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Linking Hybrid Strategy to Firm Performance: Exploring the Mediating Role of Innovation

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Abstract

Background: In the current competitive environment, companies are increasingly implementing hybrid strategies that merge cost leadership and differentiation. Nonetheless, the success of these strategies in enhancing company performance remains a matter of debate, especially in emerging markets.

Objective: This study explores the impact of hybrid strategies on firm performance in Nepal's commercial banking sector, focusing on the mediating role of innovation.

Methods: Data collected from 108 executives across 14 commercial banks were analyzed using Smart PLS-SEM.

Findings: The hybrid approach did not have a direct impact on company performance; rather, it significantly affected innovation, which subsequently had a positive effect on performance. This suggests that innovation completely mediates the relationship between strategy and firm performance.

Conclusion: Innovation is essential for translating the hybrid strategy into improved performance.

Implications: Managers must ensure that innovation aligns with strategy, while policymakers should foster innovation ecosystems within the banking industry.

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Keywords: Cost leadership strategy, Product differentiation strategy, Hybrid strategy, Innovation, Firm performance, PLS-SEM

1. Introduction

Strategic decisions are crucial factors influencing a company's success, particularly in competitive and swiftly changing business landscapes. Porter's (1980, 1985) framework of generic competitive strategies has been influential in strategic management, suggesting that companies can secure and sustain long-term competitive advantages by adopting one of three primary strategies: cost leadership, differentiation, and focus. Porter advised against blending these strategies, warning that firms caught "stuck in the middle" face the risk of strategic confusion and less than optimal performance (Porter,1985).

Previous research has consistently validated Porter's model of generic strategies (Dess & Davis, 1984; Hambrick, 1983; Powers & Hahn, 2004), highlighting that implementing strategies such as cost leadership, differentiation, or focus can boost a company's performance. Additional studies have further supported these findings by illustrating how these strategies lead to competitive advantages and better results across sectors (Hawes & Crittendon, 1984; Parker & Helms, 1992; Reitsperger et al., 1993). However, more contemporary studies have questioned the necessity of employing these strategies in isolation. Researchers have discovered that integrating cost leadership with differentiation — a hybrid strategy — can yield superior performance results compared to using a single strategy alone (Chan & Wong, 1999; Cross, 1999; Kim, Nam, & Stimpert, 2004; Hlavacka et al., 2001; Pertusa-Ortega et al., 2008; Spanos, Zaralis, & Lioukas, 2004).

This shifting viewpoint indicates that hybrid strategies allow companies to control costs while providing unique value, thereby boosting competitive advantage in complex and dynamic markets. Although there is increasing evidence, research on the effectiveness of hybrid strategies in developing economies remains scarce. In these regions, companies often encounter limitations in resources, regulatory hurdles, and changing market dynamics. The banking industry in Nepal serves as a prime example, experiencing major changes due to digitalization, regulatory updates, and growing competition (Nepal Rastra Bank, 2023). Banks are under mounting pressure to provide cost-efficient services while also innovating to satisfy a variety of customer demands. In such a setting, hybrid strategies could potentially enhance financial performance, yet there is a lack of empirical studies exploring this connection.

Furthermore, the function of innovation as a mediating factor between hybrid strategies and firm performance is not yet fully understood. Innovation, which includes advancements in products, processes, and technology, is essential for firms to successfully implement hybrid strategies by balancing cost-effectiveness with differentiation (Teece, Pisano, & Shuen, 1997). Barney (1991) argues that the Resource-Based View indicates a firm's competitive advantage is derived from its distinct and valuable internal resources. In contrast, Teece's (2007) Dynamic Capabilities Theory underscores the necessity for a company to modify and reorganise its resources to keep pace with shifting market conditions. By integrating these perspectives,

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innovation emerges as a pivotal dynamic capability that empowers firms to transform their strategic intentions into tangible outcomes. Additionally, Contingency Theory (Donaldson, 2001) contributes to this study by proposing that a strategy's success depends on its alignment with internal capabilities and external environmental demands.

This research seeks to empirically explore how hybrid competitive strategies affect financial performance in Nepal's commercial banks, emphasizing the mediating role of innovation. This study aimed to achieve four main goals. First, it investigates the direct impact of hybrid strategies on financial performance. Second, it examines the role of hybrid strategies in influencing innovation within companies. Third, it evaluates how innovation affects financial results. Finally, it examines how innovation mediates the relationship between hybrid strategies and financial performance. This study enhances the strategic management literature by presenting evidence on the interaction between hybrid strategies and innovation and their impact on firm performance in a service-focused, resource-limited emerging economy. The results provide valuable insights for managers looking to boost competitiveness and for policymakers aiming to promote innovation-driven growth within the commercial banks of Nepal.

2. Literature Review

2.1 Porter's Generic Competitive Strategies

Michael Porter's (1980, 1985) concept of generic competitive strategies is a fundamental element of strategic management theory. He described three distinct strategies for achieving a competitive edge: cost leadership, differentiation, and focus.

