ENTREPRENEURIAL ORIENTATION AND FIRM PERFORMANCE: THE CASE OF INDIAN SMEs

The concept of entrepreneurial orientation (EO) and its influence on organizational performance has received substantial attention in organizational sciences (Messersmith and Wales 2011; Stam and Elfring 2008; Wang and Altinay 2010). The emerging consensus seems to be that conversion of EO into superior firm performance depends on the context in which a firm operates (Covin and Lumpkin 2011; Lechner and Gudmundsson 2014), so that there is a need to elaborate various contingencies of the EO-performance relationship (Anderson and Eshima 2013; Rauch et al. 2009). As far the external context is concerned, EO has been widely studied in mature economies like the United States (US) and United Kingdom (UK), but among rapidly emerging major economies- the so called 'BRIC' countries (Wilson and Purushothaman 2003)- only China has received systematic attention in the EO literature (Wales et al. 2013a). EO was originally conceived as a culturally universal concept, but entrepreneurial tendencies may not be equally effective in emerging economies due to significant differences in the institutional context (Lee and Peterson 2001). It is well known that there is a rich variety of institutional arrangements across countries (Narayanan and Fahey 2005), and so greater insights into the applicability of the EO concept might be gained through attending to the specific idiosyncratic characteristics of other emerging economies such as India.

The present study examines the relationship between EO and firm performance using data collected from small- and medium-sized enterprises (SMEs) in India. In doing so, we make three contributions to the literature. First, we extend EO research beyond its traditional focus on mature western economies and China (Rauch et al. 2009), taking a substantial step towards extending the applicability of the EO concept in the emerging economy context. Second, we cast light on how specific environmental factors associated with rivals and customers- demand growth and competitive intensity- may influence the relationship between EO and firm performance. Finally, we situate our research in the context of SMEs, which have fewer hierarchical levels and shorter chain of command than large firms, as organizational impediments like hierarchical administrative structure may undermine the viability of EO efforts (De Clercq et al. 2013).

Theory and Hypotheses

Stated succinctly, EO refers to the degree to which a firm's strategic posture reflects entrepreneurial practices and behaviors (Anderson et al. 2009; Zahra et al. 2014). EO is rooted in the notion that specific management philosophies and strategy-making processes together represent an organizing structure through which knowledge is combined and embodied in new products, processes, and operational activities (Wiklund and Shepherd 2005). Continuously gathering and combining dispersed, complementary knowledge can play a critical role in recognizing novel opportunities (Floyd and Lane 2000), but such combinations do not happen automatically. This is where EO comes into play (De Clercq et al, 2010). EO enables firms to leverage knowledge available both within the firm and outside to proactively seek out new opportunities, take calculated risks to undertake new endeavors, innovatively extract superior value from existing offerings (Wales et al. 2013b).

Substantial prior research suggests that, conceptually speaking, EO should lead to superior performance (Covin and Lumpkin 2011; Edmond and Wiklund 2010). Rauch et al's (2009) meta-analysis of 51 studies provides support for a generally positive and moderately large (r = .24) association between EO and firm performance, but several studies in which the positive association has not been replicated (e.g., Baker and Sinkula 2009; Matsuno et al. 2002; Slater and Narver 2000) have highlighted the need to understand boundary conditions of when it favors decision-makers to pursue entrepreneurial strategies and when it may not (Anderson 2010; Gupta et al. 2014).

As knowledge around the EO concept has expanded, researchers have drawn attention to the direction and strength of the EO-performance relationship in emerging economies (Bruton et al. 2008). This is because the institutional contexts prevailing in emerging economies call into question the critical assumptions underlying the EO concept which originated in the developed economy of the US. Yet, with the notable exception of China, EO remains virtually unexamined in emerging economies, with almost no systematic research conducted in the strategically important countries of Brazil, India and Russia (Wales et al. 2013a). These countries are "emerging as important global players" and "have sociocultural contexts very different from those of western countries" (Nadkarni and Herrmann 2010: 1067). Emerging empirical evidence indicates that concepts and theories originating in mature economies do not necessarily fit well with the circumstances of the emerging economies. Narayanan and Fahey (2005), for example, contend that the Porter's Five Forces Framework does not apply in emerging economies. Researchers posit that the several significant differences in the institutional context between countries may restrict the applicability of specific strategy models outside of the economy in which it was originally developed and subsequently validated.

