing values approach holds that an organization's performance should be examined by its hierarchical managerial values and its gains *(Quinn and Cameron, 1983; Quinn and Rohrbaugh, 1983*). The internal process approach holds that an effective organization is one that creates healthy internal processes, in particular human processes (*Ostroff and Schmitt, 1993*). Although each one of these approaches or models makes a significant contribution to the theme of measuring organizational performance, they are still not widely used due to their lack of feasibility.

Establishing reliable and valid performance measures of local authorities is a complex task. The basic theoretical rationale, which the performance measures system should reflect, consists of accountability and the need to meet the public interest of the citizens (*Ammons, 1995; Wholey and Harty, 1992*). Measuring performance consists of three aspects of public accountability: efficiency, quality, and effectiveness (*Martin and Kettner, 1996*). The need for accountability is well rooted in Western countries, such as the US, Britain, and New Zealand (*Leithe, 1996*), but is still absent in the local government in Israel, where no systematic approach exists.

In general, two major approaches are found for measuring local government performance. One argues that the measures should reflect the broad functions that the local authorities must fulfill, including administration, human resource management, finances, tax collection, and social services (*Downs and Larkey, 1986*). Other research suggests categorizing the measures into groups, such as culture and art programs, public safety, public utilities, and others (*Leithe, 1996*). Still others support as the performance's measure the "Three Es" model: economy, efficiency, and effectiveness. However, this model has encountered serious criticism for failing to support aspects like quality, customer satisfaction (*Carter, 1991*), availability, awareness, extensiveness, acceptability, fairness, equity, and predictability (*Pollitt, 1986*).

The other approach to measuring local government performance argues that financial measures should be adopted. Its goals are to evaluate efficiency in terms of financial measures (per-unit cost) and effectiveness in terms of accomplishing budgetary purposes. The call for using financial measures came from the Governmental Accounting Standards Board (*GASB*), given that financial criteria are an expression of such behavioral norms as straightforwardness, fairness, and observance of the law. These behavioral norms were embodied in the case of the city of Bridgeport, Connecticut, which filed for bankruptcy because of budgetary deficit (see *Lewis, 1994*). In another instance, *Brown and Pyers (1988)* used financial measures to evaluate the performance of the city of Wooster, Ohio.

The financial aspect of the performance of the public sector, including local authorities, has become a subject for research and general discussion in Israel also (see Ben-Elia, 1999; Dery and Auerbach, 1997; Hecht, 1997*). It has also become a research and public issue in other countries such as Britain and the U.S.A. This interest is due to the acknowledgement that the financial problems of public sector organizations such as local authorities seriously affect the way they perform. The report by the panel on Civic Trust and Citizen-Government Relations for the 21st Century of The National Academy of Public Administration (*NAPA*) of the United States (*1999, p. 4*), stated:*

> *In America today, the relationship between citizens and government is in disarray. Many Americans do not believe that their government delivers reliable or effective public programs nor do they believe that they get much value in return for their tax dollars.*

During the 1980s Britain experienced a major reform in its local government finance owing to serious criticism leveled against the growing accumulated deficit. The tax structure of domestic property tax was replaced by a pool tax. This significant reform did not succeed as expected (*Branett, Levaggi, and Smith, 1992*), but it illustrated the point that financial problems are not restricted to one country.

The report of the *Israel State Comptroller* revealed that between 1997 and 1999 the Julis local council increased salaries and accompanying expenses by approximately 40%, and these accounted for 41.4% of the total expenditure in the council's regular budget. This increase resulted from the council's exceeding the maximal number of hired employees allowed. Furthermore, in January 1998 the Julis local council made a commitment to the Ministry of Interior to reduce its salary expenses by NIS 445,000. The State Comptroller's report revealed that during this period the local council recruited 26 new employees.

In general the public, as the most important constituent, is very concern with the financial aspect of the local government performance. This is because inferior financial performance does not enable a local authority to be accountable or responsive to its residents' needs and expectations. The following is to demonstrate this claim. The Mevasereth-Zion local council could not pay its employees their monthly salary. In the twelve months from April 2000 to March 2001, employees received their monthly salary late three times, and then only after intervention by the national government. Such poor performance causes great concern in residents about the ability of their local authority to meet even their basic needs, to say nothing of their expectations. Thus, financial performance has become a major topic for the local authority, residents, and central government, as it reflects the extent to which the local authorities are accountable and responsive. In this study we focused on evaluating the performance of the local authorities in Israel by means of financial measures.

DEVELOPING THE RESEARCH HYPOTHESES

Within the above theoretical framework, the study posited several hypotheses.

