Research Paper

Entrepreneurial Orientation and Financial Performance of Nigerian SMES: The Moderating Role of Environment. A Review of Literature

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Abstract

This paper develops a theoretical model of the relationship between four dimensions of entrepreneurial orientation (EO) and firm financial performance. Also included in the theoretical model are environmental characteristics such as dynamism and hostility that are likely to impact on the relationship between entrepreneurial orientation and firm financial performance. Hypotheses were developed regarding the various relationships between the EO dimensions that would be most appropriate in a particular environment. Future research may benefit from the study by considering the important role that environmental dynamism and hostility play in this model. The implications of this model for the policy makers, practitioners, managers and researchers are also discussed.

Introduction

Small and MMedium sized Enterprises (SMEs) represent an important part of the economies of both developed and developing countries. They are recognized as a pivot on which economic growth, job creation, poverty reduction and industrial development can be built (Obokoh, 2008; Okpara, 2011; Terungwa, 2012). SMEs development is essential in the growth strategy because of their “ability to respond to the systematic shock rapidly and their potentials to generate jobs and income at the time when the large firm sector was undergoing a rapid decline” (Krasniqi & Hashim, 2011, p.456). Nigeria, like many developing countries, has also recognized the importance of SMEs as a catalyst for economic development and poverty alleviation. Although it is difficult to accurately measure the impact of SMEs on the Nigerian economy due to dearth of records, it has been estimated that SMEs account for 97% of all businesses in the country. They employ over 50% of the national workforce and contribute about 46% to the Gross Domestic Product (National Micro, Small and Medium Enterprises (MSME) Collaborative Survey, 2013; Taiwo, Ayodeji and Yusuf, 2012).

Despite their contribution to the National Economy, fast-changing and intense worldwide competitive environment has placed Nigerian SMEs in a vulnerable position. To deal with these challenges previous research findings have suggested entrepreneurial orientation (EO) as a key ingredient for organizational success (Wiklund and Shepherd, 2005). It is further argued that firms that possess higher levels of entrepreneurial orientation will perform better than those with lower levels of entrepreneurial orientation (Davis, 2007; Rauch, Wiklund, Lumpkin and Frese, 2009). Higher level of entrepreneurial orientation allows firms to have the ability to identify and seize opportunities in a way that differentiates them from non-entrepreneurial organization (Covin, Green and Slevin, 2006). Entrepreneurial orientation represents strategy making processes that provide organizations with a basis for entrepreneurial decisions and actions (Rauch, Wiklund, Lumpkin and Frese, 2009). It encompasses specific organizational-level behavior to perform risk-taking, self-directed activities (autonomy), engages in innovation and reacts proactively and aggressively to outperform the competitors in the marketplace and hence enhances firm performance (Lumpkin and Dess, 1996).

The external environment of a firm has also been recognized as an important determinant of en-

trepreneurial orientation (Davis, 2007). The external environment not only offers new opportunities but also poses complex challenges, which firms must respond to creatively (Covin & Slevin, 1991; Zahra, 1991). Environmental conditions are usually assessed in terms of whether the environment is munificent (favorable) or hostile (unfavorable). In the Entrepreneurial Orientation (EO) literature the munificent environment is usually conceptualized through four dimensions: environmental dynamism, technological opportunities, industry growth and demand for new products; hostile environments comprise unfavorable change and competitive rivalry (Antoncic & Hisrich, 2004).

While literature on entrepreneurship has theorized the positive relationship between EO and performance, the same has not always been true, when examining this relationship empirically. Interestingly, a handful of research findings have revealed insignificant, and sometimes negative correlations between EO and performance (Ranch, Wiklund, Lumpkin and Frese, 2009; Kaya & Seyrek, 2005). By simply examining the direct EO-performance relationship, the scope on performance is limited (Rauch, Wiklund, Lumpkin and Frese, 2009). This urges research to control internal and external contingent factors in the examination of the EO-performance relationship (Lumpkin & Dess, 2001; Wiklund & Shepherd, 2005; Covin, Green and Slevin, 2006).

There is little consensus on what constitutes suitable moderators. Findings related to the influence of moderating variables on the EO-performance relationship have been mixed. For example, prior research has found both significant positive (Zahra & Garvis, 2000) and negative (Rauch, Wiklund, Lumpkin and Frese, 2009) relationships between environmental hostility and EO. While there are many possible explanations for a lack of consistency in findings related to a moderating variable, this does leave cause for concern and demands scholarly attention providing more conclusive evidence of the impact these variables have on the strength and direction of the EO-performance relationship.