. Each strategy offers a distinct path to achieve superior performance. Porter asserted that these strategies should be pursued independently, as attempting to combine them could result in firms being "stuck in the middle", leading to strategic confusion and suboptimal performance (Porter, 1985; Campbell-Hunt, 2000). However, subsequent research has questioned the idea that cost leadership and differentiation are mutually exclusive. A growing body of evidence suggests that firms can effectively integrate both strategies into what is now termed a hybrid or integrated strategy (Miller & Friesen, 1986; Proff, 2000; Spanos et al., 2004). This approach enables firms to provide unique value to customers while maintaining operational efficiency, allowing them to adapt to evolving market conditions and to meet diverse customer expectations.

2.1.1 Cost Leadership Strategy

A cost leadership strategy aims to reduce operational expenses in the industry while ensuring that acceptable quality and service levels are maintained. As Porter (1980) explains, cost leaders secure a competitive edge by minimising production and administrative expenses through economies of scale, streamlined operations, standardised procedures, and stringent cost management. This approach allows companies to offer prices lower than their competitors, attract price-sensitive consumers, and expand their customer base (Hyatt, 2001; Malburg, 2000).

Cost leadership shields against the five competitive forces by diminishing the power of buyers

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and suppliers, discouraging new market entrants, and providing resilience against substitute products (Porter, 1990). However, this may lead to low customer loyalty, as price-driven customers might switch to competitors offering slightly better deals (Cross, 1999). Despite this risk, cost leadership remains effective in sectors where customers prioritise price over features and operational scale is achievable (Singh, 2004).

2.1.2 Differentiation Strategy

Porter (1980) suggested that a differentiation strategy entails providing products or services that are distinguished by their distinct characteristics, exceptional features, or strong brand identity. Companies adopting this approach strive to generate value through innovation, design, customer service, and brand reputation, enabling them to charge higher prices and build customer loyalty (Bauer & Colgan, 2001; Allen & Helms, 2006).

Differentiation decreases price sensitivity and creates entry barriers by making it challenging to imitate. It also enhances customer relationships and diminishes the threat of substitutes (Hlavacka et al., 2001; Porter, 1985). For differentiation to succeed, companies must effectively communicate the unique value of their offerings, which may include product design, service delivery, and brand experience (McCracken, 2002; Davidson, 2001). Differentiation is particularly successful when customer preferences vary, and brand perception significantly influences purchasing choices.

2.2 Hybrid Strategy

Porter initially advised against the combination of cost leadership and differentiation; however, later research has underscored the advantages of hybrid competitive strategies that merge cost efficiency with differentiation (Miller & Dess, 1993; Wright et al., 1991). These strategies enable firms to remain responsive to shifting market conditions by providing value-added services at competitive prices (Spanos et al., 2004; Gopalakrishna & Subramanian, 2001).

Hybrid strategies have been shown to improve firm performance by utilising the cost benefits of scale while addressing varied customer preferences. However, successful execution requires a clear strategic direction and strong organizational capabilities. Firms that cannot effectively manage these competing demands may encounter the "stuck in the middle" predicament described by Porter, leading to strategic uncertainty and poor outcomes (White, 1986; Nandakumar et al., 2011).

In sectors such as banking, where both operational efficiency and service differentiation are crucial, hybrid strategies are particularly applicable. Financial institutions must offer innovative, customer-oriented services while maintaining cost control. This dual requirement makes the hybrid strategy an attractive and increasingly adopted approach in service-driven competitive markets.

2.3 Innovation

Innovation is universally acknowledged as a crucial organizational capability that enhances competitiveness, stimulates growth, and facilitates the successful execution of strategic plans (Damanpour, 1991; Schumpeter, 1934). Utterback (1971) and Hage (1999) describe innovation

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as the creation of novel products and services and the adoption of state-of-the-art processes, systems, and management practices.

From the Resource-Based View (RBV), innovation is considered a valuable and unique resource that helps firms sustain a competitive advantage (Barney, 1991). The theory of Dynamic Capabilities emphasises a company's ability to modify, integrate, and reorganise its internal resources to adapt to evolving environmental conditions (Teece et al., 1997). Innovation is particularly crucial in fast-evolving sectors such as banking, where technology, customer expectations, and regulatory landscapes are in constant flux (Beck et al., 2012; Stiglitz, 2010).

Innovation also acts as a mediating factor linking competitive strategies to firm performance. It enables firms to implement hybrid strategies more effectively by supporting both cost-reducing processes and value-enhancing differentiation (Tidd and Bessant, 2009). Innovation enhances product quality, service efficiency, and customer experience, which are key drivers of financial performance (Hurley & Hult, 1998; Lichtenthaler 2020).

2.4 Firm Performance

Firm performance is a frequently examined outcome variable in strategic and management research, indicating how well a company meets its objectives (Taouab and Issor, 2019; Tavoletti et al., 2022). It encompasses aspects such as competitiveness, operational efficiency, market share and profitability. This study evaluates performance using financial performance indicators, including profitability, revenue growth, and cost efficiency, which are particularly significant in the banking industry.

