Relationship Between Entrepreneurial Orientation and Business Performance: A Review of Literature

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The purpose of this paper is to provide a review of literature on developments in entrepreneurship theory and emergence of Entrepreneurial Orientation (EO) construct. It also explores and presents the literature on the relationship between entrepreneurial orientation and business performance. Three models—the construct model, the EO-Strategy model and the performance model—were identified as the lines of research on EO. The paper reviews a range of publications describing the methodology, findings and alternative approaches to study the performance model. It suggests that a strong entrepreneurial orientation results in high business performance. EO is a multidimensional construct operationalized in terms of variables 'innovativeness', 'risk-taking', 'proactiveness', 'autonomy' and 'competitive aggressiveness'. A combination of subjective and objective measures of performance should be used for accurate measurement of performance. Various organizational and environmental elements should be introduced as moderating and mediating variables while studying the relationship of EO with performance.

Introduction

In the systematic development of the entrepreneurship theory, the first half of the 20th century was devoted to defining the term entrepreneurship and identifying the role of entrepreneurship in the economic development of a country (Marshall, 1930; Say, 1834; Schumpeter, 1934 and 1942; Burns and Stalker, 1961; and McClelland, 1961). During the 1960s and 1970s, the focus shifted towards identification of factors affecting entrepreneurship, i.e., why entrepreneurs start enterprises? During this phase, entrepreneurship was associated with various individual and demographic traits that encourage individuals towards entrepreneurship. Factors such as need for achievement, locus of control, self-efficacy, risk-taking propensity, family influence, educational influence, work experience, etc., along with various demographic characteristics, were identified as antecedents of entrepreneurial behavior (Hagen, 1962; Kilby, 1971; Mintzberg, 1973; Conley, 1974; Weick, 1976; and Lachman, 1980). In the 1980s and 1990s entrepreneurial research moved towards identification of the dimensions of Entrepreneurial Orientation (EO) and fit between the EO-Strategy models, which align the level of EO with different strategies (Miller and Friesen, 1982; Burgelman, 1983; Galbraith and Kazanjina, 1986; Miller and Toulouse, 1986; Covin and Slevin, 1988; Zahra, 1993; Covin *et al*., 1994; Lumpkin and Dess, 1996; Dess *et al*., 1997; and Barringer and Bluedorn, 1999). Entrepreneurial opportunity recognition

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process again caught the attention of researchers during 1990s (Gartner, 1988; Venkatraman, 1989a and 1989b; Bygrave and Hofer, 1991; Shaver and Scott, 1991; and Venkatraman, 1997). The last two decades have witnessed the developments in the area of EO-performance relationship and adoption of contingency framework to EO-performance relationship, where it has been acknowledged that EO-performance relationship is affected by the organizational environment and industrial turbulence (Covin and Slevin, 1989; Zahra, 1991; Wiklund, 1999; Zahra and Garvis, 2000; Lee and Penning, 2001; Yusaf, 2002; Dimitratos *et al.*, 2004; Kraus *et al.*, 2005; Wiklund and Shepherd, 2005; Stam and Elfring, 2008; Kreiser and Davis, 2010; Grande *et al.*, 2011).

Entrepreneurial Orientation

EO has emerged as a major construct within the strategic management and entrepreneurship literature over the recent years. It can be viewed as a characteristic of organizations, which can be measured by looking at top management's entrepreneurial style, as evidenced by the firms' strategic decisions and operating management philosophy (Miller, 1983). EO should be distinguished from entrepreneurship. The essence of entrepreneurial orientation depends on how entrepreneurs implement entrepreneurship in the course of realizing their career ambition. On the other hand, entrepreneurship focuses on new entry. New entry can be accomplished by entering either into new or established markets with new or existing goods or services (Burgelman, 1983). Covin and Slevin (1988) argued that an organization's EO is the summation of the extent to which top managers are inclined to take business-related risks, to favor change and innovation in order to obtain a competitive advantage for their firm and to compete aggressively with other firms. They proposed that EO should be considered as the strategic dimension which can be observed from the firms' strategic posture running along a continuum from a fully conservative orientation to a completely entrepreneurial one. They suggest that firms with a propensity to engage in relatively high levels of risk-taking, innovative and proactive behaviors have EO, while those engaging in relatively low levels of these behaviors have conservative orientation (Covin and Slevin, 1991). According to Lumpkin and Dess (1996), EO refers to the processes, practices and decision-making activities that lead to new entry. They considered EO as a process construct, which is concerned with the methods, practices, and decision-making styles used by the managers. However, the term EO is also used to refer to the set of personal psychological traits, values, attributes and attitudes that are strongly associated with a motivation to engage in entrepreneurial activities (Kilby, 1971; Mintzberg, 1973; Miller and Toulouse, 1986; Kreiser *et al.*, 2002; and Poon *et al.*, 2006). EO is an important measure of the way a firm is organized. It has been conceptualized as the process and decision-making activities used by entrepreneur to act entrepreneurially (Lumpkin and Dess, 2001; Rauch *et al.*, 2006; Kreiser and Davis, 2010; and Ullah *et al.*, 2011). In gist, EO refers to a firm's strategic orientation and it is usually seen as the extent to which a firm innovates, takes risks to compete aggressively and acts autonomously and proactively.