Our argument is that the institutional environment in the emerging economy of India is generally unfriendly towards organizational growth, especially for SMEs who have limited leverage with the state. EO offers SMEs a way through which they can be proactive in countering the detrimental effects of these institutional forces. Our logic implies that SMEs are able to develop and strengthen their EO so as to set them on the path to success where their conservative counterparts are discouraged because of their inability to embrace proactiveness, risk-taking, and innovativeness. Thus, we hypothesize:

Hypothesis 1: For Indian SMEs, the greater the EO, the higher will be the level of firm performance.

A nuanced understanding of whether, to what extent, and under what conditions, EO is more (or less) effective merits a contingency perspective that emphasizes the importance of fit among a firm's strategic posture and other constructs of interest (Stam and Elfring 2008). Environmental contingency theory suggests that to succeed, organizational processes must fit the environment in which the firm operates (Drazin and Van de Ven 1985). While organizational environment can be classified in myriad ways (Smircich and Stubbart 1985), Bourgeois (1980) distinguishes between environmental *objects* as entities with whom the firm interacts and *attributes* as characteristics such as Aldrich's (1979) six dimensions and Dess and Beard's (1984) three facets. Empirical examinations have focused primarily on environmental attributes (Richard et al. 2007), such as studies citing Dess and Beard's (1984) three-dimensional

framework (Boyd and Gove 2006). Confronted with vast amounts of seemingly conflicting information about environmental forces (Porter 1980), selective attention and simplification processes force managers to concentrate much of their external scanning on cues and signals related to two entities in their environment: customers and competitors (Yadav et al. 2007). It is well known that when companies turn their attention away from rivals and buyers, they risk becoming irrelevant in the marketplace (Peters and Waterman 1982). Yet, limited research investigates such contingencies in emerging economies (Peng et al. 2008), and almost nothing has been published in the Indian context where opacity of information regarding customers and rivals imposes high costs on firms. Therefore, responding to Rosenbusch et al.'s (2013) calls for EO studies to consider the multidimensional nature of the environment, we investigate how EO may be aligned with two different aspects of the task environment- demand growth and competitive intensity- to result in differing performance outcomes in Indian SMEs.

Hypothesis 2: For Indian SMEs, greater the demand growth, the stronger will be the relationship between EO and firm performance.

Hypothesis 3: For Indian SMEs, greater the competitive intensity, the weaker will be the relationship between EO and firm performance.

Method

Data and Sample

To test the predictions of this study, we collected data from manufacturing SMEs located in the Indian province of Punjab. By sampling only manufacturing-based organizations, the study effectively controlled for macro-industry effects through the elimination of other industry sectors (e.g., agriculture, mining, wholesale, and retail trade) from the sample. To alleviate size-related biases on the research variables, we selected only SMEs for our study. Following the key informant approach, a founder or another senior executive at sample firms was approached in person to complete the questionnaire. In the EO literature, Wales et al. (2011) observe that the strategic posture of the firm is reflected in the views of top managers. In all, of the initial sample of 400 firms, a total of 198 firms provided final data for this study, for a final response rate of about 49%.

All constructs were measured using well-established measures (see the appendix for all scales) on a 7-point Likert-type scale (1 = *strongly disagree* to 7 = *strongly agree*). The questionnaire was administered in English, with interpretation and translation help provided by bilingual Indian assistants as needed.

Entrepreneurial orientation. EO was operationalized as a gestalt unidimensional construct (e.g., Covin et al. 2006), and measured using a seven-item instrument ($\alpha = .73$) based on prior research (Gatignon and Xeureb 1997; Hurley and Hult 1998; Jaworski and Kohli 1993).

Environmental variables. We measured competitive intensity using a two-item scale: 'competition in our industry is cut-throat' and 'there are many price wars in this industry' (Gatignon and Xeureb 1997). The two items correlate quite well ($\alpha = .63$). We measured demand

growth using three items (Zhou and Wu 2010): 'In our industry, sales have been growing and are likely to grow', 'growth rate of this industry in the past three years is very high', and 'market demand in this industry is growing rapidly' ($\alpha = .74$). Factor analysis confirmed that the items loaded on their respective constructs.

Firm performance: Venkatraman and Ramanujam (1987) note that a broad conceptualization of business performance reflects the organization's overall effectiveness in meeting multiple goals. Accordingly, we asked respondents to evaluate their performance on a multifaceted conceptualization that incorporates several aspects of organizational performance: market share, profitability, productivity, and customer satisfaction ($\alpha = .78$; Jimenez-Jimenez et al. 2008). We conducted validity check for our performance measure by obtaining objective performance data for a subsample of firms. Sales information for 36 firms revealed that profitability, measured as the net profit accrued to the firm, was significantly correlated with the item that asked respondents for their assessment of profitability ($r = .57$, $p < .001$).