As noted by Peterson et al. (2003), firm performance signifies an organisation's capacity to effectively leverage its resources to fulfil strategic goals. It is also defined as a firm's capability to outperform its competitors (Homburg & Jensen, 2007; Liu & Wang, 2022). Financial performance offers a quantifiable, objective evaluation of the success of strategic decisions, making it an appropriate variable for assessing the influence of hybrid strategies and innovation in Nepalese commercial banks.

3. Hypothesis development

3.1 Hybrid strategy and firm performance

The relationship between hybrid strategies and firm performance is a central topic in strategic management. A hybrid strategy combines cost leadership with differentiation to create a competitive edge (Pertusa-Ortega, Claver-Cortés, & Molina-Azorín, 2009; Spanos, Zaralis, & Lioukas, 2004). Although Porter (1980, 1985) initially contended that adopting both strategies simultaneously could leave firms "stuck in the middle", more recent studies have increasingly disputed this perspective.

Initial research aligned with Porter's apprehensions (Aulakh, Kotabe, & Teegen, 2000), but more contemporary empirical findings indicate that hybrid strategies can boost firm performance by merging cost efficiency with value creation, particularly in competitive and rapidly changing markets (Acquaah & Yasai-Ardekani, 2008; Pertusa-Ortega et al., 2004, 2009). Porter (1985) later conceded that companies might successfully adopt both strategic

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positions under specific circumstances, especially in swiftly evolving environments (Gabrielsson, Seppälä, & Gabrielsson, 2016).

Firms that adeptly execute hybrid strategies reap benefits such as achieving economies of scale, enhancing flexibility, and improving responsiveness to customer demands. These strategies also facilitate internal learning, boost operational efficiency, and encourage innovation (Claver-Cortés, Pertusa-Ortega, & Molina-Azorín, 2012; Kaliappen, Hilman, & Basri, 2019). Recent studies further corroborate their positive correlation with strategic agility and financial performance (Alnoor, Khaw, Chew, Abbas, & Khattak, 2023), as well as their ability to mitigate risks associated with market volatility and imitation (Claver-Cortés et al., 2012). Given their critical role in dynamic service sectors, such as banking, the following hypothesis is proposed:

H1: A hybrid strategy positively impacts bank performance.

3.2 Hybrid strategy and innovation

To successfully implement a hybrid strategy, it is essential to weave innovation into cost leadership and differentiation strategies. Research shows that hybrid strategies drive innovation by pushing companies to consistently refine their internal processes, adjust their product offerings, and discover new solutions (Sofia and Augustine, 2019; Leitner and Güldenberg, 2010). According to Alnoor et al. (2023), developing innovative capabilities is crucial for the effective execution of hybrid strategies, especially in small- and medium-sized enterprises.

These strategies enable firms to create inventive solutions to operational and market challenges, thereby encouraging innovation in both product and process areas (Espino-Rodríguez & Lai, 2014; Kaya 2015). Studies have repeatedly found that firms employing hybrid strategies often achieve higher innovation performance, gaining advantages such as increased responsiveness, customer satisfaction, and long-term adaptability (Agyapong et al., 2019; Agyapong Domeher, 2016).

H2: Hybrid strategy positively impacts innovation.

3.3 Innovation and firm performance

Innovation is widely acknowledged as a crucial factor in enhancing a company's performance, allowing businesses to adjust to shifting market dynamics, cater to changing customer demands, and effectively address technological progress and competitive challenges (Sethi et al., 2005; Sethi Park, 2001). Ongoing innovation promotes the differentiation of products and services, bolstering a company's strategic position and aiding in achieving a lasting competitive edge (Gunday, Ulusoy, Kilic, & Alpkan, 2011).

Research has consistently shown a positive correlation between innovation and company performance in different sectors. Aragón-Correa, García-Morales, and Cordón-Pozo (2007) point out that innovation boosts an organization's ability to adapt and respond strategically in ever-changing environments. Similarly, Calantone, Cavusgil, and Zhao (2002) stressed that companies with robust innovation capabilities attain better performance by improving their learning and market responsiveness. In the service industry, Choi and Williams (2013) found that innovative practices have a direct positive impact on firm-level outcomes.

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Furthermore, the successful execution of innovation is vital for harnessing its benefits. Alam et al. (2013) and Ngo and O'Cass (2012) state that "organisations need to not only innovate but also effectively manage innovation processes to optimise performance improvements" Strategically integrating and managing innovation enhances the chances of boosting profitability, market share and customer satisfaction. Based on this evidence, the following hypothesis is proposed:

H3: Innovation positively affects firm performance.

3.4 Linkage between hybrid strategy and firm performance with mediating role of innovation.

Hybrid strategies that integrate cost efficiency with differentiation improve a firm's ability to adapt to competitive environments. Nonetheless, the beneficial effects of these strategies on performance are often contingent on a firm's capacity for innovation (Sofia & Augustine, 2019). Innovation serves as a dynamic capability, allowing firms to convert strategic goals into enhanced results by promoting ongoing adaptation and value generation (Jaruzelski, Loehr, & Holman, 2011; Suoniemi et al., 2020).

