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The contingent effect of entrepreneurial orientation on small business performance inhostile environments

El efecto contingente de la orientación emprendedora sobre el desempeño de pequeñas empresas en ambientes hostiles

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Abstract

The aim of this study is to analyze the effect of entrepreneurial orientation (EO), perceived as the innovative, proactive and aggressive practices of the business entrepreneur, on the performance of small businesses operating in a hostile environment of economic decline, social turbulence and natural events. A contingency view is adopted in order to determine which EO variables best explain business performance. Data collected from 101 small craft business and analyzed with factor analysis, Pearson's bivariate correlation and hierarchical regression, indicate that small business performance depends on product innovation and proactive behavior focused on protecting market share, along with a reduced emphasis on price-based competition due to the negative impact of competitive aggressiveness on performance.

Keywords: *entrepreneurial orientation, hostile environment, performance*

Introduction

Since the 1970s, there has been growing interest in investigating the manner in which firms respond to hostile environments (Miller & Friesen, 1978; Miller & Friesen, 1983; Covin & Slevin, 1989; Lumpkin & Dess, 2001; Naidoo, 2010; Rosenbusch, Rauch, & Bausch, 2013). In general, research provides evidence of the positive effect of EO on the performance of firms immersed in hostile environments (Lumpkin & Dess, 2001; Berthon, Hulbert, & Pitt, 2004; Li, Guo, Liu, & Li, 2008; Rauch, Wiklund, Lumpkin, & Frese, 2009; Bamiatzi & Kirchmaier, 2012; Kraus, Rigtering, Hughes, & Hosman, 2012; Martins & Rialp, 2013; Wales, Gupta, & Mousa, 2013). Most studies supporting this perspective have been done on formally established firms in developed economies, where the hostile environment is due to technological, industrial, legal, or market factors. Little work, however, has been done on the impact of EO on the performance of small businesses without a formal structure, operating in adverse environments due to economic crisis, social movements and climate change in the context of emerging economies.

Thus, this study aims to contribute to the existing literature on strategy and entrepreneurship by providing insight into the impact of EO, as measured by innovativeness, proactiveness and competitive aggressiveness on the performance of small businesses immersed in a hostile environment of economic decline, social turbulence and natural events, specifically in the context of an emerging economy such as Mexico (Wright, Filatotchev, Hoskisson, & Peng, 2005). In adopting a

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contingency view, the main objective of the study is to examine how the individual dimensions of EO as well as combinations of these dimensions modify businesses performance.

This research was conducted on small businesses of the state of Oaxaca, Mexico. In particular, artisanal craft businesses whose performance was strongly affected by the 2009 global financial crisis, by the 2006 local social in Oaxaca and by natural events provoked by climate change in 2010. Quantitative and cross-sectional methodology is used to analyze with Pearson's bivariate correlation and linear regression of the data obtained from 101 craft businesses. The results of the statistical analyses provide an interesting insight into the effects of EO on performance. The results suggest that in these businesses, performance is determined emphasizing innovativeness and proactiveness, and reducing price-based competition.

The next section provides an overview of the Oaxacan craft businesses and briefly describes the hostile environment within which these businesses operated in 2010, in order to highlight the impact on their performance.

Hostile environment and performance of Oaxacan craft businesses

The Oaxacan craft businesses

In Mexico, small businesses play a very important role due to their contribution to the wellbeing of the communities in which they operate. Such is the case for the craft businesses of the southeastern state of Oaxaca, which contribute to economic development by attracting national and international tourism and generating direct and indirect employment opportunities, in addition to supporting public infrastructure (Toledo, Hernández, & Griffin,2010; Toledo-López, Díaz-Pichardo, Jiménez-Castañeda, & Sánchez-Medina, 2012). These businesses are generally small production units, representing a significant portion of the income of entrepreneurs and their families (Hernández, Domínguez, & Caballero, 2007).