EO is a key ingredient for organizational success. Three types of models are evident in the EO literature:

- The construct model, in which the dependent variable is EO and the researchers focus on its antecedents (Lachman, 1980; Miller and Toulouse, 1986; Stevenson and Jaillo, 1990; Zahra, 1991; Zahra *et al.*, 1999; Littunen, 2000; Poon *et al.*, 2006; and Holt *et al.*, 2007).
- The EO-Strategy model, which aligns the level of EO with different strategies (Mintzberg, 1973; Khandwalla, 1977; Miller and Friese, 1982; Burgelman, 1983; Galbraith and Kazanjina, 1986; Covin and Slevin, 1988; Zahra, 1993; Covin *et al.*, 1994; Lumpkin and Dess, 1996; Dess *et al.*, 1997; Frese *et al.*, 2002; and Ireland *et al.*, 2009).
- The performance model, in which the EO-performance linkage is explored, often including not only bivariate relationship, but also multivariate relationship by considering moderating and mediating variables related to external environment and/or organizational environment and by looking at the main effect between the two variables as well as interaction effect with moderating or mediating variables. (Covin and Slevin, 1989; Zahra, 1991; Wiklund, 1999; Zahra and Garvis, 2000; Lee and Penning, 2001; Yusaf, 2002; Dimitratos *et al.*, 2004; Kraus *et al.*, 2005; Wiklund and Shepherd, 2005; Stam and Elfring, 2008; Ireland *et al.*, 2009, Kreiser and Davis, 2010; Grande *et al.*, 2011; and Soininen *et al.*, 2011).

Dimensions of Entrepreneurial Orientation

EO has often been operationalized in terms of three dimensions identified by Covin and Slevin (1989), building upon the earlier work of Khandwalla (1976) and Miller and Friesen (1982), viz., 'innovativeness', 'risk-taking' and 'proactiveness', to characterize and test entrepreneurship. Later, Lumpkin and Dess (1996) identified two more dimensions, 'autonomy' and 'competitive aggressiveness', to conceptualize EO. However, it has sometimes been argued that 'autonomy' is an internal organizational driver of entrepreneurship, which influences the organizational climate for entrepreneurship (Hadji *et al.*, 2007; and Hough and Scheepers, 2008). Secondly, some researchers claimed that 'Competitive Aggressiveness' forms a part of the proactiveness dimension and does not represent a separate dimension (Hough and Scheepers, 2008; and Chang and Lin, 2011).

Innovativeness of entrepreneurs is measured by the propensity by which they innovate their business (Miller and Friesen, 1982); their willingness to try new ways which are different from the existing; the enthusiasm to adopt new ideas or new methods to their business operation; and the eagerness to implement the innovation strategy in their business (Khandwalla, 1987). Innovativeness reflects a firm's tendency to engage in and support new ideas, novelty, experimentation and creative processes (Lumpkin and Dess, 1996) that may result in new products, services, or technological processes and which may take the organization to a new paradigm of success (Swiezczek and Ha, 2003). It also implies seeking creative, extraordinary or strange solutions to problems and needs. Schumpeter (1934) considered entrepreneurship to be essentially a creative activity and entrepreneur as an innovator who carries out new combinations in the field of men, money, material, machine and management. According to him, entrepreneur is an economic man who tries to maximize his profits by making innovations in any one of the following fields: (1) new products; (2) new production methods; (3) new markets; or (4) new forms of organization. The degree of an entrepreneur's innovativeness will decide how far and how deep the innovation will go in business in order to meet both the strategic goal formulated for the business and the requirements from the environment (Hult *et al*., 2004). Innovativeness represents a basic willingness to depart from existing technologies or practices and venture beyond the current state-of-the-art (Covin *et al.*, 2006). An innovative strategic posture can be linked to firm performance as it increases the chances that a firm will realize first mover advantage, stay ahead of their competitors, gain a competitive advantage and capitalize on emerging market opportunities that lead to improved financial results (Kreiser *et al*., 2002; Hult *et al*., 2004; and Kreiser and Davis, 2010).