An examination of the literature reveals that a great deal of research on EO-performance relationship has been conducted. However, these studies were based in the West (e.g. Rauch, Wiklund, Lumpkin and Frese, 2009; Covin & Wales, 2012). Specifically, a coherent research linking four EO dimensions (innovativeness, proactiveness, risk-taking and competitive aggressiveness) with firm performance where environmental dynamism and hostility act as moderating variables is disappointingly scarce in Nigeria. Since very little research has been conducted on this study in Nigeria, undeniably, there is a knowledge gap in the understanding of this issue with regard to the Nigerian environment. This study is therefore an attempt to address knowledge gaps in the existing literature and to propose a conceptual framework for the inter-relationship of entrepreneurial orientation and firm performance.

This study investigates the relationship between entrepreneurial orientation (innovativeness, proactiveness, risk-taking and competitive aggressiveness) and firm financial performance, as well as to determine the moderating effect of external environmental factors (dynamism and hostility) on this relationship within the Nigerian SMEs context. The research is organised and structured as follows: first, it establishes the background of the study and this is followed closely by a literature review in which past studies on entrepreneurial orientation, external environment, firm financial performance and relevant theories are reviewed to prepare ground for the study. Next, the study presents the hypotheses developed to be tested and this is followed

by methodologies employed in both data collection and analysis. Finally, the study discusses a findings, conclusion, contributions and implication for future research.

Literature Review

Overview of the Entrepreneurship Field

Over the past decades, increasing attention has been paid to the concept of entrepreneurship (Covin, Green and Slevin, 2006; Eggers, Kraus, Hughes, Laraway and Snyckerski, 2013), and its impact in the economic development of a country (Uhlener & Thurik, 2007; Levenburg & Schwarz, 2008; Urban, 2008; Tang, Zhang and Li, 2008; Kuratko, 2009). A brief review of the history of entrepreneurship will aptly help to improve our understanding of entrepreneur and entrepreneurship. The term “entrepreneur”, coined by Richard Cantillon through his work ‘*Essai sur la Nature du Commerce en Général*’ published posthumously in 1755 and 1931 (Hortovanyi, 2010), was derived from the French verb “entreprendre” – meaning to undertake various economic endeavors (Kuratko & Hodgetts, 2001). The verb “entreprendre” and its noun form “entrepreneur” were popularised by early scholars (e.g. Say, 1817).

The word “entrepreneurship”, on the other hand, refers to the “creation of organizations” (Gartner, 1988, p.47). The suffix ‘ship’ refers to activities of an individual who draws results from certain actions (Huang, Wang, Cheng and Yien, 2011). The word itself as claimed by Culhane (2003), was “articulated” by Schumpeter (1934). The field evolved by drawing on many other established disciplines such as economics, sociology, psychology as well as various branches of management sciences (Hortovanyi, 2010). In the systematic development of the entrepreneurship theory, the first half of the 20th century was devoted to defining the concept of entrepreneurship and identifying its role in the economic development of a country (Schumpeter, 1934). During the 1960s and 1970s, the focus shifted towards identification of factors affecting entrepreneurship, such as why entrepreneurs start enterprises? And between 1980s and 1990s entrepreneurial research moved towards identification of dimensions of entrepreneurial orientation (EO) and fit between EO-strategy models (Miller & Friesen, 1982; Covin & Slevin, 1988; Lumpkin & Dess, 1996).

The last two decades have witnessed the development 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 & Slevin, 1989; Zahra, 1991; Wiklund, 1999; Zahra & Gavis, 2000; Dimitratos, Lioukas and Carter, 2004; Krauss, Frese, Friedrich and Unger, 2005; Wiklund & Shepherd, 2005; Kreiser & Davis, 2010; Grande, Madsen and Borch, 2011). More recently, entrepreneurship field has grown to rank among the most dynamic, vital and relevant in management sciences (Wiklund & Shepherd, 2005).