Research indicates that innovation acts as a bridge between hybrid strategies and a company's performance by enhancing its ability to address both internal and external challenges (Rubio-Andrés et al., 2022). Consequently, innovation is a crucial mechanism through which hybrid strategies yield superior firm performance. Thus:

H4: Innovation mediates between hybrid strategy and firm performance.

Based on the literature and hypothesis developed, the research model is presented in Figure 1.

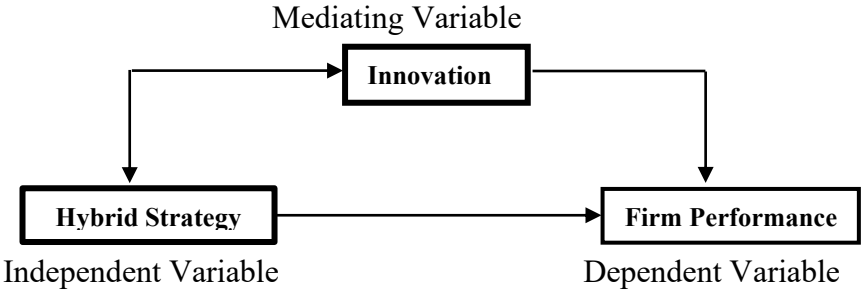

Figure 1: Conceptual framework

4. Methods

4.1 Sample and data collection

This research utilizes a quantitative methodology alongside a cross-sectional survey framework. It investigates the connection between hybrid competitive strategies, innovation, and the performance of firms within Nepal's commercial banking industry.

By 2024, Nepal has 20 licenced commercial banks, including state-owned, joint venture, and public entities. To ensure a representative sample across these ownership types, a stratified sampling technique was employed to select 14 banks.

In total, 280 questionnaires were distributed, with 20 sent to each selected bank. The study utilised purposive sampling to focus on senior executives and department heads who possess extensive knowledge of their banks' strategic, operational, and innovation activities. The participants included top-level executives such as CEOs, Deputy CEOs, and Assistant CEOs.

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The sample also featured Chief Financial Officers, Chief Operating Officers, Chief Business Officers, and various Department Heads.

Between 5 July and 12 October 2024 data were gathered using a self-administered questionnaire in paper format. To boost the response rate, follow-up was conducted weekly via phone and email. Of the 280 questionnaires distributed, 120 were returned, with 12 excluded due to incomplete or inconsistent answers, resulting in 108 valid responses and a response rate of 38.57%. This rate is consistent with the typical survey participation levels in the banking sector of emerging markets (Sekaran & Bougie, 2016).

The questionnaire was first created in English and subsequently translated into Nepali to ensure that it was both culturally appropriate and easy to comprehend. A back-translation method was employed to preserve content validity (Brislin 1970). The tool employed well-established scales to assess hybrid strategy, innovation, and company performance, with participants' responses recorded on a five-point Likert scale from 1 ("Strongly Disagree") to 5 ("Strongly Agree") (Bryman & Bell, 2015).

Of the 108 participants, 67.6% were men and 32.4% were women. The participants' age distribution revealed that 49.1% were aged 41–50 years. Meanwhile, 33.3% were in the 51–60 age bracket. Furthermore, 16.7% were between 31 and 40 years old, and only 0.9% were under 30. In terms of educational qualifications, 81.5% had a master's degree, 13.0% had a bachelor's degree, 4.6% had an M.Phil., and 0.9% had a Ph.D.. The job roles included CEOs (9.3%), Heads of Departments (66.7%), Deputy CEOs (4.6%), Assistant CEOs (9.3%), CFOs (3.7%), COOs (3.7%), and Chief Business Officers (2.8%). Work experience ranged, with 29.6% having more than 20 years, 28.7% having between 13 and 16 years, 16.7% having between 9 and 12 years, and 12.0% having between 5 and 8 years.

SPSS version 25 was used for data analysis, focusing on descriptive statistics and preliminary evaluations. To analyze the research model and test the hypotheses, PLS-SEM was applied using SmartPLS 4. This method is well-suited for handling complex models and moderate sample sizes, with a range of 100–200 participants being adequate for producing reliable results (Hair, Hult, Ringle, & Sarstedt, 2019). During the data collection process, ethical guidelines were rigorously followed. All participants took part voluntarily, informed consent was secured from each individual, and their responses were kept private.

4.2 Measures

This study employed both established and modified measurement scales to explore the connections between hybrid competitive strategy, innovation, and firm performance within Nepal's commercial banking industry. In this context, the hybrid strategy is the independent variable, innovation the mediating variable, and firm performance the dependent variable. The final instrument consisted of 28 items adapted from validated scales used in previous studies.

4.2.1 Hybrid Strategy

The concept of a hybrid competitive strategy integrates two key aspects: cost leadership and product differentiation. This approach aligns with theoretical views suggesting that companies

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can pursue both strategies simultaneously to boost their performance (Porter, 1985; Spanos et al., 2004).

