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Framework of entrepreneurial orientation and networking: a study of SMEs performance in a developing country

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Abstract
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Keywords
developing, entrepreneurial, country, study, orientation, performance, smes, framework, networking

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Framework of Entrepreneurial Orientation and Networking: A Study of SMEs Performance in a Developing Country

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ABSTRACT

SMEs with higher levels of Entrepreneurial Orientation (EO) have been found to perform better than those, which lack such orientation. The dimensions of EO, namely autonomy, innovativeness, risk-taking, proactive, and competitive aggressiveness contribute to firm performance independently. However, these EO dimensions are considered insufficient for the SMEs to enter global markets. Due to their limited resources and lack of knowledge as well as access to foreign markets, SMEs in developing countries (such as in Indonesia) that participate in international business have to possess the capability to establish networks. Networking also provides firms to gain access to resources that they do not possess. This study proposes a conceptual framework that integrates the capability to establish networking in the EO–performance relationship.

Keywords: entrepreneurial orientation, networking, firm performance, SMEs, Indonesia

BACKGROUND

Indonesian Small and Medium Enterprises (SMEs) play an important role in economic development and income growth. SMEs account for more than 99.8% of the total number of enterprises in Indonesia (Ministry of Cooperative and Small Medium Enterprises, 2008). In terms of their important role in the nation’s economy, SMEs’ contribution to the Indonesian Gross Domestic Product accounted for 53.6% in 2007. Furthermore, of the 6.3% of economic growth in Indonesia during the same period, as much as 2.4% came from SMEs (Ministry of Cooperative and Small Medium Enterprises, 2008). Some SMEs in Indonesia have the potential to contribute to international trade as well.

However, globalisation and trade liberalisation issues pose serious challenges to Indonesian SMEs. They have to prepare themselves for severe competition, not only from domestic but also from international companies. On the other hand, globalisation also offers opportunities for SMEs to enter new foreign markets.

Previous studies (Knight, 2000, Dess et al., 1997) suggested that under globalisation, SMEs with an entrepreneurial orientation (EO) are more likely to perform better than those that lack such an orientation. According to Knight (2000) with their relatively limited resources and lack of capabilities, SMEs have to possess EO to survive or even to outperform their competitors in global markets. Globalisation requires SMEs to take self-directed actions, to be more innovative, proactive, aggressive and risk-taking in order to take advantage of opportunities in the marketplace (Zahra and Garvis, 2000). Furthermore Rauch, Wiklund et al. (2009) stated that the influence of EO on performance is
more obvious in small firms. Interestingly, other findings (Slater and Narver, 2000, Lee et al., 2001) were unable to identify a significant relationship between EO and firm performance.

Previous entrepreneurship research suggested that EO is only part of the essential factors in explaining firm performance (Coulthard, 2007). Another significant aspect, i.e. business relationships or networks, is considered to enhance the EO - performance model (Madsen, 2007). Due to their limited resources and lack of knowledge, as well as access to enter foreign market, the SMEs that participate in international business have to possess the capability to establish networks (Wright and Dana, 2003, Welch and Welch, 2004, Zain and Ng, 2006). This means that, under globalisation, EO dimensions namely autonomy, innovativeness, risk-taking, proactiveness, and competitive aggressiveness, are considered insufficient for the business players, particularly SMEs in developing countries, to enter foreign markets. The inclusion of relationship or networking in the current EO - performance model is also suggested by Coulthard (2007: 36) who discovered this factor in his study “more by accident than design”. Therefore, this study will integrate the capability to establish networking in the EO – performance relationship model.

Furthermore, as the majority of EO - firm performance relationship studies have been conducted in developed (‘western’) countries, their findings may not be applicable for firms in developing countries. While Thomas and Mueller (2000) argued that certain dimensions of EO may differ across countries, Naldi, Nordqvist et al. (2007) suggested that national culture may affect EO adoption. Hence, the purpose of this paper is to address some gaps in knowledge in the existing literature and to propose a conceptual framework for the interrelationship of entrepreneurial orientation, networking and the performance of SMEs in Indonesia.

LITERATURE REVIEW

Entrepreneurial Orientation (EO)

Entrepreneurial Orientation (EO) became a salient concept within strategic management and entrepreneurship literature in the last twenty years (Kreiser et al., 2002, Morris et al., 2008). Rauch, Wiklund et al.(2009) who reviewed previous EO - performance relationship studies revealed that an
increase in the quantity of such studies has occurred around the world. Therefore, they concluded that “EO represents a promising area for building a cumulative body of relevant knowledge about entrepreneurship” (2009: 778).