Oaxacan craft businesses lack a formal organizational structure, with all of the members of the family participating in business activities. Consequently, the number of participants in the business remains close to constant, increasing only when a son marries and brings his wife to live in his parents' house, and decreasing only when a child leaves the family home (Hernández, Domínguez, & Mendoza, 2010; Toledo-López *et al*., 2012). With this traditional business model and an entrepreneurial posture that emphasizes innovative, proactive and aggressive practices, whilst avoiding risk taking behavior and autonomy in dealing with the competition, craft businesses have been able to remain in the market for decades (Malinowski, De la Fuente, & Drucker-Brown, 1982; Mendoza-Ramírez & Toledo-López, 2014).

However, with rapid changes in the global economic landscape, local social turbulence and the unforeseen natural events of 2010, the Oaxacan craft businesses faced a hostile environment which severely affected performance and threatened their survival. A brief description of each of the abovementioned factors and their impact on business performance are listed below.

Hostile environment sources and their impact on the Oaxacan craft businesses performance.

• The 2009 global financial crisis had a very significant impact on Mexico, as it led to a decrease in the principle economic indicators that make up Mexico's primary sources of external income: petroleum exportation, tourism, and remittances from immigrants in the United States (Ritchie, Amaya, & Frechtling, 2010). This economic decline had important negative repercussions for the economic activity of Oaxaca, where the crisis led to a decrease in the flow of circulating currency and in the real value of salaries; these, in turn, negatively affected the buying power of consumers.

This situation severely impacted the performance of craft businesses. With the diminished real value of salaries, the number of clients also decreased and, the consequent

decrease in sales negatively affected business performance. The decrease in sales worsened with the decrease in the influx of tourists to Oaxaca (Segura, 2009; Chabela, 2011), as craft businesses do not have their own market and their sales depend principally on tourism (Hernández *et al*, 2010).

–Social turbulence as a result of the 2006 social-political movement in Oaxaca. The social turbulence affected the activities of various economic sectors, but mostly the traditional crafts sector (Martínez, 2008; Zafra, 2008; Hernández et al., 2010) due to the unstable environment created by street blockades, mass marches and protests, and the closing of governmental offices, which significantly affected both safety and social coexistence (Sorroza, 2008). The systematic presence of those social disruptions, even after four years of the aforementioned movement, along with public insecurity resulting from violence associated with the struggle against organized crime, negatively affected the performance of craft businesses by generating unfavorable conditions for the commercialization of their products (Chabela, 2011).

–The effects of the natural events provoked by climate change in 2010. Events provoked by climate change threaten business performance due to their unpredictability in magnitude, duration, date, and location (Linnenluecke & Griffiths, 2010). In particular, prolonged droughts and high temperatures, or the intense and continuous rains associated with hurricanes directly impact the performance of craft businesses, as the production of the majority of craft products is dependent on climatic factors, which can either facilitate or interrupt the production process (Domínguez, Hernández, & Guzmán, 2008).

The continuous rains originated by hurricane Frank in 2010 (Mejía, 2010) had a significant impact on craft businesses' performance. The production of merchandise for commercialization decreased, client orders were not completed on time, and product quality was low. The pottery and metalwork sectors were seriously affected, as the drying process of pottery pieces prior to firing depends on the heat from direct sunlight, and in the case of the metalwork the painting and decoration process depends on the humidity levels (Domínguez *et al*., 2008). Moreover, the above-average rainfall in 2010 had the so called flow effect (Abdul-Akeem, 2010) on business performance, as it caused the deterioration of principal roadways in Oaxaca, which in turn affected the tourism and consequently led to a low level of sales for craft businesses.

In summary, the above discussion poses a harsh situation that compelled craft business entrepreneurs to make decisions in order to successfully cope with the uncertainty imposed by the hostile environment in which they operated in order to ensure business survival. And so, how do the EO practices used by small craft businesses modify performance that has been diminished by a hostile environment?