Although no single definition of entrepreneurship exists (Williams, Round and Rodgers, 2010), many perspectives can be found in literature, but the most common definition of the concept came from Richard Cantillon cited in Roux and Couppey (2007, p. 8) who defined entrepreneurship as “a process of a self-employment with an uncertain return”. An entrepreneur is seen as “someone who consciously makes decisions

about resource allocation, in that he chooses to pay a certain price, consequently also bearing the risks of enterprise” (Cantillon cited in Lowe & Marriot, 2006). In other words, an entrepreneur is a person, agent or middleman who buys goods or services at a lower price and sells them at a higher price.

The Entrepreneurial Orientation Construct

The entrepreneurial orientation (EO) construct which emerged from the early work of Miller (1983), has become a major construct within the strategic management and entrepreneurship literature in the last three decades (Covin & Lumpkin, 2011; Miller, 2011; Covin & Wales, 2012). As noted by Rauch, Wiklund and Lumpkin et al. (2009, p. 778), “EO represents a promising area for building a cumulative body of relevant knowledge about entrepreneurship.”.

EO refers to the decision making styles, practices, processes and behaviors that lead to an ‘entry’ into new or established markets with new or existing goods and services (Lumpkin & Dess, 1996; Wiklund & Shepherd, 2003; Walter, Auer and Ritter, 2006). This definition implies that EO leads to new or existing markets but also explicitly recognizes that this can be achieved with either new or existing goods or services (Kraus, Kauranen and Reschke, 2011).

Dimensions of Entrepreneurial Orientation

Entrepreneurial Orientation has often been operationalized in terms of three dimensions identified by Miller (1983) through his definition of an entrepreneurial firm as one that “engages in product market innovation, undertakes somewhat risky ventures, and is first to come up with ‘proactive’ innovation, beating competitors to the punch” (Miller, 1983, p. 771). Covin and Slevin (1988) converted Miller’s three dimensions of innovativeness, proactiveness and risk taking into a measurable scale. Most researchers agree that EO is a combination of these three dimensions (Wiklund, 1999) and majority of studies (e.g. Covin & Slevin, 1989; Naman & Slevin, 1993; Zahra & Gavis, 2000; Kemelgor, 2002; Wiklund & Shepherd, 2005) follow the three dimensional model proposed by Miller (1983).

More recently, Lumpkin and Dess (1996) identified two additional dimensions, ‘autonomy’ and ‘competitive aggressiveness’, to complement the original three dimensions proposed by Miller (1983). Lumpkin and Dess (1996) argued that, to be successful, a firm requires autonomy from strong leader or creative individuals, without any restrictions imposed by the firms bureaucracy. On the other hand, competitive aggressiveness describes Miller’s (1983, p. 771) idea of “beating competitors to the punch”. This implies how a firm responds to the threats both from within and outside the organization.

However, the current study has opted not to include autonomy given its limited application and the minimal amount of data available for evaluation of this construct. Thus, this section discusses four EO dimensions: innovativeness, proactiveness, risk-taking and competitive aggressiveness, in more details below.

- **Innovativeness**

Innovativeness reflects a firm tendency to engage in and support new idea, novelty, experimentation and creative processes (Lumpkin & Dess, 1996) that may result in new products, services, or technological

processes and which may take the organization to a new paradigm of success (Swierczek & Ha, 2003). Schumpeter (1934) was one of the first to point out the importance of innovation in the entrepreneurial process. He considered entrepreneurship to be essentially a creative activity and entrepreneur – an innovator who carries out new combinations in the field of men, money, material, machines and management.

- Proactiveness

Proactiveness is conceptualized as processes which are aimed at “seeking new opportunities which may or may not be related to the present line of operation, introduction of new products and brands, ahead of competition and strategically eliminating operations which are in the mature or declined stages of the life-cycle” (Venkatraman, 1989, p. 949). This reflects a firm’s ability to introduce strategic changes, adoption and elimination of operations based on their current stage in the life-cycle (Swierczek & Ha, 2003; Green, Covin and Slevin, 2008).

- Risk-Taking

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 (1755) 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 (Zahra, 1991; Wiklund & Shepherd, 2003).

- Competitive Aggressiveness

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 competitors in the market place (Lumpkin & Dess, 1996; Krauss, Frese, Friedrich and Unger, 2005). It also reflects the willingness of a firm to be unconventional rather than rely on traditional methods of competing. This concept is used to measure how entrepreneurial firm deals with threats, and it also refers to the firm responsiveness directed toward achieving competitive advantage (Lumpkin & Dess, 2001; Frese, Brantjes and Hoon, 2002; Grande, Madsen and Borch, 2011).