Some scholars use different terminologies in discussing this firm-level behaviour in entrepreneurship, such as strategic posture (Covin and Slevin, 1991), corporate entrepreneurship (Zahra and Covin, 1995, Zahra et al., 1999, Kuratko, 2007) and entrepreneurial orientation (Lumpkin and Dess, 1996, Becherer and Maurer, 1997, Lyon et al., 2000, Moreno and Casillas, 2008). However, entrepreneurial orientation (EO) is the most widely applied.

Entrepreneurial orientation refers to the specific organisational-level behaviour to perform risk-taking, self-directed activities, engaged in innovation and react proactively and aggressively to outperform the competitors in the marketplace (Lumpkin and Dess, 1996). According to Rauch, Wiklund et al. (2009: 763) “EO represents the policies and practices that provide a basis for entrepreneurial decisions and actions”. In other words, EO refers to how the firm acts entrepreneurially. As firm behaviour is the central and essential element in the entrepreneurial process, it has been the reason why some researchers are interested in investigating EO (Covin and Slevin, 1991).

Previous studies showed that EO is a key ingredient for organisational success and has been found to lead to higher performance (Zahra and Covin, 1995, Wiklund and Shepherd, 2005). Lumpkin and Dess (1996) also suggested that EO is source of competitive advantage. Firms that possess higher levels of EO will perform better than those with lower level of EO (Lyon et al., 2000, Rauch et al., 2009). By adopting higher levels of EO, it allows the firms to have the ability to identify and seize opportunities in a way that differentiates them from non-entrepreneurial firms (Covin and Slevin, 1991).

**Entrepreneurial Orientation Dimensions**

The specific dimensions of EO were introduced for the first time by Miller (1983). He suggested that the entrepreneurial firm is 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: 771). Accordingly, Miller identified the salient dimensions of EO as innovative, risk taking, and proactive.

Almost twenty years after Miller’s work in 1983, Lumpkin and Dess (1996) proposed adding two additional dimensions, i.e. autonomy and competitive aggressiveness, to complement the three dimensions introduced by Miller (1983): innovative, risk taking and proactive. Lumpkin and Dess (1996) argued that, to be successful, a firm requires autonomy from strong leaders or creative individuals, without any restrictions from the firm’s bureaucracy. The other dimension, competitive aggressiveness, describes Miller’s idea (1983: 771) of “beating competitors to the punch”. It represents how a firm responds to threats and not only seizes opportunities as indicated by Miller’s proactive dimension.

Opinion is divided among researchers about the extent of EO dimensions, which need to be present for a firm to be considered entrepreneurial. Miller (1983) suggested that only firms that possess all three dimensions (i.e. innovative, risk-taking, proactive) should be considered as entrepreneurial. According to Miller (1983: 780):

In general, theorists would not call a firm entrepreneurial if it changed its technology or product line (‘innovated’ according to our terminology) simply by directly imitating competitors while refusing to take any risks. Some proactiveness would be essential as well. By the same token, risk-taking firms that are highly levered financially are not necessarily considered entrepreneurial. They must also engage in product-market or technological innovation.

In other words, Miller (1983), and supported by Covin and Slevin (1991), emphasised that the EO dimensions are best viewed as a unidimensional concept.

On the other hand, Lumpkin and Dess (1996) argued that any firms which engage in an effective combination of autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness can be considered as entrepreneurial. This suggests that to become an entrepreneurial firm, it is not necessary for all five dimensions to co-exist (Chow, 2006). As a multidimensional concept, the effect of each dimension of EO on firm performance can be observed independently (Lumpkin and Dess, 1996). Lumpkin and Dess (2001) suggested that the value of each dimension can vary independently and might not be the same at different stages of firm development. Furthermore, in examining the entrepreneurial process, it is beneficial to identify the unique contributions of each sub-
dimension of EO such that firms could seek the best combination to improve firm performance (Kreiser et al., 2002). Studies conducted by some researchers (Rauch et al., 2005, Coulthard, 2007, Hughes and Morgan, 2007) supported Lumpkin and Dess’ argument. These studies implied that some dimensions of EO are responsible for improving firm performance, while other dimensions may have little or even no influence at all. This suggests that the effect of EO dimensions on firm performance varies, possibly depending on different industry context, business environment or stages in a firm’s development.