ORGANIZATIONAL REPUTATION, SCA, AND FINANCIAL PERFORMANCE

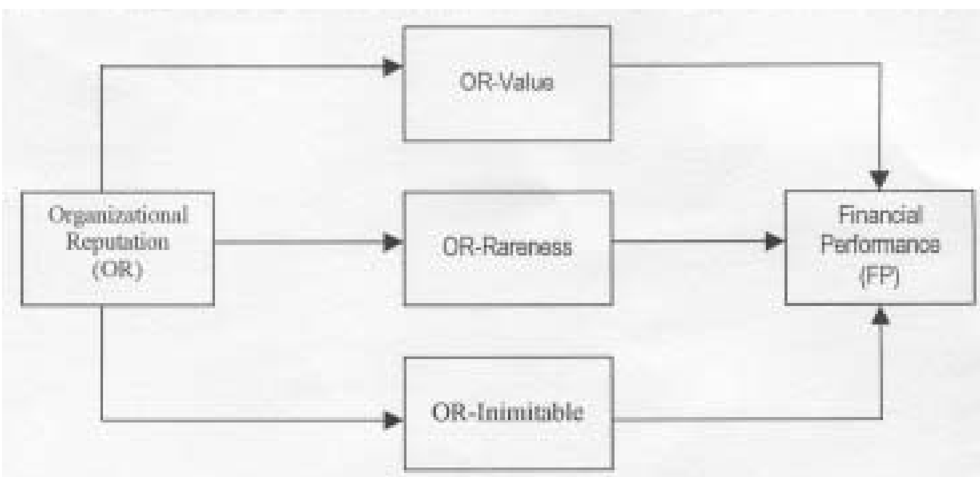
In terms of the relationship among resources and capabilities, SCA, and superior performance, it has been suggested that the best way to win in a competitive world is to build core competencies, which will create SCA and lead to superior performance (*Prahalad and Hamel, 1990*). A competitive advantage rather than external environment is the primary source of superior performance (*Grant, 1991, p. 117*). Capabilities gap underlying the differentiation between an organizations and its competitors, and becomes the real source for SCA (*Coyne, 1986*). The running for SCA underlying the basic assumption, according to which it is more likely to attain superior performance than without it.

OR acts as a core resource that may create SCA and lead to superior performance (*Hall, 1992, 1993*). Organizational reputation is a resource that rivals find it hard to imitate because of its social complexity, hence it plays a significant role in SCA. This insight is fortified by the efforts which organizations invest in order to build a solid favorable reputation.

According to *Fombrun and Shanley* (*1990, p. 234*), organizational reputation is the outcome of a competitive process in which organizations signal their key characteristics to constituents in order to maximize their status.

For an organization to be deemed to possess SCA, its OR must meet several successive conditions. According to *Barney (1997, p. 142)*, if (1) the resource that an organization possesses is valuable, in that it enables the organization to exploit opportunities or neutralize threats; (2) if this resource is possessed by a small number of competing organizations; and (3) if this resource is costly to imitate, then it may be the organization's strength, hence a potential source of competitive advantage. To our knowledge, the substitutability or tradability of intangible resource, particularly organizational reputation, has not been studied as yet. The present research (a) covered the extent to which OR was valuable, rare, and inimitable, and (b) tested the basic assumption that possession of SCA would eventually lead the organization to superior performance. These rationales suggested the following hypotheses, depicted in Figure 1:

FIGURE 1: A Conceptual Model Of Organizational Reputation, Sca (Value, Rareness, And Inimitability), And Financial Performance



HYPOTHESIS 1a: The more favorable the reputation of the organization, the greater its value, rarity, and inimitability.

HYPOTHESIS 1b**:** A positive relationship exists between organizational reputation and financial performance of the local authorities, mediated by the three tests for SCA (OR-value, OR-rarity, and OR-inimitability).

DEMOGRAPHIC TRAITS AND ORGANIZATIONAL ENVIRONMENT

The organizational demography is known as one of the important factors explaining variance in performance. The most common demographic traits used to explain organizational failure and mortality are size and age (*Baum and Oliver, 1991; Hannan and Freeman, 1989; Levinthal, 1991; Morgan, 1986; Pfeffer, 1982*). However, in examining LA in Israel we have to consider its unique characteristics. First, we need to consider the sectors embraced by LA, which essentially are two: Arab-Druze and Jewish. Being aware that the Arab-Druze sector is laggard, we take that sector is an important factor in the prediction of variance in performance. The second characteristic is legal status, which defines forms of local authorities: (a) city, with the largest population, normally above 20,000 inhabitants; (b) local council, with fewer than 20,000 twenty thousand inhabitants, and normally in charge of only one municipal settlement; and (c) regional council, in charge of more than one rural settlement. This characteristic may affect performance.

This logic suggested the following hypothesis:

HYPOTHESIS 2a: The size, age, sector, and legal status of the local authorities affect their performance.

The concept of organizational environment as an important factor in explaining variance in performance is well rooted in organizational and strategic literature. In organization science, the relationship between environment and effectiveness is expressed in the view of the organization as an open system of inputs and outputs (*Katz and Kahn, 1978*). This view originates from the law of thermodynamics. Whereas a closed system will not survive for long, an open system can keep on living as it delays entropy by importing crucial energies from the external environment (*Bailey, 1994*). In these terms, organizational behavior is a function of the external environment (*Burns and Stalker, 1979; Lawrence and Lorsch, 1967; Scott, 1992)*. Each organization competes by utilizing the resources that make possible its continued existence, acknowledging that only organizations able to adapt to the environment will avoid mortality (*Aldrich, 1979; Hannan* *and Freeman, 1989; Miles and Snow, 1994*). This logic suggested the following hypothesis:

HYPOTHESIS 2b: The organizational environment affects the financial performance of local authorities.