Risk-taking refers to the tendency to take bold actions such as venturing into unknown new markets and committing a large portion of resources to ventures with uncertain outcomes. Cantillon (1730) described entrepreneur to be a rational decision maker "who assumes risk and provides the management of the firm". In the 1800s, John Stuart Mill argued that risk-taking is the paramount attribute of entrepreneurship. Risk-taking implies willingness for committing huge resources to opportunities which involve probability of high failure (Mintzberg, 1973; Zahra, 1991; and Wiklund and Shepherd, 2003). Risk handling is the process in which potential risks to a business are identified, analyzed, mitigated and prevented, along with the process of balancing the cost of protecting the company against a risk versus the cost of exposure to that risk. The ideal way to cope with risk is to perceive risk at its inception, and taking risk under control right from its inception stage (Cornelia, 1996). Entrepreneurs, in actuality, tend to proactively deal with the risks. Risk-taking has a curvilinear relationship with performance of entrepreneurial firms. Research suggests that entrepreneurial firms exhibiting moderate levels of risk-taking would outperform in market as compared to firms exhibiting either very high or very low levels of risk-taking (Begley and Boyd, 1987; Kreiser *et al*., 2002; Tang *et al.*, 2008; and Kreiser and Davis, 2010). Factors such as process of forming a risk problem (Baird and Thomas, 1985; and Stewart and Roth, 2001); results of past risk-taking (Covin and Slevin, 1989; Goll and Rasheed 1997; and Swierczek and Ha, 2003); and the ability to perform under risky conditions (Brockhaus, 1980; Lichtenstein and Brush, 2001; Dimitratos *et al*., 2004; and Soininen *et al.*, 2011) affect the risk-taking ability of entrepreneur.

Proactiveness is an opportunity-seeking, forward-looking perspective involving introducing new products or services ahead of the competition and acting in anticipation of future demand to create, change and shape the environment (Lumpkin and Dess, 1996; and Kreiser *et al*., 2002). Proactiveness is manifested in: (1) aggressive behavior directed at rival firms; and (2) the organizational pursuit of favorable business opportunities. It is simply the ability to take initiative, whenever the situation demands. Porter (1985) suggested that in certain situations, firms could utilize proactive behavior in order to increase their competitive position in relation to other firms. Proactiveness is concerned with first mover and other actions aimed at seeking to secure and protect market share and with a forward-looking perspective reflected in actions taken in anticipation of future demand (Venkatraman, 1989a and 1989b; Naman and Slevin, 1993; Lee and Penning, 2001; and Dimitratos *et al.*, 2004). It is not only in defense, but in offence as well. It refers to processes aimed at anticipating and acting on future needs by seeking new opportunities which may or may not be related to the present line of operations, introduction of new products and brands ahead of competition, strategically eliminating operations which are in the mature or declining stages of life cycle (Swierczek and Ha, 2003; Green *et al.*, 2008; Stam and Elfring, 2008; Clercq *et al.*, 2010; and Kreiser and Davis, 2010). Thus, proactiveness pertains to a willingness to initiate to which competitors then respond.

Competitive aggressiveness refers to a firm's propensity to directly and intensely challenge its competitors to achieve entry or improve position, that is, to outperform industry rivals in the marketplace (Kraus *et al.*, 2005). It also reflects the willingness of a firm to be unconventional rather than rely on traditional methods of competing. This aspect is used to measure how entrepreneurial firms deal with threats, and it also refers to the firm responsiveness directed toward achieving competitive advantage (Lumpking and Dess, 2001; Frese *et al.*, 2002; and Grande *et al.*, 2011). In literature, the terms proactiveness and competitive aggressiveness are often used interchangeably but there is a difference between both terms. Proactiveness states how a firm relates to market opportunities in the process of creating demand, while competitive aggressiveness refers to how firms relate to competitors, that is, how firms respond to trends and demand that already exist in the marketplace (Lumpkin and Dess, 2001).

Autonomy refers to the independent action of an individual or a team in bringing forth an idea or a vision and carrying it through to completion (Lumpkin and Dess, 1996). In general, it means the ability and will to be self-directed in the pursuit of opportunities. In an organizational context, it refers to freely taken action, irrespective of organizational constraints, for establishment and smooth running of a venture (Shrivastava and Grant, 1985; Stevenson and Jaillo, 1990; and Kraus *et al.*, 2005). Autonomy in firms may vary with the size of organization, management style, or ownership (Lumpkin and Dess, 1996).