Despite the debate in EO dimensions and their uniqueness in affecting firm performance, Lumpkin and Dess (1996) suggested that other factors, namely internal and external factors of the firm, may affect EO dimensions in influencing the success of firm. Internal factors represent organisational structure or characteristics of founder and/or top manager, while external factors refer to the industry or business environment. Lee and Peterson (2000) who investigated entrepreneurship at the broader level, i.e. societal level of countries, supported Lumpkin and Dess (1996) arguing that a nation’s culture influences entrepreneurial activities in that country, which in turn affects firm competitiveness.

The influence of nation’s culture on entrepreneurship studies has also been discussed by Kreiser, Marino et al. (2002). According to them, most entrepreneurship studies are based on samples from the United States and employed entrepreneurial measurements developed for studies in that country. They argued that these measurements might not be applicable in all international settings due to differences in national culture. Mueller and Thomas (2001) also found that some cultures are more favourable for entrepreneurship practices than other cultures.

**Relationship between Entrepreneurial Orientation and Performance**

The relationship between EO and firm performance has become the central focus of interest for studying EO (Covin et al., 2006) and to date, findings have been mixed. Numerous studies have showed that EO, directly or indirectly, has a positive relationship with firm performance (Wiklund and Shepherd, 2005, Li et al., 2009, Zahra and Garvis, 2000, Hughes and Morgan, 2007). This means that firms that adopt more EO perform better than those with lack of such orientation. This association may
be related to the fact that today's dynamic business environment causes product life cycles to become shorter and uncertainty to increase (Rauch et al., 2005). In addition, the actions of competitors as well as customers are unpredictable. Firms, therefore, are required to conduct innovation regularly, anticipate demand, take into account the risk, and aggressively compete to maintain or find new positions in the marketplace. However, the way do this may vary, according to their position in the industry (leader/follower).

The work carried out by Hughes and Morgan (2007) is one of the studies that investigates the direct effect of each dimension of EO on performance. They discovered that the contribution of each EO dimension to firm performance varies, and even some dimensions are found not correlated at all with firm performance. Other researchers (Wang, 2008, Wiklund and Shepherd, 2005), however, suggested that by investigating the direct effect of EO on firm performance, it will not provide a comprehensive description of the relationship. Therefore, most researchers have applied other variables to the model EO – firm performance (Covin and Slevin, 1991).

Interestingly, the empirical findings of EO-performance relationship studies were mixed. Covin, Slevin et al. (1994) revealed no significant relationship between strategic posture (EO) and firm performance. Similarly, Slater and Narver (2000) were unable to provide any evidence of a positive relationship between EO and profitability. Moreover, Lee, Lee et al. (2001) found in their study that EO may not significantly increase the firm performance.

**Autonomy**

Autonomy refers to the ability to make decisions and to proceed with actions independently, without any restrictions from the organisation (Lumpkin and Dess, 1996). It also reflects the strong desire of a person to have freedom in the development of an idea and in its implementation (Lumpkin et al., 2009). Protas (2008) suggested that autonomy offered by firms would motivate employees to work in a positive manner that could lead to higher firm performance. From reviewing four prior studies on different industries in Australia, Coulthard (2007) argued that firms cannot function entrepreneurially without giving autonomy to their employees. His finding showed that autonomy is the most important factor for improving firm performance across industries. It is apparent that giving
autonomy to all players in the organisation will motivate them to act entrepreneurially, and in turn improve firm performance.

**Proposition 1: Autonomy is likely to lead to superior firm performance**

**Innovativeness**

Innovativeness reflects a firm’s ability to engage in new ideas and creative processes that may result in new products, markets, or technological process (Rauch et al., 2009). Thompson (cited in Calantone et al., 2002: 515) defined innovation as “the generation, acceptance, and implementation of new ideas, processes, products, or services”. Covin and Miles (1999) believed that innovation is a crucial part of a strategy and that entrepreneurship cannot exist without it. However, by reviewing previous EO studies in four different industries within Australia, Coulthard (2007) found that innovativeness is not the most significant dimension.

According to Landström (2005), innovativeness is related to creativity. Without creativity, there will be no force to be innovative. Creativity is a source of ideas that will lead to the innovation of products, services, processes, markets, or technology.

**Proposition 2: Innovativeness is likely to lead to superior firm performance**

**Risk-taking**

Risk-taking refers to a firm’s willingness to take calculated business opportunities in the marketplace, even when their outcomes are uncertain (Lumpkin and Dess, 2001). Firms with risk-taking behaviour of EO are described as firms that are bold and aggressive in pursuing opportunities, such as incurring heavy debt or making large resource commitments to obtain high returns by taking advantage of opportunities provided by the environment (Lumpkin and Dess, 1996).