Control variables. To account for variance caused by variables not directly linked to the research question, we controlled for managerial, organizational, and industrial factors. Specifically, we controlled for management's perceived flexibility as it has been shown to be an important factor for firm success in the Indian context (Nadkarni and Hermann 2010), firm age (years since founding), firm size (numbers of employees), and industry membership.

Analyses and Results

We conducted hierarchical regression to test the predictions, entering controls in the first step (Model 1) and main effects in the second step (Model 2). As expected, EO was significantly positively related to firm performance ($\beta = .38$, $p < .001$). Thus, hypothesis 1 was supported. Model 3 adds the direct effects of the two contingency variables. Variables were mean centered before entering the interaction effects. Model 4 indicates that the interaction between 'demand growth' and EO is significantly positively related to firm performance, lending support to Hypothesis 2 ($\beta = .19$, $p < .05$). The interaction between 'competitive intensity' and EO supports Hypothesis 3 (Model 4: $\beta = -.27$, $p < .01$).

Discussion

There is emerging agreement in the literature that an entrepreneurial mind-set and deep-seated perspective about entrepreneurship drives growth and success of firms (Chaston and Sadler-Smith 2012; Dess and Lumpkin 2005). This may be especially true in emerging economies that have become centers of intense entrepreneurial activity over the last two decades (Bruton et al. 2008). Because emerging economies represent "situations of fundamental and comprehensive institutional transformation" (Gupta et al. 2013; Shenkar and von Glinow 1994), they offer interesting contexts for research on entrepreneurial phenomena. Yet, prior research has often treated EO through the prism of advanced mature economies so that boundary conditions, particularly with regard to the institutional environment of emerging economies, are left implicit. With a view to begin addressing this knowledge void, we explored the manifestation of EO in Indian SMEs and examined the performance gains that result from a corporate dedication to entrepreneurship in the rapidly emerging economy of India.

We believe our research contributes to the literatures on emerging economies (Xu and Meyer, 2013), entrepreneurial orientation (Wales et al. 2013a), and environmental contingency theory (Hatch and Cunliffe 2006). Emerging economies serve as a laboratory for investigating interactions between organizational strategies and local contexts. Studies that consider institutional idiosyncrasies and contextual nuances of emerging economies and link them with observed findings, as we do in the present study, are critical to meaningful theory development in a globalizing world (Xu and Meyer 2013). Wales et al. (2013a: 364) noted a "particular glaring …lack of research" on EO in countries like India, and so the finding that EO has a strong positive association with performance in Indian firms provides useful evidence about the concept's validity and applicability in such international contexts. The present study adds to recent research investigating the alignment of strategic processes with demand growth and competitive intensity (e.g., Fang et al. 2008; Homburg et al. 2014). Considering that these two environmental forces are directly related to the power of customers and competitors respectively in the firm's immediate environment (Porter 1980), they seem to offer considerable potential to better understand the environmental contingencies influencing organizational competitiveness (Donaldson 2001).

We acknowledge certain limitations that point to fruitful avenues for future research. Like most EO studies, our research also uses cross-sectional data, which prohibits unambiguous confirmation of underlying directions of causality between the constructs of interest. Miller (2011) noted that EO literature relies considerably on self-reported and perceptual measures, which can introduce respondent bias in the sample. The challenges associated with obtaining archival information about SMEs, especially in societies like India where considerable economic activity may be off-the-books, are well known, yet future research would benefit from developing alternative EO measures that use archival data. We are also cognizant that in large countries like India, significant differences exist between various parts of the same country (Gupta et al. 2013), and the extent to which support for the predictions tested here varies between samples drawn from various regions of the country remains for future research to examine.

Conclusion

Scientific progress about the EO concept has been accompanied by increased attention to the context in which the EO-performance relationship is embedded (Wales et al. 2013a). Countries like India, that are characterized by weak institutional environment, are complex settings from both a theoretical and a practical perspective (Peng et al. 2008), and present an interesting empirical context to test and extend existing theories (Narayanan and Fahey 2005). Our results indicate that Indian SMEs benefit from EO, particularly when demand growth is high and competitive intensity is low. For researchers, our findings provide support for the applicability of the EO concept, and the identification of its environmental contingencies, in the context of a rapidly emerging major economy. For practitioners, our study offers practical advice to whether and when entrepreneurship should be a part of their strategic posture.

References

Available from the authors.