There are diverse opinions to the issue whether various dimensions of entrepreneurial orientation are independent of each other or not. Covin and Slevin (1989) argued that entrepreneurial orientation is best viewed as a unidimensional concept. On the contrary, Lumpkin and Dess (1996) opined that various dimensions of EO may occur in different combinations and hence, it is a multidimensional construct. The basic premise underlying this argument is that each of these subdimensions of EO may have a differential relationship with entrepreneurial outcomes. For example, risk-taking has shown a curvilinear relationship with performance, while innovation and proactiveness have a positive and direct relationship with performance (Kreiser *et al.*, 2002; Tang *et al.*, 2008; and Kreiser and Davis, 2010).

Business Performance

Literature on the construct of performance reveals that there is no consensus among the researchers on the appropriate measures of business performance indicators. As a result, a wide diversity of performance measures, i.e., objective and subjective measures, as well a financial and nonfinancial measures were used across studied, which leads to high diversity in EO-performance relationship (Chakravarthy, 1986; Venkataraman and Ramanujam, 1986; Murphy *et al*., 1996; and Combs *et al*., 2005). Research that considers only a single dimension or a narrow range of the performance indicators may produce misleading results. Therefore, the question arises as to what is the appropriate form of performance measurement. Should it be financial? e.g., sales growth, return on investment, income growth or profitability; or nonfinancial, e.g., satisfaction level of stakeholders or positive response in community; or both. It has been widely accepted by the researchers that objective measures of performance are more appropriate than subjective measures of performance. Objective data, however, is very difficult to obtain as respondents are reluctant to release sensitive information to the outsiders (Dess and Priem, 1995). On the other hand, owners and managers are generally inclined to provide subjective evaluation of their firm performance, which lacks strong reliability (Wiklund, 1999; and Wiklund and Shepherd, 2005). Alternatively, performance can be viewed to be multidimensional in nature and therefore it is advantageous to integrate various subjective and objective measures of performance for accurate measurement of performance (Lumpkin and Dess, 1996; Murphy *et al*., 1996; Yusaf, 2002; Combs *et al*., 2005; and Wiklund and Shepherd, 2005).

Entrepreneurial Orientation – Performance Relationship

The relationship between entrepreneurship and firm performance has received considerable attention in the organizational and entrepreneurial literature over the last two decades. Scholars have theorized that the incidence of firm-level entrepreneurial behaviors, i.e., the propensity to engage in relatively high levels of risk-taking, innovative and proactive behaviors is positively associated with organizational profitability and growth (Covin and Slevin, 1991; Lumpkin and Dess, 1996; Wiklund and Shepherd, 2003; Covin *et al*., 2006; Ireland *et al*., 2009; and Soininen *et al*., 2011). However, the magnitude of this relationship seems to vary across studies. While some studies found that businesses that adopt a strong EO perform better than firms that do not adopt an EO (Covin and Slevin, 1988; Wiklund and Shepherd, 2003; Hult *et al*., 2004; Kraus *et al*., 2005; and Kreiser and Davis, 2010), studies also report of lower correlations between EO and performance (Zahra, 1991; Dimitratos *et al*., 2004; and William and Sinkula, 2009). Other set of studies failed to find a significant relationship between EO and performance (Covin *et al*., 1994; George *et al*., 2001; and Tang and Koveos, 2004). Some studies have shown that the relationship between EO and performance is not that straightforward, rather it is shaped like inverted U (Bhuian *et al*., 2005; and Tang *et al*., 2008), which means that a high degree of EO is not always desirable in certain market and structural conditions. Thus there is a considerable variation in the reported relationships between EO and business performance. The reasons for variation in results can be attributed to factors like difference in the scales of entrepreneurial orientation being used, difference in methodology being adopted, opinion regarding moderating variables and different indicator components of performance being measured.

Literature suggests that the relationship between EO and performance is not that straightforward, rather it is influenced by the interference of various elements of organizational and industrial environment. Venkatraman (1989b) suggested the moderating effects, mediating effects, independent effects and interaction effects models for investigating the impact of third variables as a means of exploring contingency relationships.