Cost leadership was assessed using six criteria derived from Porter (1985), Power and Hahn (2004), Allen and Helms (2006), Islami, Mustafa, and Latkovikj (2020). Participants were asked to rate how much their bank offers prices lower than those of competitors, employs well-trained staff, manages operating expenses efficiently, innovates in processes and services, prioritises operational efficiency, and invests in technology-driven delivery systems.

The evaluation of product differentiation involved seven criteria from identical sources, determining whether the bank: makes significant investments in technology; sets higher prices; enhances its products/services; allocates more than average on advertising; establishes a strong reputation; employs creative marketing strategies; and prioritises the development of new products/services. These 13 elements collectively represent a company's hybrid strategy.

4.2.2 Innovation

Innovation was evaluated using eight criteria from Schumpeter (1934), the OECD Oslo Manual (2005), and related literature. The assessment covered both product and process innovations. Participants assessed their banks' efforts, including launching new products, broadening product lines, entering new markets, customising products, making process changes, adopting advanced technologies, overhauling procurement, and updating internal systems.

4.2.3 Firm Performance

Firm performance was evaluated using seven indicators that represent perceived financial outcomes, adapted from the works of Kaplan (2001), Danso, Ghartey, and Amankwah-Amoah (2016), Allen and Helms (2006), Li and Zhang (2007), and Luk et al. (2008). Over the last three years, participants have provided subjective evaluations of ROA, ROI, ROE, profit margin growth, market share expansion, competitive standing, and overall financial performance.

This subjective method has been validated by previous studies as a dependable measure of performance (Dess & Robinson, 1984).

5. Results

The analysis and interpretation of a Partial Least Squares (PLS) model consists of two main stages. Initially, the focus was on thoroughly evaluating the reliability and validity of the measurement model. Subsequently, the structural model was scrutinised to assess the proposed relationships (Barclay et al., 1995).

5.1 Evaluation of the measurement model

Before analysing the structural model, the measurement model was evaluated using PLS-SEM to ensure that the latent constructs were reliable and valid (Barclay, Higgins, & Thompson, 1995). As all constructs in this study were modelled reflectively, including a second-order molecular construct for the hybrid strategy, the focus was on evaluating indicator reliability, internal consistency reliability, convergent validity, and multicollinearity diagnostics.

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5.1.1 Indicator Reliability

The reliability of the indicators was determined by evaluating the outer loadings of each observed item concerning its latent construct. According to Hair et al. (2019), "outer loadings of 0.70 or higher are considered acceptable."In this study, most items met or exceeded this threshold. However, item FP_5, which had a loading of 0.542, was retained because of its theoretical significance and its role in enhancing the overall reliability of the scale.

5.1.2 Internal Consistency Reliability

Cronbach's Alpha and Composite Reliability were used to assess internal consistency. Each construct showed values surpassing the suggested threshold of 0.70, signifying that the items reliably measured their underlying constructs. The Cronbach's alpha values ranged from 0.795 to 0.863. Furthermore, the Composite Reliability (CR) values ranged from 0.830 to 0.895 (Table 1). These findings indicate that the constructs possess adequate internal consistency.

5.1.3 Convergent Validity

Convergent validity was evaluated using the AVE. According to Fornell and Larcker (1981), "an AVE value exceeding 0.50 signifies that the latent construct accounts for more than 50% of the variance in its measured indicators." All constructs obtained AVE values ranging from 0.547 to 0.710, indicating strong convergent validity.

5.1.4 Multicollinearity

The Variance Inflation Factor (VIF) was used to evaluate multicollinearity. All VIF scores were below the conservative limit of 3.3, suggesting that multicollinearity was not an issue among the indicators (Diamantopoulos & Siguaw, 2006). The results for factor loadings, Alpha, CR, AVE, and VIF are shown in Table 1.

Table 1

Item loading, reliability and validity

Construct	Item	Loading	Cronbach's Alpha	Composite Reliability	AVE	VIF
Cost Leadership Strategy	CLS1	0.842	0.803	0.83	0.71	1.214
	CLS4	0.843				1.214
Firm Performance	FP1	0.749	0.863	0.895	0.553	2.342
	FP2	0.765				2.325
	FP3	0.761				2.017
	FP4	0.784				1.81
	FP5	0.553				1.649
	FP6	0.745				1.883
	FP7	0.817				2.221
Innovation	Inn5	0.721	0.815	0.879	0.645	1.408
	Inn6	0.844				1.943
	Inn7	0.829				1.956
	Inn8	0.814				1.91
Product Differentiation	PDS2	0.687	0.795	0.857	0.547	1.472

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PDS3	0.818	1.712
PDS4	0.782	1.585
PDS5	0.747	1.56
PDS7	0.653	1.461

5.1.5 Discriminant validity

To evaluate discriminant validity, the data were analysed using both the Fornell-Larcker criterion and the Heterotrait-Monotrait Ratio. Table 2 presents the square roots of the AVE values, which are emphasized along the diagonal. These values were higher than the corresponding inter-construct correlations, confirming that the Fornell-Larcker criterion was met (Fornell & Larcker, 1981). Moreover, all HTMT values were below the conservative limit of 0.90, as suggested by Henseler, Ringle, and Sarstedt (2015). This outcome confirms that the constructs meet the essential requirements of discriminant validity.

