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Entrepreneurial orientation (EO) and growth of firms: key lessons for managers and business professionals

Abstract

This research provides a useful framework for identifying small firms' propensity to engage in Entrepreneurial Orientation (EO). We examine the impact of the EO as a main resource and capability on small firm's growth. The growth seems to come out as an important demonstration of the entrepreneurial orientation of small firms. Thus, this research builds on prior conceptual research that suggests a positive integration between entrepreneurial orientation and Resource-Based View (RBV). The results support the necessity to identify explicative variables of multiple levels to explain the growth of small firms. The adoption of an entrepreneurial orientation as an indispensable variable to the growth oriented small firms seems pertinent.

Keywords: resources-based view, entrepreneurial orientation, growth of small firms.
JEL Classification: L26, L60, L100, M1.

Introduction

This research provides a useful framework for identifying a small firms' propensity to engage in Entrepreneurial Orientation (EO). The objective of this research is to examine the impact of the EO on growth of the small firms. It seems essential to identify the strategic variables which may reflect the practice, the process, the organizational methods and the decision-making style that small firms use and that probably influence their growth.

Several authors when referring to the Resource-Based View (RBV) do it more in a strategic context, presenting resources and capabilities as essential to gaining a sustained competitive advantage and, consequently, to a superior performance (Barney, 1991; Janney and Dess, 2006; Runyan et al., 2006; Teece, 2007). Some of them adopted RBV from a strategic point of view considering a resource as a strength that firms can use to formulate and to implement their strategies. The resources and capabilities of the firm are the main competences for formulating strategy (Porter, 1985; Barney, 1991).

It is well known that the strategy dimensions are of great importance and besides, they consider that an EO has a great impact on growth. Miller and Friesen (1982) claim that entrepreneurial firms innovate courageously and regularly, while taking considerable risks in their product/market strategies. Miller (1983) identifies the initiative of a firm concerning: (i) *innovation*; (ii) *risk taking*; and (iii) *proactiveness*, as the essential dimensions of entrepreneurship.

This way, the co-relations of entrepreneurship could be searched for in a vaster field than the one related to the individual. An entrepreneur is, frequently, considered as an innovative and creative person, suitable to manage a firm which emphasizes innovation.

1. RBV and entrepreneurial orientation

The RBV of the firm becomes one of the most widely used theoretical frameworks in the management literature (Foss and Ishikawa, 2007; Newbert, 2007; Teece, 2007). The foci of RBV are competitive advantages generated by the firm, from its unique set of resources. Understanding sources of sustained competitive advantage for firms has become a major area of research in the field of strategic management.

Although most researches based on sources of sustained competitive advantage, there is little doubt that this approach has been very fruitful in clarifying our understanding of the firm's environment impact on growth.

According to RBV a firm's internal strengths and weaknesses rest on two fundamental assumptions. First, building on Penrose (1959), this work assumes that firms can be thought of as bundles of productive resources and that different firm possesses different bundles of these resources. This is the assumption of firm resource heterogeneity. Second, drawing from Selznick (1957) and Ricardo (1966), this approach assumes that some of these resources are either very costly to copy or inelastic in supply. This is the assumption of resource immobility.

Basically, RBV describes a firm in terms of the resources that firm integrates. Frequently, the term *resource* is limited to those attributes that enhance efficiency and effectiveness of the firm. A general resources' availability will neutralize the firm' competitive advantage. Once, for a firm to take high levels of performance and a sustained competitive advantage, it needs to acquire heterogeneous resources that should be difficult to create, to substitute or to imitate by other firms.

Resources can be tangible or intangible in nature. Tangible resources include capital, access to capital and location (among others). Intangible resources consist of knowledge, skills and reputation, EO, among others. Resources are insufficient for obtaining a sustained competitive advantage and a high performance as well (Teece, 2007; Newbert, 2007). Being so, firms must be able to transform resources in capabilities, and consequently in a positive performance. Firms reach a superior performance, not because only they have more or better resources, but also because of their distinctive competences (those activities that a particular firm does better than any competing firms) allow to do better use of them.