In the moderating-effects model, the form or strength of the EO-performance relationship varies with organizational structure. Covin and Slevin (1988) suggested that organizations are arrayed along a mechanistic-organic continuum, which constitutes "two formally contrasted forms of management system". 'Organic organizations' typically are decentralized and informal, and have emphasis on lateral interaction and an equal distribution of knowledge throughout the organizational network. On the contrary, 'mechanistic organizations' tend to be highly centralized and formal. Many researchers argue that EO needs to be associated with the low structural formalization, decentralization and low complexity inherent in the organic organization structures for better performance (Khandwalla, 1977; Covin and Slevin, 1991; Naman and Slevin, 1993; Kreiser and Davis, 2010; and Kraus *et al.*, 2011).

The mediating-effects model considers EO to be an antecedent variable, firm performance to be the outcome, and integration of organizational activities to be the mediating variable. Effectively integrating activities and processes intervene in the relationship between EO and performance. Miller (1983) suggested that such integrating activities would include the "extensive use of structural integration devices such as committees and task forces". Porter (1985) suggested the term horizontal organization, which consists of horizontal structures, horizontal systems and horizontal human resource practices to integrate activities across business units within a corporation.

In independent-effects models, EO and environmental munificence are depicted as having independent effects on the firm performance. Environmental munificence refers to the availability of resources and the amount of external opportunities that are present in a specific environmental setting and can also be considered as the profitability or growth rates of the industry in which a firm competes (Mintzberg, 1973; Miller and Frieses, 1978; Miller, 1983; Dess and Beard, 1984; and Covin and Slevin, 1988). This relationship is consistent with the traditional industrial organization paradigm which suggests that the industry within which a firm competes has a critical impact on its performance (Porter, 1985).

Lastly, in interaction-effects models, various elements of organizational and industrial environment are believed to interact with EO to influence firm performance (Naman and Slevin, 1993; and Lumpkin and Dess, 1996). Wiklund (1999) indicated that increase in firm performance related to EO is sustainable over long periods of time, but this relationship may be contingent on the environmental context in which the firm operates. Wiklund and Sheperd

(2005) suggested that studying multivariate configurations of an entrepreneurial orientation and other important constructs may provide a more complete understanding of the entrepreneurial orientation-performance relationship than bivariate models. Other variables, in addition to EO, could also influence performance directly or may moderate the relationship between EO and performance. Rauch *et al.* (2006) claimed that relationship between entrepreneurial orientation and performance is moderated by national culture, size of business organization, and technology intensity of the firm. Stam and Elfring (2008) have highlighted the role of network centrality in EO-performance relationship. Kreiser and Davis (2010) suggested that no single structure is universally appropriate for an organization. The contingent factors upon which the appropriate structure depends may include organizational factors like strategy, size, support, resources, etc., and environmental factors like dynamism, munificence, regulations and industry turbulence, etc. Contingency theory further suggests that congruence or 'fit' among key variables such as industry conditions and organizational processes is critical for obtaining optimal performance and the relationship between two variables is dependent upon the interference of a third variable, therefore, by introducing moderators into EO-performance relationships, the misleading inferences can be reduced and more precise and specific understanding about EO-performance relationship can be developed (Covin and Slevin, 1989; Zahra, 1991; Zahra and Garvis, 2000; Jogaratnam, 2002; Dimitratos *et al.*, 2004; Hult *et al.*, 2004; Wiklund and Shepherd, 2005; Rauch *et al.*, 2006; Green *et al.*, 2008; Kreiser and Davis, 2010; Grande *et al.*, 2011; and Soininen *et al.*, 2011).

Conclusion and Suggestions

EO is an important measure of the way a firm is organized, and it is often conceptualized as the process and decision-making activities used by managers to act entrepreneurially. On the basis of extensive review of literature and by considering the arguments of various researchers, the paper acknowledges EO as a key ingredient for organizational success. The review suggests that EO is a multidimensional construct operationalized in terms of the variables 'innovativeness', 'risk-taking', 'proactiveness', 'autonomy' and 'competitive aggressiveness'. The literature on business performance reveals that a variety of performance measures, i.e., objective and subjective measures (financial and nonfinancial), are used across the studied, which results in high variation in EO-performance relationship. It is observed that the objective measures of performance are more appropriate than subjective measures of performance. However, respondents are generally reluctant to release sensitive information to outsiders. Therefore, a combination of subjective and objective measures of performance is recommended for accurate measurement of performance. The paper suggests that a strong EO results in high business performance. The review also highlights the importance of contingency and configuration framework to understand a more accurate picture of EO-performance relationship. Instead of focusing on bivariate relation, future research on EO-performance relation should adopt contingency and configuration approach (which emphasizes two- and three-way interaction effect) by introducing various organizational and environmental elements as moderating and mediating variables. ✪

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