Table 2

Discriminant validity

Discriminant validity- HTMT ratio					Fornell-Larcker Criterion				
	CLS	FP	Inn	PDS		CLS	FP	Inn	PDS
CLS					CLS_	**0.843**			
FP	0.623				FP_	0.448	**0.744**		
Inn	0.842	0.575			Inn_	0.585	0.488	**0.803**	
PDS	0.866	0.454	0.761		PDS_	0.577	0.388	0.622	**0.741**

These results demonstrate that each construct is distinct from the others, thereby confirming the discriminant validity of the measurement model.

5.2 Structural model assessment

After confirming the validity of the measurement model, the structural model was evaluated. This phase was designed to explore the suggested connections between hybrid strategies, innovation, and company performance. This study utilised PLS-SEM with SmartPLS 4, incorporating a bootstrapping technique with 5,000 sub-samples. The evaluation of the structural model concentrated on analysing the direct effects, R^2, f^2, and Q^2.

5.2.1 Direct Effects

Table 5 illustrates that the link between the hybrid strategy and innovation is both positive and statistically significant ($\beta = 0.707$, $t = 12.49$, $p = 0.001$), suggesting that implementing a hybrid competitive strategy boosts innovation capabilities. Additionally, the connection between innovation and firm performance is statistically significant ($\beta = 0.281$, $t = 1.96$, $p = 0.050$), indicating that innovation has a positive impact on financial performance. However, the direct link from the hybrid strategy to firm performance did not reach statistical significance ($\beta = 0.291$, $t = 1.86$, $p = 0.063$), implying that the hybrid strategy's effect on performance might be indirect and mediated through innovation.

5.2.2 Coefficient of Determination (R^2)

The R^2 values demonstrate the degree to which the independent constructs account for the variance. For innovation, an R^2 of 0.499 signifies that the hybrid strategy explains 49.9% of

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the variance. Regarding firm performance, the R^2 of 0.279 indicates that the combination of the hybrid strategy and innovation accounts for approximately 28% of the variance. These values suggest a moderate level of explanatory power (Hair et al., 2019).

5.2.3 Effect Size (f^2)

The effect size (f^2) measures the contribution of each external construct to the internal constructs' R^2 value. The findings indicate that the hybrid strategy has a substantial and significant impact on innovation ($f^2 = 0.997$, $p < 0.01$), whereas its influence on firm performance is minimal and not significant ($f^2 = 0.059$). Additionally, innovation has a minor effect on firm performance ($f^2 = 0.055$). Based on Cohen's (1988) guidelines, an f^2 value of 0.02 represents a small effect size. An f^2 value of 0.15 is considered moderate, whereas an f^2 of 0.35 is regarded as large.

5.2.4. Predictive Relevance (Q^2)

The Q^2 values were evaluated using the blindfolding method. A Q^2 value above zero indicates that the model possesses predictive relevance. The Q^2 for innovation was 0.498, while for firm performance, it was 0.215, thereby affirming the model's predictive capability for both constructs (Chin, 1998).

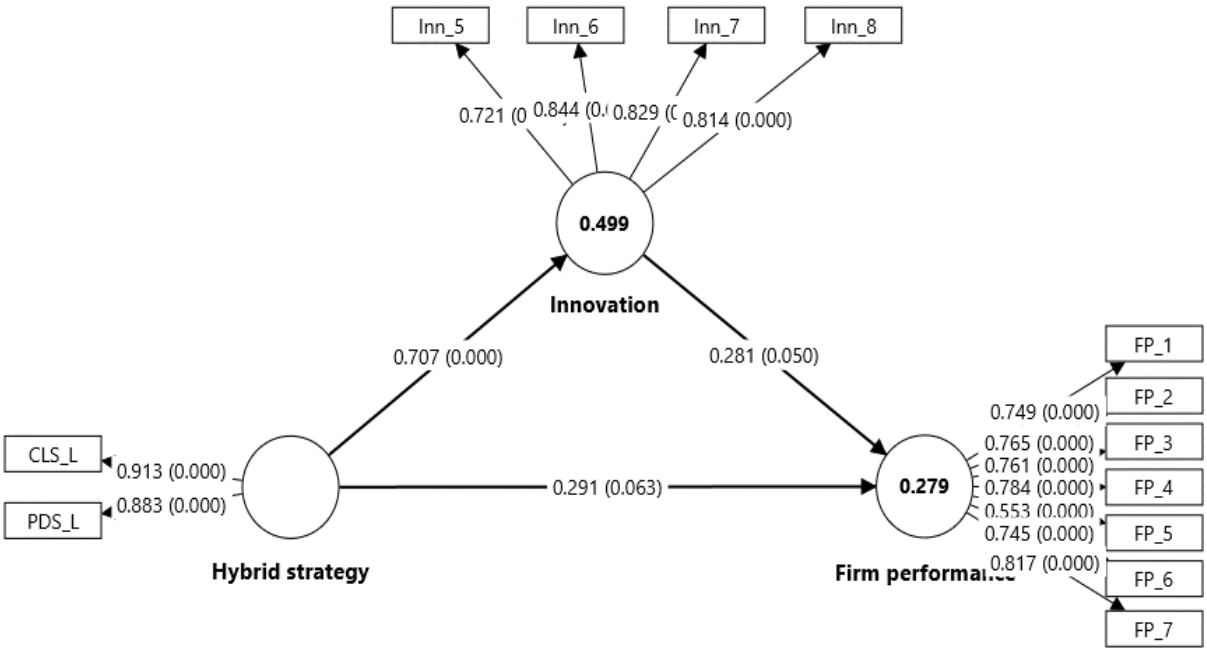

Figure 2. Hypothesis test results.