From the strategic viewpoint, the environment is considered an important factor in determining the variance in performance. In general, two approaches are found. The first considers the environment the most valuable source for acquiring competitive advantage and effectiveness, since the environment dictates the strategic decisions of the system (*Bourgeois, 1980a, 1980b; Porter, 1980*). The second approach also considers the environment as an important factor, but not the most valuable one, since it accords the internal side much more consideration (*Andrews, 1971; Ansoff, 1965; Hitt and Ireland, 1985; Hofer and Schendel, 1978; Selznick, 1957*). The RBV goes a step beyond the second approach, maintaining that any organization should ground its competitive strategy in the state of its internal resources in relation to environmental opportunities and threats (*Barney, 1991; Peteraf, 1993; Porter, 1991; Reed and DeFillipi, 1990*) as a source of creating SCA (*Barney, 1995; Conner, 1991; Grant, 1991; Peteraf, 1993*).

Since all the above views argue that both the internal and external sides should be considered, the question is which is most competent to furnish an explanation. The strategic literature offers non-uniform evidence. For instance, *Hansen and Wernerfelt (1989)* found that the external market factors were independent with respect to explaining variance in performance, but by comparison internal factors had more than twice the explanatory power. Thus, this logic suggested the following hypothesis:
HYPOTHESIS 2c: The group of demographic and environmental factors is a less important source of above-normal performance than organizational reputation.

METHOD

SAMPLE

Participants were from 263 LAs in Israel, these being 62 municipalities, 148 local councils (with two industrial local councils excluded as their function is very different), and 53 regional councils. As for the internal distribution, 53 municipalities belonged to the Jewish sector and nine to the Arab-Druze sector; 76 local councils belonged to the Jewish sector and 72 to the Arab-Druze sector; 52 regional councils belonged to the Jewish sector and one to the Arab-Druze sector. We mailed each municipal general management or local/regional council clerk (this function is equivalent to the general management) a survey requesting information on the independent and mediator variables. The participants were asked to name their LA to enable us to match the survey data to the non-survey data (the financial data). The survey was mailed from and returned to a university address, in a self-addressed envelope. While 106 surveys were returned, only 99 were usable as the others failed to provide a name and therefore could not be matched with specific local authorities.

The overall response rate was 37.6%, and the internal distribution was as follows: 39.2% from the local authorities belonged to the Jewish sector and 34.1% to the Arab-Druze sector. Further internal distribution indicated that 41.5% of the municipalities were from the Jewish sector and 22.2% from the Arab-Druze sector; 39.5% of the local councils were from the Jewish sector and 36.1% from the Arab-Druze sector; 36.5% of the regional councils were from the Jewish sector, leaving none from the Arab-Druze sector. The average size of the local authorities was 29,217 inhabitants, with a minimum of 1,000 and a maximum of 621,100. The average age was 36.89 years, with the minimum age of 2 and a maximum of 53 years.

The dependent variable data were gathered from a *Ministry of Interior (1999)* report, containing the annual financial reports of the local authorities for 1997 and 1998. The control variables were obtained from Publication 1046 (*Local authorities in Israel 1995: Physical data (1997)*) of the Israel Central Bureau of Statistics, as well as from internal reports of the Ministry of Interior. As we used a financial ratio that considered the inhabitants within the sub-measures, we obtained these data from the Social Science Data Archive (SSDA) of the Hebrew University of Jerusalem.

DEPENDENT VARIABLE
FINANCIAL PERFORMANCE.

This dependent variable was developed to meet the unique financial system of the local authorities in Israel (for a comprehensive discussion, see *Hecht, 1997*) and the way in which the financial reports are presented. Further, the nominal definition of this variable was based on papers that explore such aspects as liquidity, budgetary balance, and financial efficiency *(see Razin, 1998; 1999*). However, our study added other aspects, which have not been tested, and gave a more accurate answer to long-term and immediate liquidity. The measure consisted of seven financial ratios, assessed on a ratio scale of an average of two years (in order to create more stability and accuracy in the analysis), and which showed good internal consistency reliability

(Cronbach alpha=.82). The seven items are:

(1) Self-incomes ratio: defined as the ratio of all the self-incomes to the overall incomes of the regular budget. Self-incomes consist of all the incomes (taxes, grants, fees) that the local authority collects directly from the inhabitants, businesses, and other assets within its jurisdiction (*Hecht, 1997, p. 21*). Incomes of the regular budget consist of property taxes, fees, surcharges, general grants, finances from ministries, and single incomes (*Hecht, 1997, p. 21*). The closer the ratio is to one, the better the financial state of the local authority.

(2) Ratio of non-regular budget incomes to loan load (amount): defined as the ratio between the total amount of the incomes of the non-regular budget (excluding loans) and the total amount of loans. The non-regular budget incomes consist of all the incomes derived from fees related to development and loan activities *(Hecht, 1987, pp. 232-239*). The loan load is defined as a non-final income, which is accepted from banks and the state budget for execution of investments in infrastructure and development. The loan load has to be confirmed by the ministries of the Finance and Interior, and the interest must be paid following agreement between the parties (*Hecht, 1997, pp. 42-43*). The closer the ratio is to one, the better the financial state of the local authority.