Avlonitis and Salavou (2007) added that firms with strong entrepreneurial behaviour are attracted to projects of higher level of risk to get higher level of return. On the contrary, a risk-averse firm will avoid doing something that provides uncertain yield to changing environment. This behaviour will result in weaker performance as the firm is not willing to capture market opportunities (Hughes and Morgan, 2007).
Proposition 3: Risk-taking is likely to lead to superior firm performance

Proactiveness

Proactiveness can be described as “taking initiative by anticipating and pursuing new opportunities related to future demand and by participating in emerging markets” (Lumpkin and Dess, 1996: 146). Being a proactive firm is demonstrated by a firm’s awareness and responsiveness to market signals (Hughes and Morgan, 2007). According to Rauch, Wiklund et al. (2009: 763), proactiveness is “an opportunity-seeking, forward-looking perspective characterised by the introduction of new products and services ahead of the competitions and acting in anticipation of future demand”.

Kropp, Lindsay et al. (2008) suggested that proactiveness involves the identification and evaluation of new opportunities, and monitoring market trends. By conducting these activities, some studies discovered that proactive firms introduce new products in the market ahead of their competitors (Venkatraman, 1989). However, Coulthard (2007) argued that proactiveness is not always being the first mover in the market.

Hughes and Morgan (2007) and Coulthard (2007) found that at the embryonic stage of firm growth, proactiveness was a critical factor that affected firm performance improvement. The role of proactiveness was less important once a firm was established.

The words proactiveness and competitive aggressiveness are often used interchangeably. However, Lumpkin and Dess (1996) distinguished between them, suggesting that proactiveness reflects a firm’s reaction to opportunities in the market place whereas competitive aggressiveness refers to a firm’s response to a competitor’s challenges.

Proposition 4: Proactiveness is likely to lead to superior firm performance

Competitive Aggressiveness

According to Lumpkin and Dess (1996: 148), “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”. These actions may be based on product
innovations and/or market development. In order to surpass their industry rivals, firms can demonstrate responsive or reactive action. Responsiveness may take the form of head-to-head competition or direct attack on competitors, such as when a firm enters to the market where the competitor is already present. In contrast, reactive shows direct reaction to a competitor’s action, for example where a firm cuts the price of its product when a competitor introduces a new product to the chosen market (Lumpkin and Dess, 1996).

**Proposition 5:** Competitive aggressiveness is likely to lead to superior firm performance

**Networking**

The significant role of networks in influencing entrepreneurial process and outcomes has also been asserted by several authors (Butler et al., 2003, Hoang and Antoncic, 2003). Entrepreneurship theory implies that the essence of entrepreneurship is the ability to detect, willingness to pursue and exploit the opportunity in the marketplace (Stevenson and Jarillo, 1990, Shane and Venkataraman, 2000, Oviatt and McDougall, 2005). Yet, not all entrepreneurs have capabilities and sufficient resources to utilize those opportunities. They need collaboration with the economic actors to enable them to carry out some activities in order to gain access to resources and markets (Zain and Ng, 2006). Clearly, they need to develop networks in business to take advantage “to exploit new opportunities, obtain knowledge, learn from experiences, and benefit from the synergistic effect of pooled resources” (Chetty and Holm, 2000: 77). For that reason, Dubini and Aldrich (1991) acknowledged that entrepreneurship is naturally a networking activity. Network is considered as one of the most powerful assets since it provides access to power, information, knowledge, technologies, and capital (Elfring and Hulsink, 2003, Inkpen and Tsang, 2005).

Based on the nature and source of the relationships, networks can be distinguished into two broad categories, namely (1) personal networks (Sawyer et al., 2003) or informal networks (Shaw, 2006), and (2) business networks (Wright and Dana, 2003) or organisational networks (Premaratne, 2001). The former refers to informal relationships that involve relatives, friends, and acquaintances. The latter is concerned with relationships between actors that control business activities, such as customers, distributors, suppliers, competitors, and government (Forsgren and Johanson, 1992).
Premaratne (2001) and Butler, Brown et al. (2003) suggested that personal networks may provide small firms with a higher and more stable flow of information and advice. Similarly, Shaw (2006) discovered that small firms in Scotland rely more on informal rather than formal sources to acquire information and advice. On the other hand, Morris, Woodworth et al. (2006) found that entrepreneurs in Bulgaria and the Philippines utilise business networks to gain access to capital and business training.