Table 5

Direct relationship test results with R^2, f^2 and Q^2.

Path	β (O)	t-value	p-value	R^2	f^2	Q^2
Hybrid Strategy → Firm Performance	0.291	1.86	0.063	0.279	0.059	0.215
Hybrid Strategy → Innovation	0.707	12.49	0.000	0.499	0.997	0.498
Innovation → Firm Performance	0.281	1.96	0.050	0.279	0.055	0.215

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The findings from the structural model indicate that the hybrid strategy has a notable effect on innovation, which subsequently enhances the firm's performance. Nevertheless, the hybrid strategy's direct effect on performance was not statistically significant, suggesting that innovation may mediate this connection. The model exhibits satisfactory explanatory power and predictive relevance, highlighting the strategic role of innovation in achieving performance outcomes in Nepal's banking sector.

5.2.5 Mediation analysis

This study explored how innovation acts as a mediator in the link between hybrid strategy and firm performance, following the methodology described by Hair et al. (2019). This methodology involves examining the total, direct, and indirect effects, as well as computing the Variance Accounted For (VAF). To assess the significance of the mediation effects, a bootstrapping method with 5,000 resamples was used.

Table 6 shows that the hybrid strategy has a statistically significant impact on firm performance ($\beta = 0.491$, $t = 5.086$, $p < 0.001$), highlighting its role as a strong predictor of performance outcomes. The indirect effect, facilitated by innovation, was also significant ($\beta = 0.199$, $t = 1.961$, $p = 0.050$), confirming the mediating function of innovation. Conversely, the hybrid strategy's direct effect on firm performance was not statistically significant ($\beta = 0.292$, $t = 1.858$, $p = 0.063$), indicating that the strategy primarily affects performance through innovation. To further substantiate the mediation, the Variance Accounted For (VAF) was computed, yielding a result of 40.53%. As this surpasses the 40% threshold, it signifies complete mediation (Hair et al., 2019). These results affirm that innovation completely mediates the impact of hybrid strategies on the performance of Nepalese commercial banks.

Table 6

Mediating Effect of Innovation on Hybrid Strategy and Financial Performance

Type of effect	Effect between	Path coefficient	T stats	P value	Remark
Total effect	Hybrid strategy -> Firm performance	0.491	5.086	0.000	Significant
Indirect effect	Hybrid strategy -> Innovation -> Firm performance	0.199	1.961	0.050	Significant
Direct effect	Hybrid strategy -> Firm performance	0.292	1.858	0.063	Insignificant
VAF	IE/TE	40.53%			
Conclusion	Full mediation effect of innovation between hybrid strategy and firm performance.				

The mediation analysis confirmed that innovation fully mediates the relationship between a hybrid strategy and firm performance. This emphasises the crucial role of innovation as a strategic capability that enables firms to transform their hybrid strategy, integrating cost leadership with differentiation, into concrete performance enhancements. These findings are particularly significant for companies in highly regulated and competitive environments, such as Nepal's banking sector, where strategic innovation is vital for long-term success.

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6. Discussion

This study explored how a hybrid competitive strategy impacts the performance of firms in Nepal's commercial banking industry, with innovation serving as an intermediary factor. The findings offer significant contributions to the strategic management literature, particularly concerning financial institutions in emerging markets.

In contrast to what was anticipated and previous research in other industries (e.g., Acquaah & Yasai-Ardekani, 2008; Spanos, Zaralis, & Lioukas, 2004) has shown, the direct link between a hybrid strategy and firm performance was not statistically significant. This indicates that simply merging cost leadership with differentiation strategies does not directly enhance the financial performance of Nepalese commercial banks' financial performance. Instead, performance advantages are realised when hybrid strategies are successfully implemented as innovative organizational practices.

This study establishes a strong positive link between hybrid strategies and innovation, indicating that banks that adopt hybrid strategies are more likely to engage in innovative processes, technologies, and service delivery mechanisms. This conclusion is in line with the work of Alnoor et al. (2023) and Claver-Cortés, Pertusa-Ortega, and Molina-Azorín (2012), who pointed out that hybrid strategies promote innovation by fostering agility, strategic flexibility, and resource integration. In the context of Nepal's banking industry, this can be seen in the form of digital transformation, personalised financial services, and the automation of internal operations.