(3) The efficiency of collecting ratio: defined as the ratio of the total amount of actual collecting to the total amount for collecting. The total amount of actual collecting consists of property taxes and water and drainage fees. The total amount for collecting consists of accumulated debt from earlier years and the current year debt minus exemptions, discounts, and cancellation of self-incomes *(Hecht, 1997, pp. 21-27*).

(4) Per-inhabitant collecting ratio: defined as the ratio of the total amount of actual collecting (see definition above) in the current year to the total of

permanent residents at the end of the year. Permanent residents means all permanent residents and immigrants in Israel, as well as permanent residents absent from Israel for less than a year while the survey was in operation (*Central Bureau of Statistics, 1997, p. 19*).

(5) Per-inhabitant surplus (deficit) ratio: defined as the ratio of the surplus (deficit) in the regular budget (i.e., the difference between the total amount of incomes in the regular budget and its expenses) and the total permanent residents at the end of the year. The total amount of incomes in the regular budget was defined in the first ratio above. The total amount of expenses in the regular budget consists of general administration, local services, state services, enterprises, and other expenses (*Hecht, 1987, p. 184*).

(6) Current ratio: nominally defined as the ratio of the total amount of current assets to the total amount of current obligations on the balance sheet. Since we needed to accord with the financial report structure of the local authorities, this ratio was redefined as the ratio of the total amount of current assets (excluding investments, investments for covering budgeted funds, accumulated deficit in the regular budget, and temporary net deficits in the non-regular budget) to the total amount of current obligations (excluding development funds, budgeted funds, accumulated surplus in the regular budget, and temporary net surplus in the non-regular budget). The total amount of current assets consists of all the current properties for the short run (up to one year), such as customers, bank remainders, investments, and other debtors. The total amount of current obligations consists of all the current debts for the short run (up to one year), such as suppliers and budgeted funds.

(7) Incomes to expenses ratio in the regular budget: defined as the ratio of the total amount of incomes to the total amount of expenses in the regular budget. Both were defined in ratio (5) above.

INDEPENDENT VARIABLE
ORGANIZATIONAL REPUTATION.

This measure is a partial integration of two measures established by *Fortune* magazine, adapted by us match the unique function of LA in Israel. The first measure was derived from items in a survey of 600 managers and experts regarding the reputation of U.S. cities. It consists of items such as: flexible and high-quality manpower; accessibility to markets; favorable attitude for businesses; a fine public education system; convenient air service to major cities; low cost of housing; jobs; facilities; taxes and quality of life (see *Bromley, 1993*). The other measure is the annual corporate reputation survey among 8000 high executives, outside directors, and financial analysts, who were asked to rate the 10 largest companies in their own industry on eight attributes, using a scale of 0 (poor) to 10 (excellent). The attributes were: quality of management; quality of products or services; innovativeness; long-term investment value; financial soundness; ability to attract, develop, and keep talented people; community and environmental responsibility; and use of corporate assets (see, e.g, *Smith, Fortune, January 29, 1990*). This measure has been used by numerous scholars, including *Fombrun and Shanley (1990); Fryxell and Wang (1994); Gatewood, Gowan, and Lautenschlager (1993); McGuire et al. (1988*), and others.

However, to our knowledge, no one has yet examined the OR of LA in Israel. This was the primary reason for our adapting a partial integration of established measures, while still considering the unique attributes of LA. The measure used consisted of nine items, the first four based on the corporate reputation survey of *Fortune* magazine and the others based on the city reputation survey of *Fortune*. The items were assessed on a seven-point scale, ranging from 1 = "Strongly disagree" to 7 = "Strongly agree." The measure showed good internal consistency reliability (Cronbach alpha=.82). The nine statements were: "The quality of management of my local authority is credited with a very favorable reputation"; "The ability of my local authority to attract, develop and keep talented people is credited with a very favorable reputation"; "The quality of services my local authority supplies is credited with a very favorable reputation"; "The financial soundness of my local authority is credited with a very favorable reputation"; "In my local authority, the education system is credited with a very favorable reputation"; "In my local authority, the municipal facilities are credited with a very favorable reputation"; "In my local authority, the tax system is credited with a very favorable reputation"; "In my local authority, the transportation system is credited with a very favorable reputation"; and "The quality of life in my local authority's jurisdiction is credited with a very favorable reputation."

MEDIATOR VARIABLES

Sustainable competitive advantage: All three mediator variables reflected tests that the resource (reputation) should follow in order to create SCA, as suggested by *Barney (1986, 1991*).
OR-Value: This measure consisted of one item and was used to assess how valuable the organizational reputation is for the local authority's success. The item was: "The reputation we are credited with is very valuable in the success of the local authority" (see *Barney, 1986, 1991, 1997*).

OR-Rareness (Uniqueness): This measure consisted of one item and was used to assess how rare the resource (reputation) was. The item was: "The reputation the local authority is credited with is very rare (unique)" (*see Barney, 1986, 1991, 1997*).

OR-Inimitability: This measure consisted of one item and was used to assess how hard it was for other local authorities to imitate the reputation won by the local authority. The item was: "It is hard for other local authorities to imitate the reputation my local authority has built" (see *Barney, 1986, 1991, 1997; Collis and Montgomery, 1995; Dierickx Cool, 1989; Reed and DeFillippi, 1990*).