The concept of capabilities is frequently used to define a group of individual qualifications, assets and accumulated knowledge, exercised through organizational processes allowing reaching a better coordination of activities and a better use of resources. The capabilities are many times developed either in functional areas or in combination of physical, humans or technological resources, controlled by the firm. Capabilities along with the resources are the core competences on firm's strategy formulation and therefore constitute the firm's identity. In the dynamic perspective, capabilities approach is a theoretical stream inside the RBV. This theory considers that, on one hand, the firms are constantly creating new combinations of capabilities and, on the other hand; the market competitors are continually improving their competences or imitating the most qualified competences from other firms. This approach puts emphasis on internal processes, assets and market position as restricting factors not only the capability to react but also the management capability to coordinate internal competences of the firms.

In this sense, it is pointed out the following question: what extent the resources and the central capabilities are identified and applied in a strategic way to create a competitive advantage? Barney (1991) developed the VRIO model structured in a series of four questions to be asked about the business activities a firm engages in: (1) the question of Values; (2) the question of Rarity; (3) the question of Imitability; and (4) the question of Organization. The answers to these questions determine whether a particular firm resource or capability is a strength or weakness. The VRIO model describes ways that firms can expect to be successful.

An important factor that assures a long-term competitive advantage is the sustainability of the firm's capabilities or their core competences. Sustained capabilities are those that are not easy or quickly reproduced by the competitors and must form the base of firm's strategy. These resources and capabilities are the key for the achievement of competitive advantage and should be protected.

It is hard to imagine a small firm taking advantage of opportunity and having a considerable impact in the market without growing. The advantages of early growth are internal (learning effects) as well as external (market position). In this sense, the growth seems to come out as an important demonstration of the entrepreneurial behaviour of small firms. Entrepreneurial opportunity recognition is the ability to identify situations in which new goods, services, raw materials, markets and organizing methods can be introduced through the formation of new means, ends, or means-ends relationships (Eckhardt and Shane, 2003; Phillips and Tracey, 2007).

When studying the strategy of small firms and in particular the strategic choices, which can influence the growth, it looks pertinent to discuss about the dimensions of EO. Miller (1983: 770) suggests that an entrepreneurial firm is one that "engages in product market innovativeness, undertakes somewhat risky ventures, and first to come up with proactive innovations, beating competitors to the punch. A non-entrepreneurial firm is one that innovates very little, is highly risk adverse, and imitates the moves of competitors instead of leading the way". Miller (1983) developed a measuring instrument to capture the dimensions of EO in empirical research. Although the same measuring instrument is used, different designations are used to measure the same dimensions. Besides, there is little consensus about the type of dimension involved.

Based on Miller (1983) and others (Colvin and Selvin, 1989; Merz et al., 1994; Dess et al., 2007) we use the same measuring instrument, but argue that such an instrument reflects the strategic orientation of the entrepreneur and that it should be considered as a philosophy of entrepreneurial behaviour which guides the firm as it deals with the environment. Brown (1996) and Dess *et al.* (2007) suggest that EO is connected with the will that a firm possesses to commit itself into entrepreneurial behaviour. This can be achieved if there is an incorporation to a new or current market with a new or current product, or still, if there is the launching of a new business.

In this context, and according to Miller (1983), the concept of EO is seen as a combination of three dimensions: (1) *innovativeness* – is concerned with supporting and encouraging new ideas, experimentation and creativity likely to result in new products, services or processes; (2) *risk taking* – measuring the extent to which individuals differ in their willingness to take risk is contentious; and (3) *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 action taken anticipation of future demand.

Without dynamic capabilities to convert resource into advantage, entrepreneurial resources do not translate into performance. This view endorse the RBV on firm performance, namely, entrepreneurial resources (such human and financial capital or access to networks through which these capitals can be acquired) determine entrepreneurial success. Therefore, the entrepreneur's networks are crucial for acquiring the requisite complementary resources and capabilities. The entrepreneurial process involves the gathering of scarce resources from environment and the resources are usually obtained through the entrepreneur's network.