External Environment

The environment construct in the strategic management literature emanated from the contingency school of management, which emphasized the role of environment in the definition of strategies, and subsequently its influence on firm performance. Several management researchers of the likes of Emiry and Trist (1965), Child (1972), Bourgeois (1980), Dess and Beard (1984), and others have all attempted to explain the role of environment in the definition of firms’ strategies, and its impact on firm performance.

- Dimensions of the External Environment

Three of the primary environmental variables considered in existing EO literature are environmental

munificence, dynamism and hostility. These variables have been noted to influence the EO construct in relationship with performance as well as their impact on the relationship between the individual dimensions of innovativeness, proactiveness, risk-taking and competitive aggressiveness and firm performance.

- **Environmental Munificence**

Environmental munificence refers to the scarcity or abundance of resources available in an environment and demanded by one or more firms (Dess, Lumpkin and McFarlin, 2005). From the firm level of analysis, the level of munificence is directly related to a firm's ability to acquire resources from the environment and may impact firm performance (Davis, 2007).

- **Environmental Dynamism**

Environmental dynamism comprises of numerous variables – for example, speed in which the environment is changing (stability-instability), turnover rates, and predictability-unpredictability; each aspect contributing to uncertainty. Miller and Friesen (1983) defined dynamism as the rate of change and innovation in an industry as well as the uncertainty or unpredictability of the actions of competitors and customers. Organizations competing in environments where high levels of dynamism are present must have the flexibility to adapt to a changing environment to ensure organizational survival (Mthanti, 2012). A quickly changing environment increases risk and unpredictability, but is a common characteristic of many industries (Davis, 2007). A lower level of dynamism in an environment indicates possible slowing of the economy or, under most circumstances, an industry that is well established and non-turbulent. Organizations operating in a more stable environment have the luxury of added stability and predictability of environmental change, as well as greater ability to react and change with the environment.

- **Environmental Hostility**

In many ways, hostility is the counter-munificence measure as it represents the intensity of competition and scarcity of resources in a firm's environment. It has been commonly used to describe the unfavorable external forces in an organization's environment. Davis (2007) defined hostility as the degree of threat to the firm posed by the multi-facetedness, vigor and intensity of the competition and the downswings and upswings of the firm's principal industry. As indicated by its definition, hostility poses a threat to the viability of a firm and has been examined in relation to firm performance and the competitive behavior of a firm (Corbo, 2012).

- **Firm Performance**

Performance is a widely used concept in many areas. Usually, performance is a measure of how well a mechanism or a process achieves its purpose. In enterprise management, Wu and Zhao (2009) define an organization's performance as how well the organization is managed and the value the organization delivers for customers and other stakeholders. Performance is related to achieving stockholder and investor interests. To attain superior relative-performance, an organization must achieve its expected objective with greater efficiency and effectiveness to match its competitors (Wu & Zhao, 2009).

Theoretical Framework and Hypothesis Development

Scholars have theorised that an entrepreneurial organization that has the ability to offer various lines of product and excellent technological support will obtain greater financial rewards (Sorescu, Chandy & Prabhu, 2003). Several authors have reported that the characteristics of proactive firms such as being responsive to market signals, have accessed to scarce resources, and strongly committed to improving product and service offerings enable high performance returns (Day & Wensley, 1988; Green, Barclay and Ryans, 1995; Wright, Kroll, Pray and Lado, 1995a; Wright, Stephen, Janine and Mark, 1995b).

Past empirical evidence suggests that the risk-taking dimension is positively related to firm performance (Rauch, Wiklund, Freese and Lumpkin, 2004). The positive effect of risk taking on firm performance is due to the fact that firms that have the courage to make a significant resource commitment to high-risk projects with high returns would definitely have the advantage of boosting their firms' incomes. While scholars (e.g. Morgan & Strong, 2003) found no relationship between competitive aggressiveness and firm performance, other researchers (e.g. Covin & Covin, 1990; Lumpkin & Dess, 2001) found significant positive relationship between competitive aggressiveness and firm performance. Accordingly, the following hypotheses were proposed for testing:

H1: There is a significant positive relationship between innovativeness and financial performance of SMEs in Nigeria.

H2: There is a significant positive relationship between proactiveness and financial performance of SMEs in Nigeria.

H3: There is a significant positive relationship between risk-taking and financial performance of SMEs in Nigeria.