CONTROL VARIABLES

The control variables system consisted of two sets: demographic and environmental. The demographic variables group comprised four measures, two of which - size and age - are considered the most common demographic variables (*Hannan and Freeman, 1989; Morgan, 1986; Pfeffer, 1982*), and important factors in explaining organizational failure and mortality (*Baum and Oliver, 1991; Levinthal, 1991*). The other two measures (sector and legal status) are demographic but also structural, and they were used to match the unique characteristics of the local authorities in Israel. The other set of variables was the environmental group. Organizational behavior is deemed to be a function of the external environment (*Burns and Stalker, 1979; Lawrence and Lorsch, 1967; Scott, 1992*), and organizational survival depends on use of resources that allow adaptation to the environment (*Aldrich, 1979; Hannan and Freeman, 1989; Miles and Snow, 1994*). The following are the demographic and environmental measures.

AGE: Some LAs were established as settlements prior to 1948 (the year of the establishment of the State of Israel), but 1948 was used as the baseline in calculating the age. This is a ratio scale measure assessed as the age in years. Average age was 36.89 years.

SIZE: Size of LA was measured by the number of permanent residents. This is the most acceptable criterion, as the number of permanent residents will better reflect their scope of activities (see *Razin, 1998, 1999*). This is a ratio scale measure. The average size was 292,217 inhabitants.

SECTOR: Basically, this refers to two sectors: the Arab-Druze sector (with a majority of Arab-Druze inhabitants), and the Jewish sector (with a majority of Jewish inhabitants). This is a nominal scale measure. A score of 0 was assigned to the Jewish sector, and a score of 1 to the Arab-Druze sector.

LEGAL STATUS: The legal status defines the various forms of LA: (a) city, (b) local council, and (c) regional council, as defined on pp. 17-18 above. This is a nominal scale measure, so we created two dummy variables - city and regional council - as against the local council, which was the reference group. As such, the first dummy variable compared city council (=1) with local council (=0), and the second compared regional council (=1) with local council (=0).

ORGANIZATIONAL ENVIRONMENT: This elusive concept was defined as a reflection of both the internal and external aspects (*Pfeffer and Salancik, 1978*). It was based on the measure developed by *Miller and Droge (1986)*, and was matched to the local authority's environment. The measure consisted of five items, which were assessed on a seven-point scale, ranging from 1 = "Strongly disagree" to 7 = "Strongly agree." The measure showed acceptable internal consistency reliability (Cronbach alpha=.64). The five statements were: "My local authority must rarely change its customer practices to keep up with other local authorities"; "The rate at which the services of my local authority are becoming obsolete is very slow"; "Actions of other local authorities are quite easy to predict"; "Demand and customer tastes are quite easy to forecast"; and "The operation/technology system is not subject to very much change."

DATA ANALYSIS

Defining the core resources of the firm is one of the most complicated tasks in the field. According to *Hoskisson, Hitt, Wan, and Yiu (1999, p. 442*), "because the RBV emphasizes the idiosyncratic nature of a firm's resources and capabilities, empirical testing of the resource-based theory faces great challenges." *Rouse and Daellenbach (1999*) suggested adopting a fieldwork-based or ethnographic type, and *Zahra and Pearce (1990*) supported in-depth case studies as a promising approach for research in strategic management. However, the recent advance of the resource-based view has posed new challenges before the use of quantitative methods (*Hoskisson et al., 1999, p. 447*).

PATH ANALYSIS

The research model of the relationships between OR, OR-Value, OR-Rareness, OR-Inimitability, and financial performance in Figure 1 were assessed by path analysis with LISREL VIII. Estimating a path analysis model for directly observed variables with LISREL differs from the original path analysis technique developed in the 1930s. Rather than estimating each equation separately, LISREL considers the model as a system of equations, and estimates all the structural coefficients directly (*Joreskog & Sorbom, 1993*). An advantage of structural equation programs is their ability to estimate the parameters in a path model while correcting for the biasing effects of random measurement error. The usual approach is to estimate structural relationships among latent variables that are free of measurement errors. In this study, however, the multi-item scales were treated as single indicators of each construct because of the large number of parameters (64 latent variables) relative to the size of the sample. In view of this decision, we corrected for random measurement errors by equating the random error variance associated with each construct to the product of its variance multiplied by the quantity one minus its estimated reliability (*Bollen, 1989*).

MODEL EVALUATION

To assess the fit of the model in Figure 1, we used several goodness-of-fit indices, as suggested in the Structural Equation Modeling (SEM) (see *Bentler and Bonnet, 1980; Joreskog and Sorbom, 1993; Kline, 1998*). These included (1) the Chi-Square ratio; (2) Chi-Square divided by the degree of freedom (_2/df); (3) Relative Fit Index (RFI); (4) Normed Fit Index (NFI); (5) Goodness-of-Fit Index (GFI); (6) Adjusted Goodness-of-Fit Index (AGFI); (7) Comparative Fit Index (CFI); (8) and Root Mean Square Error of Approximation (RMSEA). Also assessed were the (9) Expected Cross-

Validation Index (ECVI); (10) 90 Percent Confidence Interval for ECVI; (11) ECVI for Saturated Model.