Some of these resources may provide direct solutions to operational problems while others increase the firm legitimacy in the market-place and indirectly provide access to resources needed for the pursuit of economics goals.

2. Method

The empirical data used in this research are drawn from dataset collected using a structured mail questionnaire. The initial population consisted of Portuguese manufacturing small firms[1]. The questionnaire was developed partly by using seven-point Likert scales to minimise executive response time and effort. Pre-tests for getting feedback regarding the clarity of the survey items were conducted with four firms of varying sizes and belonging to different sectors. A total of 1470 small firms were identified from Group Coface[2] database. Of those, 825 were selected randomly and in a stratified way. A total of 168 questionnaires were obtained, yielding a satisfactory effective response rate of 20,4%. Two types of statistic analysis were developed in this study: a bivariate and a multivariate analysis. The statistic software SPSS (Statistical Package for the Social Sciences) was used as a support to all the statistic analyses developed during the present research.

3. Measures

3.1. Independent variables: resources and capabilities. The resources and capabilities considered in present research are: (i) *entrepreneur resources* (age of entrepreneur, gender, experience and education level, founder of the firm and formation in management); (ii) *firm resources* (human resources and financial resources); (iii) *entrepreneur's networks* (the informal networks, external networks, and institutional networks); and (iv) *entrepreneurial orientation* (*innovativeness*, the development of new and unique products, services or processes; *risk taking*, a will to pursue risky opportunities, taking the chance of failing; and *proactiveness*, an emphasis on the persistence and creativity to overcome obstacles, until the innovator concept is completely implemented).

3.2. Dependent variable: growth. Two objective measures of growth were included: (1) the sales growth, and (2) the employment growth. It was calculated based on the change of the number of employees which took place from the year 2002 to 2003. The growth variable is made up of four indicators: (i) the change of the number of employees from year 2002 to 2003; (ii) the change in the amount of business from year 2002 to 2003; (iii) the growth of the sales compared to that of the competitors; and (iv) the growth of the market value compared to that of the competitors.

3.3. Control variable: firm's age. There are firm specific and external factors that may affect a firm's growth, regardless of its EO. We used the firm's age as control variable. Firm's age is normally calculated from the firm's years. This variable was used to verify if the firms, as they grow older, become less entrepreneurial, as it is frequently argued, so it is expected that there will be a negative relation between the firm's age and the EO.

4. Analysis and results

The firms of the sample are divided into two groups based on the rates of annual increase of sales and the number of employees in year 2002 to 2003. The firms which present an increase in the employment rate bigger than 25% and/or an increase in the sales rate[3] bigger than 25% are identified as *high-growth firms*. According to this criterion, we find 90 low-growth firms and 78 high-growth firms.

The differences do not seem to be casual or caused by forces out of the control of the firms. The entrepreneur of the high-growth firms, for example, adapts the products so that they can enter new markets and the entrepreneurial quality of the entrepreneur has some importance to the growth. The entrepreneur of the high-growth firms use a strategy more directed to flexibility and to the change. They are more concerned with the new market opportunities and/or have a better capability to react to new opportunities.

Consequently, there seems to be an association between the resources and capabilities and EO in several aspects. Variables which, in different ways, report that EO, as well as product innovation, perception of business opportunity, distinguish the high-growth firms from the low-growth ones.

[1] The criteria adopted by the European Union were chosen to define small firm and select the sample of the current research (firms with no more than 49 employees).

[2] Coface Mope is a subsidiary of the French business Group COFACE.

[3] Inflation was not considered.

5. The effect of resources and capabilities on growth

The *Entrepreneurial Orientation* is the variable that contributes more to the explanation of the growth. The variables *Founder of the firm* and *External networks* are also higher. All the other meaningful coefficients present a similar magnitude and it is difficult to establish any definite order of importance among them.

There is a set of variables that do not contribute to explain the growth of small firms, namely, age of entrepreneur, gender, experience and education level, size of management staff, firm' size compared to competitors, availability of capital, distribution of capital, and institutional networks.