Some researchers have discussed the advantages of using network relationships. Zain and Ng (2006) and Watson (2007) suggested that networking enables SMEs to gain access to resources that they do not possess. Andreosso-O’Callaghan and Lenihan (2008) highlighted the role of networks in minimising transaction cost and exchange knowledge, which in turn will lead to superior performance.

Networks play a significant role for achieving efficient business operation under globalisation (Möller and Halinen, 1999). With the limited resources and lack of knowledge as well as access to enter foreign markets, firms’ participation in international business, especially for SMEs, is highly dependent upon their relationship with a variety of market intermediaries or networks (Welch and Welch, 2004, Zain and Ng, 2006, Wright and Dana, 2003). Such networks act as a facilitator for internationalisation by offering a shorter time as well as a lower cost to enter foreign markets compared to companies with limited business relationships (Coviello and Cox, 2007, Sjöholm, 2003). Furthermore, they minimise the risk associated with the process of internationalisation (Zain and Ng, 2006, Johanson and Mattsson, 1988).

Interestingly, Zain and Ng (2006) found in their study of Malaysian SMEs that business networks are beneficial in creating trust, confidence, and credibility of the firms in foreign markets. This finding encourages firms, especially in developing countries, to build business networks when they are going to penetrate international markets in order to reduce negative perceptions of their countries. Due to its numerous advantages, networking is considered as one of the potential sources of a firm’s competitive advantage (Chiu, 2009, Andreosso-O’Callaghan and Lenihan, 2008, Ritter and Gemünden, 2004).

**Relationship between Networking and Firm Performance**
Several researchers have tried to investigate the relationship between networking and firm performance. The results, however, have been inconsistent. According to Gulati, Nohria et al. (2000: 203) "by examining the network relationships in which they are embedded, the performance of firms can be more fully understood". Networking ultimately leads to superior firm performance (Andreossi-O'Callaghan and Lenihan, 2008, Ritter and Gemünden, 2004).

On the other hand, Cooper, Gimeno-Gascon et al. (1994) failed to show any significant relationship between the use of professional advisors and firm survival. A further investigation of this relationship was carried out by Watson (2007) who examined the relationship between networking and firm performance of established SMEs in Australia. As firm performance measurement, he used survival, growth and ROE. In his study, he found that networking was positively related with firm survival, and to a lesser extent, growth. Yet, he was unable to find a significant relationship between networking and ROE. Another interesting finding was that formal and informal networks were both associated with firm survival, but only formal networks were associated with growth. In addition, neither formal nor informal networks were associated with ROE.

From the discussion above, it can be concluded that networking plays a significant role in a firm's success in both domestic and international markets, particularly under globalisation, which is characterised by more opportunities and challenges. Networking that is effectively managed will serve as a source of competitive advantage and it will lead to the superior performance of firms.

Proposition 6: Networking is likely to lead to superior firm performance

PROPOSED THEORETICAL FRAMEWORK

This study proposes a theoretical framework that examines the influence of each EO dimension on the performance of SMEs in a developing country (Indonesia). This means that the role of autonomy, innovativeness, risk-taking, proactiveness, and competitive aggressiveness on SMEs' performance will be observed independently as stated in Proposition 1 through Proposition 5. All of these dimensions have been identified in developed countries, and, as previously discussed, findings have been mixed. There may be many reasons for such mixed findings, including different industries,
different status of companies within their industry (leader/follower) and different stages of growth. In exploring the dimensions of EO therefore, care needs to be taken to identify contextual factors precisely both of the company and the culture in which the company operates.

This proposed model also integrates the capability to establish networking in the EO – firm performance relationship as stated in Proposition 6. The proposed theoretical framework is presented in Figure 1. The proposed research will not only assess the impact of these factors on SMEs’ performance, but will also be open to the possibility of additional factors being relevant in this context.

CONCLUSION

This study will attempt to address the gaps in the current literature related to the impact of entrepreneurial orientation on firm performance in developing countries, particularly in Indonesia. By applying the proposed theoretical framework, the contribution of each dimension of EO to SMEs’ performance will be examined independently. The possibility that additional dimensions may apply in developing countries will also be explored. Moreover, the significance of networking and its possible impact on firm performance in both domestic and international markets will also be investigated. This will allow the authors to suggest directions for future research on entrepreneurial orientation for SMEs.
REFERENCES


Figure 1: Proposed Theoretical Framework

Entrepreneurial Orientation

- Autonomy
- Innovativeness
- Risk-taking
- Proactiveness
- Competitive Aggressiveness
- Networking

Firm Performance