The first seven indices are commonly applied in assessing LISREL models. Because the chi-square test is sensitive to sample size, the ratio of the model chi-square to degrees of freedom was used as another fit index. A ratio of less than 2.0 was considered to indicate a fairly good fit for the hypothesized model. Although there are no statistical distributions for the RFI, NFI, GFI, AGFI, CFI, and RMSEA indices, common practice suggests that the first five indices should exceed .90. RMSEA was proposed by *Browne and Cudeck (1989)*, and used to test the null hypothesis of close fit, which is much more meaningful than the null hypothesis of perfect fit. *Browne and Cudeck* provided the following guidelines: a RMSEA lower than .05 indicates a "very good" fit; a value from .05 to .08 indicates a "fair to mediocre" fit; a value from .08 to .10 indicates a "poor" fit; and a RMSEA greater than .10 means a "very bad" fit. They deemed RMSEA superior to any of the aforementioned goodness-of-fit indices as a measure of model error. ECVI, on the other hand, is a measure of overall model discrepancy across all possible calibration samples. In other words, it measures both model error and sampling error; the smaller the ECVI, the less the overall discrepancy.

To test Hypotheses 2a and 2b, multiple regression was used. To test Hypothesis 2c, which claims to be a competing hypothesis, multiple hierarchical regression was used, where the demographic and environmental variables were entered in the first step, and the organizational reputation in the second.

RESULTS

Table 1 shows the means, standard deviations, and correlations among the dependent, independent, mediator, and control variables (excluding the local council dummy code). Results showed acceptability of the measures of this study and good reliability of the variable scales, with .92, .64, and .82 alphas for OR, environment, and FP, respectively. Further, the results implied preliminary support for some of the research hypotheses. Sector was found to be highly negatively correlated with financial performance (r=-.512, p<0.001), and also negatively correlated with reputation (r=-.265, p<0.01). This means that Arab-Druze local authorities failed to build a favorable reputation and evinced inferior financial performance to that of the Jewish local authorities. Regional councils displayed better financial performance than local councils (r=.206, p<0.05), and the local authorities viewed the organizational environment as certain showed superior performance (r=.282, p<0.01).

Variables	5	6	7	8	9	10	11
12. Municipality							
13. Regional council							
14. Size							
15. Age							
16. Sector							
17. Organizational environment	-.191	(.64)					
18. Organizational reputation (OR)	-.265**	.628***	(.92)				
19. OR-value	-.184	.580***	.870***				
20. OR-rareness	-.117	.531***	.638***	.553***			
21. OR-Inimitability	-.231*	.500***	.649***	.555***	.733***		
22. Financial performance (FP)	-.512***	.282**	.495***	.446***	.248**	.422***	(.82)

***P<0.001; **P<.01; *P<.05. Note: N=97-99.

TABLE I: Means, Standard Deviations, Internal Consitency Reliability, And Intercorrelations (Reliabilities In Parentheses)

The correlation between OR and the three tests of SCA was highly positive, as were the correlations among them. The correlation between OR and RV was the highest (*r*=.870, *p*<0.001), which raises the question of collinearity. This correlation was expected, due to our method of using an established measure of OR rather than just pointing out the value of the resource of OR. It was reasonable to expect that the greater the scale of OR, the greater its value, since when the respondents perceived their OR scale highly, they would also do so for the value of the OR. Further, since we used the path analysis procedure of the LISREL program, the research did not suffer from potentially harmful effects of collinearity, as would have been the case had we used regression equations analysis (see *Belsley, Kuh, and Welsch, 1980*).

Other correlations that had to be addressed were those between OR, the three tests of SCA, and FP. OR positively correlated with FP (*r*=.495, *p*<0.001); RV positively correlated with FP (*r*=.446, *p*<0.001); RR positively correlated with FP (*r*=.248, *p*<0.01); and RI positively correlated with FP (*r*=.422, *p*<0.001).

HYPOTHESES 1a and 1b: The relationship of organizational reputation, SCA (value, rarity, and inimitability), and financial performance.

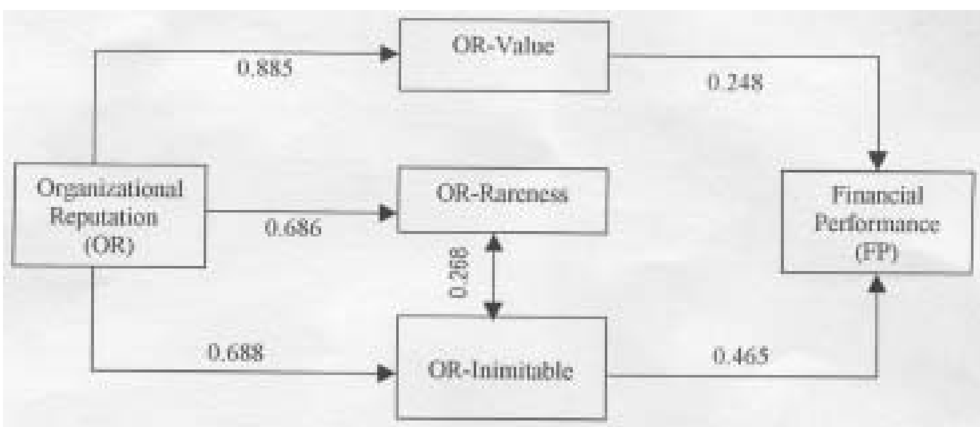


FIGURE 2: A Model Of Organizational Reputation, Sca (Value, Rareness, And Inimitability), And Financial Performance.