The *Entrepreneur resources* dimension showed a greater number of not significant variables not influencing the growth. In what concerns *Firm resources*, only the firm's size variable appears as meaningless in the prediction of growth. The negative influence of the firm's age on growth suggests that younger firms grow more than older ones.

The association between resources and capabilities and growth is strong. A particularly consistent result is the positive influence of the EO to the growth. Their strategies are directed to proactiveness, risk taking and innovativeness. The results indicate that the firms which have an EO and show some growth are guided so that they can take opportunities. It seems that the perception of the environment influences the firm is growth, but it also seems that the firm may have some influence on the environment where it operates.

6. Key lessons for managers and business professionals

From a practical perspective, this study provides meaningful lessons for managers and business professionals. First of all, what should entrepreneurs do?

Firstly, this research points out that entrepreneurial firms seems to have more capability to introduce new products featuring more differentiated characteristics for the market and these firms seem to take full advantages of their areas of strength (innovativeness, proactiveness and risk taking) in responding to customers constantly calling for unique benefits and superior value. It highlights the necessity of firms to develop superior EO of all their members and also to invest on better resources and consequently superior capabilities as a way of reaching higher levels of growth. Entrepreneurs should devote time to scan the competitive environment. They should know who their competitors are, what their products are, what kind of strategies they employ, what their competitive advantages are, and how they acknowledge future technologies and trends. Knowledge of these things informs the entrepreneur of the various kinds of businesses that exist, of the kinds of gaps that exist and of possible future trends.

Secondly, we argue that EO, based on proactiveness, innovativeness and risk taking, has effect on firm's growth. Entrepreneurs compete not only to identify promising opportunities, but also for the resources necessary to exploit those opportunities. Firm's survival depends on continuous growth and ability to defend against the ongoing moves of competitors. The main reasons for highlighting the entrepreneurship arise from internal and external variables, that is, it depends on the strategic necessity of the firms and on the degree of existing businesses maturity. More innovative and proactive businesses were more likely to have been found by entrepreneurs with a clear perception of an opportunity related to the commercialization of a new or existing technology, to hold personal objectives reflecting an enterprise focus: with a concern for employees, and a perception of the business as an entity existing outside of and beyond themselves and who aimed for substantial growth.

It is not enough that the competitive environment is known and gaps located. Those who are most likely to succeed are entrepreneurial individuals and/or organizations concentrating on search of proactive opportunities. Entrepreneurs should vision the future (based on competitive scanning and existing knowledge) and in terms of the most probable future trends in the business.

Proactiveness in competition, innovativeness and willingness to take risks are increasingly seen as crucial activities in the development of competitiveness. Not all firms are equally innovative, proactive or open to risk. Managers will choose to engage in entrepreneurial behavior if they believe that outcomes resulting from their actions, including various types or rewards, will meet or exceed their expectations. It is generally recognized that the relationship between an individual's efforts and the performance that results from those efforts is moderated by the persons' skills, capabilities, and role perceptions. Are some management and leadership styles more effective and creative in creating an entrepreneurial context? The entrepreneur plays a main role in the entrepreneurship process. An entrepreneur is most often regarded as an innovative and creative person suitable to manage a firm that emphazes innovation. The proactiveness of a firm indicates that it searches for new opportunities, probably reflecting these characteristics of the entrepreneur.

Finally, the pursuit of EO within a firm creates a new and potentially complex set of challenges on practical level in the following aspects: managers typically find themselves in uncharted territory when it comes to entrepreneurship. They lack guidelines regarding how to formulate entrepreneurial strategies, manage entrepreneurial employees, or redirect resource towards entrepreneurial activities. Traditional management practices often do not apply when trying to foster entrepreneurship. This means they are not organized in ways that allow them to create the future.

The entrepreneurship does not start with the creative concept for a new product, service or process. It begins with an opportunity, which can be defined as a favorable set of circumstances creating a need or an opening for a new business concept or approach.