Moreover, innovation plays a crucial role in shaping a company's performance, highlighting its importance as a fundamental driver of profitability, operational effectiveness, and competitive advantage (Tidd & Bessant, 2009; Gunday, Ulusoy, Kilic, & Alpkan, 2011). In sectors such as banking, which are both highly regulated and competitive, innovation enables companies to adapt to evolving market dynamics, improve customer satisfaction, and maintain growth (Lichtenthaler, 2020).

Mediation analysis plays a crucial role in demonstrating complete mediation, showing that the effect of the hybrid strategy on a firm's performance is fully mediated by innovation. This result bolsters the Resource-Based View (RBV) (Barney, 1991), which highlights the critical role of firm-specific resources in gaining a competitive advantage. This corresponds with the Dynamic Capabilities Theory (Teece et al., 1997), which underscores a firm's proficiency in modifying and reorganizing its resources to cope with environmental shifts.

The findings also align with the assertions of Albers and Rundshagen (2020) and Gabrielsson, Seppälä, and Gabrielsson (2016), who concluded that hybrid strategies reach peak effectiveness in swiftly evolving and unpredictable settings, but only when innovation is a key component. For commercial banks in Nepal, this highlights the strategic necessity of thoroughly integrating innovation into their business frameworks and implementation strategies.

In conclusion, while hybrid competitive strategies present strategic possibilities, innovation primarily drives enhanced financial performance. The findings offer practical guidance for banking executives, encouraging them to prioritise the development of innovative capabilities

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as a strategic asset. Furthermore, this study contributes to the ongoing dialogue on competitive strategy in emerging markets, emphasising that innovation should be regarded as a fundamental strategic function rather than a supplementary task.

7. Conclusion

This study examines how a hybrid competitive strategy affects the performance of firms in Nepal's commercial banking sector, with innovation serving as a mediating element. The results provide valuable theoretical and practical insights into this field.

7.1 Theoretical Implications

This study makes a significant contribution to strategic management by questioning Porter's (1980, 1985) conventional belief that cost leadership and differentiation should be pursued independently of each other. The findings indicate that hybrid strategies on their own do not directly enhance firm performance. Instead, innovation acts as a complete mediator in this relationship, highlighting that the benefits of hybrid strategies on performance are primarily achieved through innovation.

The Resource-Based View (Barney, 1991) suggests that innovation is a vital intangible asset for maintaining a long-term competitive edge. Furthermore, these insights align with the Dynamic Capabilities Theory (Teece, Pisano, & Shuen, 1997), which emphasises the necessity of utilising internal strengths, such as innovation, to adjust hybrid strategies in response to changing environmental conditions.

This research enhances theoretical insights by demonstrating how internal capabilities can bridge the divide between strategic goals and actual performance results, particularly in highly regulated and competitive service industries, such as banking.

7.2 Practical Implications

This study underscores the fact that relying solely on a hybrid strategy is inadequate for achieving high performance. Managers in Nepalese commercial banks should prioritise developing innovative capabilities, including service improvements, digital transformation, and process optimisation, to effectively implement strategies and achieve measurable results. While the hybrid strategy lays the groundwork, innovation is the key driver.

Moreover, innovation should be integrated as a fundamental aspect of strategic planning and decision making, rather than being regarded as a supplementary function. Organisations that cultivate a culture conducive to innovation, backed by leadership and systems, are more likely to maintain competitive advantages and adapt to market changes.

Moreover, bank leaders should prioritise fostering environments that support innovation by allocating resources to training, technology, and organizational learning. This approach will help ensure that strategic goals are achieved through concrete innovative results.

This study provides recommendations for policymakers and regulators in Nepal's financial industry. By fostering innovation through investments in digital infrastructure, offering regulatory flexibility, and providing incentives, banks can be better equipped to adopt hybrid strategies, thereby boosting their competitiveness and resilience in the sector.

7.3 Limitations and future research directions

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Although this research offers valuable insights into the impact of hybrid strategies and innovation on company performance, it does have some limitations. A major limitation of this study is its cross-sectional design, which restricts the capacity to determine cause-and-effect links between the variables. To address this, future research should adopt longitudinal designs to better observe how hybrid strategies and innovation evolve over time and how they more accurately shape performance outcomes.

Second, concentrating exclusively on Nepal's commercial banking sector might restrict the applicability of these results. Future research should apply the model to other sectors, such as manufacturing or telecommunications, and examine variations among different company sizes and ownership structures, including SMEs and multinational corporations.

Third, the use of self-reported performance data might have led to biases. To improve validity, it would be beneficial to include objective financial metrics, such as ROA or market share, and to draw from multiple data sources.

Fourth, viewing innovation as a unified concept may conceal the distinct influences of various innovation types. Future research should differentiate between product, process, marketing, and organizational innovations to analyse their specific roles in the connection between hybrid strategies and performance.

Ultimately, while quantitative methods have their strengths, relying on them alone may not fully capture the nuances of the strategic and innovation processes. Incorporating mixed-methods research that includes qualitative elements, such as interviews or case studies, can provide a more complete contextual understanding.

By overcoming these constraints, theoretical models will be improved, offering companies more effective guidance for implementing innovation-focused hybrid strategies, especially in developing markets such as Nepal.

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