For the examination of hypotheses 1a and 1b, SEM was conducted by means of LISREL VIII (*Joreskog and Sorbom, 1993*). Figure 1 shows the relationships derived from the model. As suggested by the SEM literature (e.g., *Joreskog and Sorbom, 1993; Kline, 1998*), the following goodness-of-fit indices were performed for the assessment of the model-fitting: _2/df - this ratio is recommended to be less than 3; RFI, NFI, GFI, AGFI and CFI - these values are recommended to be greater than .90; RMSEA - recommended to be up to .05, and acceptable up to .08. The indices indicated that the model had an acceptable fit with the data: $\_^{2}$(3)=2.745; _2/df=.915; RFI=.979; NFI=0.994; CFI=1.00; GFI=.989; AGFI=.944 RMSEA=.00; ECVI =.387; 90 Percent Confidence Interval for ECVI=(.337; .421), ECVI for Saturated Model=.316, and ECVI for Independence Model=4.608.

The model explored several significant relationships and supports, in general most of the theoretical underpinnings of hypotheses 1a and 1b. The model suggested strong positive relationships between OR and RV, RR, and RI. This finding provided strong support for hypothesis 1a, namely the more favorable the OR, the greater respondents would perceive the OR as valuable, rare, and difficult to imitate. Furthermore, a relationship between RR and RI was found, indicating that local authorities that perceived their OR as a rare resource would also perceive it as difficult for competitors to imitate. Yet no relationships between the value of the OR and its rarity and inimitability tests were found.

Lastly, the model suggested an almost complete mediation relationship, as expected in hypothesis 1b, according to which a positive relationship between organizational reputation and financial performance of the local authorities would be mediated by the three tests for SCA (value, rarity, and inimitability). Although the intercorrelation matrix (see Table 1) indicated a positive correlation between OR and FP, it was not, as expected, the complete picture. Rather, it argued for a mediation model, which follows the theoretical argument of the resource-based view. According to this view, in order to gain superior performance, an organization should build a core resource that creates SCA. The SCA position is the way to success. Our model suggested that the effect of OR on FP is mediated through the extent of its value and inimitability, but not through its rarity.

Control Variables	Dependent Variables
Demographic Variables	Financial Performance β (t)
Municipality	-.124 (-1.078)
Regional council	.041 (.389)
Size	.089 (.866)
Age	.004 (-.110)
Sector	-.527 (-5.287***)
R^2	.279
Adjusted R^2	.240
F equation	7.110***
Organizational environment	.282 (2.881**)
R^2	.080
Adjusted R^2	.070
F equation	8.298**

***P<0.001; **P<.01; *P<.05. Note: N=96-97.

TABLE II. Multiple Regression Results For The Efects Of Demograhphic Variables And Organizational Environment On Financial Performance

HYPOTHESES 2a and 2b: The effects of demographic and environmental factors on financial performance, and their power of explanation versus that of the organizational reputation.

The regression results for hypotheses 2a and 2b are summarized in Table 2. Two factors were found to have a relationship with FP. First, sector was negatively associated with FP (-.527, p<.001). That is, LAs of the Arab-Druze sector exhibited inferior FP than LAs of the Jewish sector. Other demographic features were not significantly associated with FP, so hypothesis 2a was only partially supported. Second, the organizational environment was positively related to FP (.282, p<.01). This finding indicated that LA leaders who perceive their organizational environment as certain have better FP than LA leaders that perceive their organizational environment as uncertain. Hence, hypothesis 2b was supported.

HYPOTHESES 2c: The power of explanation for variance in performance of the demographic and environmental factors versus the organizational reputation.

TABLE III: Hierarchical Regression Results For The Power Of Explanation Of The Demographic Variables And Organizational Environment, Versus Organizational Reputation For Variance In Financial Performance.

Variables	Step 1 β (t)	Step 2 β (t)
Control Variables		
Municipality	-.077 (-.668)	-.089 (-.831)
Regional council	.069 (.662)	.044 (.453)
Size	.086 (.857)	.129 (1.378)
Age	-.156 (-1.540)	-.089 (-.934)
Sector	-.479 (-4.794***)	-.405 (-.4264***)
Organizational environment	.208 (2.295*)	-.053 (-.493)
Independent variable		
Organizational Reputation		.420 (3.844)***
R^2	.318	.414
Adjusted R^2	.273	.369
Standard error	.46636	.43462
F equation	7.078***	9.097***
ΔR^2		.096
F for ΔR^2		14.777***

***P<0.001; **P<.01; *P<.05. Note: N=96-97.

The hierarchical regression results for hypothesis 2c are summarized in Table 3. To examine this hypothesis, two steps were required. In the first step, we entered each control variable (demographic and environmental) to ascertain its power of explanation. The findings indicated that the control variable group explained 31.8% of the variance, and the F-test was significant at p<.001. In the second step, we entered the control variables and then the OR. The findings suggested that while the control variables explained 31.8% of the variance, the OR added another 9.6% to this explanation. This finding therefore supported hypothesis 2c.