Two of the methods firms can use to enhance their competitive position through innovativeness are: (i) fostering creativity and experimentation – to innovate successfully, firms must break out of the patterns that have shaped their thinking. For example, Tim Warren, director of research and technical services at the oil giant Royal Dutch/Shell, was sure that Shell's employees had vast reserves of innovative talent that had not been tapped; (ii) investing in new technology, R&D, and continuous improvement – for successful innovation, firms must seek advantages from the latest technologies.

Proactivieness refers to a firm's efforts to seize new opportunities. Firms can use two other methods to act proactively: (1) introducing new products or technological capabilities ahead of the competition – maintaining a high level of proactiveness is central to the corporate culture of some major corporations. Sony's mission statement asserts, for example, Sony should always be the pioneer with our products – out front leading the market. Sony believes in leading the public with new products rather than asking them what kind of products they want; (2) continuously seeking out new product or service offerings – firms that provide new resources or sources of supply can benefit from a proactive posture. For example, Aerie Networks is a Denver firm that aspires to expand the U.S. fiber-optic network extensively. Two factors make its efforts to be especially proactive. First, it is laying cable that contains 432 fibers, compared with the 96 strands that established firms like AT&T typically install; second, it worked for over a year to form an alliance with gas pipeline rivals that made it possible to use up to 25,000 miles of pipeline right-of-way across 26 states.

About risk taking, firms can use the following two methods to reinforce their competitive position through risk taking: (1) researching and assessing risk factors to minimize uncertainty – although all new business endeavours are inherently risky, firms that do their homework can usually reduce their risk; (2) using techniques that have worked in other domains – risky methods that other firms have applied successfully may be used to advance corporate ventures.

Following is an example of an entrepreneurial firm – YDreams – that has achieved remarkable growth by pursuing an opportunity.

6.1. YDreams. YDreams is a Portuguese technology solutions provider founded in June 2000 with offices near Lisbon, Portugal, and several partners in Europe, Asia, South America and the USA. YDreams develops technology which powers pioneering products and services for the entertainment and wireless internet industries. The firm has been profitable from the start, working with major Portuguese and international clients. This has helped it in recruiting the very best on an international level. YDreams has an attractive compensation policy, including bonuses for productivity, creativity and profitability, as well as distribution of equity. Professional training is also available, both in Europe and the United States, through partnership programs with leading companies and universities. Senior collaborators will also qualify for internships at MIT (Massachussets Institute of Technology).

Working environment is demanding in terms of quality and project deadlines, but schedules are quite liberal and flexible. Technology and entertainment markets require open minds and a 'good idea, let's do it' attitude – they are very aware of that, and make a point of promoting and publicly recognizing people who author or co-author distinguished products and ideas.

Many entrepreneurial firms offer products that are fairly standard and certainly not unique. However, they have come up with highly innovative process that is the major source of competitive advantage, that is, they result in lower costs, faster operations, more rapid delivery, improved quality, or better customer service. Today firms find that they must be more innovativeness than in time past. Much of the pressure to innovative is due to external forces, including the emergence of new and improved technologies, the globalization of markets, the fragmentation of markets, government desregulation, and dramatic social change.

There is a set of potential constraints that could be found when the entrepreneurs trying to implement an EO within firm. They are as follows:

- *systems* – firms are typically dependent on formal managerial systems that have evolved over the years which provide stability, order and coordination to an increasingly complex internal corporate environment that is a strong disincentive for EO;
- *structure* – as a firm designs more hierarchical levels into the organizational structure, the capability to identify opportunities, achieve management commitment reallocate resources, take risks or implement effective market place moves becomes problematic;
- *strategic direction* – frequently firms have sophisticated planning systems that produce comprehensive strategies for marketing production and corporate finance but ignore the subject of entrepreneurship and innovation altogether;
- *policies* – there is a tendency for existing policies and procedures to impose unrealistic timetables and performance benchmarks on entrepreneurial programs;
- *people* – sometimes people represent the greatest obstacle to entrepreneurship; in this sense, the attempt to increase the EO of a firm must take place to change peoples' attitudes and perceptions;
- *culture* – firms noted as successful innovators tend to foster a strong entrepreneurial culture; this culture is built around a central set of values that pervade every aspect of firm's operations creating the standards and providing the direction for growth and development.