H4: There is a significant positive relationship between competitive aggressiveness and financial performance of SMEs in Nigeria.

Prior studies have theorized that the relationship between EO- and firm performance is dependent on environmental factors (Lumpkin & Dess, 1996; Zahra, 1996). Studies (e.g. Zahra 1996; Zahra & Bogner, 2000) posit that organizations respond to innovative requirements in dynamic settings by pursuing new radical technologies and other pioneering activities. Lumpkin and Dess (2001) noted the importance of a proactive nature in the presence of dynamic environments. Lumpkin and Dess (2001) further found a positive relationship between the sales growth and profitability of a firm and the link between proactiveness and dynamism.

According to Davis, 2007 dynamic environments require a greater level of risk-taking in strategic decision-making and processes to more effectively and successfully respond to the invariable state of change, dynamic environments; require organizations to increase decision-making speed in responding to environmental change (Davis, 2007). As a result, dynamism can be expected to have a positive impact on the relationship between risk-taking and firm performance. Proceeding from the above arguments, it is evident that a dynamic envi-

ronment will positively impact the relationships between each of the EO dimensions and firm performance. Accordingly, this study proposes that:

H5: Environmental dynamism moderates the relationship between innovativeness and financial performance of SMEs in Nigeria.

H6: Environmental dynamism moderates the relationship between proactiveness and financial performance of SMEs in Nigeria.

H7: Environmental dynamism moderates the relationship between risk-taking and financial performance of SMEs in Nigeria.

H8: Environmental dynamism moderates the relationship between competitive aggressiveness and financial performance of SMEs in Nigeria.

As indicated by Lumpkin and Dess (2001), hostility is often referred to as "the obverse of munificence". Several authors have examined the influence of hostility on EO, but findings have been mixed across studies. For example, studies have reported both positive (Zahra & Garvis, 2000; Covin, Green and Slevin, 2006) and negative (Becherer & Maurer, 1997; George, Wood Jr. and Khan, 2001) correlations between hostility and EO. Early entrepreneurship research examined hostility in relation to the strategy-performance relationship (Covin & Slevin, 1989). For instance, McGee and Rubach (1997) found that environmental hostility moderated the relationship between competitive strategy and firm performance. These findings are consistent with the suggestions of Ettlie (1983) who proposed a link between environmental hostility and the implementation of strategic moves promoting and fostering both innovative and entrepreneurial practices. However, Khan and Manopichetwattana (1989) in their study of 50 Texas manufacturers found that hostility had a negative impact on innovation, causing the firm to pull in its horns. Other research found opposite results. For example, Covin and Slevin's (1989) seminal study found that small entrepreneurial firms perform best in hostile environment. Accordingly, this study hypothesizes that:

H9: Environmental hostility moderates the relationship between innovativeness and financial performance.

H10: Environmental hostility moderates the relationship between proactiveness and financial performance.

H11: Environmental hostility moderates the relationship between risk taking and financial performance.

H12: Environmental hostility moderates the relationship between competitive aggressiveness and financial performance.

Fig. 1 Conceptual Framework

Conclusion and Suggestions

The current study is the first of its kind to the best of the authors' knowledge to examine the relationship between EO and financial performance of SMEs using environmental dynamism and hostility as moderating variables. The study was motivated by the need to improve upon our understanding of the relationships that exist among the EO and firm financial performance. The review suggests that EO is a multi-dimensional construct operationalized in terms of the variables: innovativeness, proactiveness, risk taking and competitive aggressiveness. The review also highlights the importance of contingency and configuration framework to understand a more accurate picture of EO-performance relationship. The literature on performance reveals that a variety of performance measures are used across studies (financial and non-financial). The paper suggests that a strong EO results in high firm performance.

The model presented in this study incorporates the role of contingency factors such as dynamism and hostility; future research may look at some other contingency factors such as munificence, heterogeneity and industry life cycle. Future studies may consider including other dimensions of EO, notably autonomy (Lumpkin & Dess, 1996) and larger samples.

Future research is also encouraged to compare the triple model of Covin and Slevin to the five-dimensional models of Lumpkin and Dess (1996) to provide support for the convergent validity of both measures (Kreiser and Davis, 2010). In addition, research is also needed to investigate the dynamic relationship among environment, EO and financial performance using longitudinal data. Other performance variables that also deserve

some further research in the EO performance study include learning orientation, operational performance, innovative performance and marketing orientation.

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