DISCUSSION

The present research explored the mediating relationship of OR to FP through the three SCA tests. In addition, the paper examined the effects of demographic features and organizational environment on FP, and their power of explanation for variance in performance, as compared with the power of explanation of OR.

The findings showed that the relation between OR and FP was mediated through two tests for SCA: the extent of the resource value and its inimitability. Further, the research found effects of both demographic and environmental factors on FP, but the OR added to the power of explanation of variance in FP. This means that the OR was a more important source of explanation of variance in the performance of LA in Israel. The findings of this study, however, furnished empirical support for the theoretical insights of the resource-based view in association with the relation of OR, SCA, and FP, as well as with the extent of OR as a core resource. Further, the findings showed a strong negative correlation between the sector and FP, meaning that the LAs of the Arab-Druze sector failed to achieve performance superior to that of the LAs of the Jewish sector. In addition, the study found a positive correlation between organizational environment and FP, meaning that certain environments constituted a positive factor contributing to superior FP among LA.

Another interesting issue addressed by this study was the operationalization of several fundamental theoretical arguments of the strategic literature for RBV. First, the study demonstrated a strong relationship between OR and the extent of its value. However, we cannot talk of one measure as it did not exceed the value of .95 (*Jaccard, Turrisi and Wan, 1990, p. 31*), and it is important to differentiate these two. In other words, the questionnaires pointed to the quality of the resource, under the classic established measurement procedure, as it was very similar to the rating procedure for the extent of the value of the resource. However, the findings were slightly different regarding the extent of the resource’s rarity and inimitability. Although strong correlations were found between OR and rarity and inimitability, it is suggested that a research method that differentiates the quality of the resource from its rarity and inimitability be adopted, as neither exceeded the value of 0.7. Nevertheless, the study showed that the greater the quality of the resource, the greater its value, rarity, and inimitability.

The second fundamental theoretical argument highlighted by the study was the relationship between the three SCA tests and FP. A correlation was found between OR-value and FP, but more significant was the path between OR-inimitability and FP. Moreover, no significant correlation was found between OR-rarity and FP. That is, an organization's quest for above-normal performance should concentrate more on building and acquiring an OR that meets the tests of inimitability and value, rather than rarity, as the latter did not show any contribution to winning financial success. This empirical suggestion partly supported the theoretical insights of the core resource in regard to the importance of the resource-value (*Barney, 1986, 1991,1997*) and the resource-inimitability (*Barney, 1986, 1991, 1997; Collis and Montgomery, 1995; Dierickx and Cool, 1989; Reed and DeFillipi, 1990*), but provides poor support for the importance of the resource-rarity, as claimed by *Barney (1986, 1991, 1997*). The same is true for the intercorrelation of the three SCA tests. The RBV does not presume that these correlations must occur, as each test is different from the others. The findings partly supported this argument, as a positive correlation between the resource-rarity and the resource-inimitability did occur, but no other relationship with the resource-value was found (*see Barney, 1991*).

The third fundamental theoretical argument of the study was that the relation between OR and FP was mediated through two tests for SCA: the extent of the resource value and the difficulty in imitating it. Although the model did not show complete mediation, as the rarity test did not transfer any effect from the OR to the FP, the findings still strongly supported the theoretical insight of the relationship of OR, SCA, and above-normal performance. The results also provided empirical support for the perspective of *Hall (1992, 1993), Fombrun (1996), Nachum (1996),* and others, in viewing OR as a core resource that creates SCA.

The fourth fundamental theoretical argument of the study was that although the demographic variables and the organizational environment are independent in their power of explanation of the variance in FP, the OR adds another 9.6% to the power of explanation. This is to say that the explanation of variance in FP lies more in the internal resources, such as OR, and less in the demographic features and the organizational environment.

Two more theoretical implications are noteworthy. One concerned the finding of a strong negative correlation between the sector and FP, meaning that the LAs of the Arab-Druze sector failed to achieve performance superior to that of the LAs of the Jewish sector. This provides empirical support for the argument of the Arab-Druze leaders, according to which their inferior FP (among other activities) was more likely a structural problem than just a problem that they created. The second finding was that of a positive correlation between organizational environment and FP, meaning that a certain environment is a positive factor for LAs in order to gain superior FP. This suggests that the LAs with above-normal FP perceived the environment as more certain, hence less harmful, than did the LAs with inferior FP.

Finally, this study examined some of the basic theoretical insights of the RBV in relation to LA, and extended the theory to areas of organizational research that were not previously addressed. Further, the study suggested a valuable supplement for the lack of empirical infrastructure of the RBV. As a result, the RBV may obtain greater empirical and theoretical validity.

Several limitations of this research should be mentioned. First, as this study ventured into somewhat new ground, the data must be interpreted cautiously. Second, the empirical model proposed here is a preliminary method that should be put to other tests. Third, the FP measure must be further tested to determine its criterion validity. Finally, as the model is employed for the public sector and local authorities, future research should be conducted in order to extend its base to other research populations, from both business and public sectors. An important contribution of this study is the call for identification of core resources, such as OR, which follow the SCA tests, and the need to test their predictive power of variance in performance.

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