For example, the Procter & Gamble is far from being a star-up firm, yet CEO A.G. Lafley (2006 CEO of the Year) has taken measures to ensure that entrepreneurship is alive and well in the firm. There are at least three characteristics that distinguish Lafley as an entrepreneur:

(1) He believes in the 'high touch' to shape P&G's internal culture. Just communicating across time and space, coordinating across time and space, is very difficult. We use the Intranet. *"We're all running around with BlackBerries and cell phones"*. But we also try to use a lot of high touch. His style is to bring P&Gers together to learn from other P&Gers who are actually line or functional leaders: "*You have to bring people together to learn from each other"*. Getting employees to engage with each other in these ways seems to help them concentrate on the human dimension of understanding consumers.

(2) He does not drive the organization purely by the numbers. Many CEOs impose financial targets on their operating units and manage by the numbers. P&G units have annual plans, of course. But Lafley's management style is to focus everyone on their mission: *"I try to get them to focus on the strategy choices, the capabilities, executing everything we do with consistency and excellence"*. Excellent financial results seem to follow.

(3) He is so personal himself. Lafley is on the board of General Electric and is positioned at the very heart of Corporate America. But he does not maintain the same kind of psychological distance that many executives in his position do: *"I try to exercise five times a week; I can't tell you how many ideas I've had while exercising or in the shower"*. He also tells visitors how he is learning to meditate to ease the pressures of the job. *"My wife has learned how to do this – just sort of quieting yourself, just relaxing, no television or radio running; Calming yourself is incredibly important"*. That degree of personal candor also helps shape the P&G culture.

Lafley makes the following recommendations for keeping established firms entrepreneurial and agile: (i) increase one-on-one consumer research; (ii) consider brand expansions; (iii) encourage cross-division exchange of ideas; (iv) be willing to consider ideas from outside sources; (v) know when you have tested enough; and (vi) get designers more involved.

In sum, EO would seem to depend both on the capabilities of operational level participants to exploit entrepreneurial opportunities and on the perception of EO that there is a need for entrepreneurship at the particular moment in its development. This research presented some managerial implications for firms to compete successfully in the marketplace. Managers should understand that the firms are integrating more and more in global markets, managers should reshape the business practices by promoting EO. Our research findings suggest that entrepreneurial firms appear to grow fast and enjoy greater market share, the desired outcome of the firm. Managers and policy makers may enhance EO by different approaches.

In addition, as our results lend some support to positive association between EO and growth, it seems that an entrepreneurial strategy may encourage the firms to be more proactive in formulating and planning, more risk taking in implementing plans, and more innovative in delivering products and services for growth.

Conclusion

This study makes contribution to the literature on entrepreneurship and strategy research by investigating the impact of the resources and capabilities and EO of the firms on its growth and by the operationalization of the EO concept. In this paper we have focused on EO (intangible resource) as one important dimension of RBV and its impact on growth of small firms. We defined the constructs of EO as innovativeness, risk taking and proactiveness. Confirmatory factor analysis confirmed that these three constructs were statistically significant indicators of EO.

This research complements existing studies, and the results suggest that the firms which grow more, are entrepreneurially oriented, they detect opportunities and obtain an advantage when searching for those opportunities. However, not all firms search for opportunities. A possible explanation could be the entrepreneur's attitudes, that is, the desire to growth or not.

Concerning the issue of the EO influence on firm's growth, it seems that the entrepreneurship has, in fact, an important role as firms which grow better have the tendency to develop an EO supported by proactiveness, innovativeness and risk taking. Based on the most important and consistent results, it was possible to identify the following factors influencing the growth of the small firm: (i) the high-growth firms have a strategic orientation that can be classified as entrepreneurial; (ii) the entrepreneur resources, firm resources and entrepreneur's networks have a great importance to growth; (iii) youngest firms have the tendency to grow more than older ones. The results support the need for explanatory variables of multiple levels to explain growth. The setting of the EO as an indispensable variable to the growth of small firms seems to be conceptually and empirically pertinent.

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