Theoretical framework

Entrepreneurial orientation

The EO construct arose from the entrepreneurship and strategic management perspectives and thus combines the features of entrepreneurial and strategic behavior. EO is therefore posited as a posture that may be utilized by firms as a response mechanism to a hostile environment, in order to maintain or improve performance (Covin & Slevin, 1989; Knight, 1997; Urban & Barreira, 2010).

This entrepreneurial construct has been represented and measured from two operational approaches: the unidimensional approach (Covin & Slevin, 1989), which suggests treating EO as a gestalt construct because of the co-variance between its three core dimensions – innovativeness, proactiveness and risk taking- meaning that dimensions cannot be taken individually; and the multidimensional approach (Lumpkin & Dess, 1996), which considers EO as a construct composed of five dimensions -innovativeness, proactiveness, risk taking, autonomy and competitive aggressiveness-, which firms can adopt, in varying combinations, as the basis of their strategies, based on

internal characteristics or on the environment in which they operate.

Researchers tend to support the multidimensional EO approach over the unidimensional one because analyzing the relationship between individual EO dimensions and performance explains organizational results better than the analysis of a summated EO construct. Moreover, the multidimensional approach of EO stresses the potential for each dimension, individually or in combination with other dimensions to have a different impact on performance, depending on the firm's internal and external factors (Lumpkin & Dess, 1996; Lumpkin & Dess, 2001; Dess & Lumpkin, 2005). Based on these considerations and the primary focus of this study, this paper adopts the multidimensional approach of OE.

Entrepreneurial orientation and performance

The contingency view states that the context of the organization determines the best way for it to organize itself in order to achieve optimal effectiveness (Betts, 2003). Hence, the fit between the firm's strategy and its context – the external environment, or the organizational characteristics such as structure, administrative systems, and managerial characteristics – has significant, positive implications for performance (Venkatraman & Prescott, 1990). Such a fit can be derived from the combination of two related variables to enhance performance (Venkatraman, 1989). Thus, following Betts (2003) the contingency view is adopted in this study in order to identify the effective combinations of factors and characteristics that lead to a superior performance.

Various studies carried out in firms immersed in hostile environments show the positive effect of different individual EO dimensions on performance; as well as the effect of different combinations of EO dimensions on performance. One example is the study of Kraus *et al*. (2012) which indicates that in a recession environment, innovativeness and proactive behavior allows small and medium-side enterprises to increase profits, cash flow and growth rates. Risk taking, however, negatively affects performance. Studies carried out in similar environments indicate that, in economic crises, firms that innovate in commercialization through improvements in product design, distribution, promotions, and price, can develop high-margin products and gain a competitive advantage based on differentiation and cost. This allows them to sustain their growth rate and survive volatile market conditions (Bamiatzi & Kirchmaier, 2012; Ndubisi & Iftikhar, 2012; Naidoo, 2010).

Moreover, the findings of Li *et al*. (2008) suggest that, in an environment of technological turbulence, firms with proactive behavior possess significant abilities to explore and exploit opportunities generated by technological trends and developments; this allows them to immediately commercialize the technological advances that they develop and consequently improve performance. Similarly, the results of Lumpkin and Dess (2001) indicate that, in hostile environments, proactiveness and competitive aggressiveness have positive effects on different measures of performance.

Additionally, the study of Escribá-Esteve, Sánchez-Peinado, L. and Sánchez-Peinado, E. (2008) provides interesting insights into the combined effect of different EO dimensions on performance. These authors found that, in an environment of technological and market turbulence, firms that adopt a proactive posture towards exploring the competitive market in search of potential opportunities, take preemptive actions towards competitors, and also implement exhaustive decision-making processes, achieve growth in sales and market share, as well as increased client loyalty. Similarly, Lechner and Gudmundsson's (2014) results suggest that the survival of small firms is positively affected by the combination of innovativeness, proactiveness, competitive aggressiveness and autonomy. Such a combination of EO dimensions allows small firms to increase performance by pursuing differentiation strategies.

The empirical evidence found in the aforementioned studies indicates a close

relationship between EO dimensions and performance. It also suggests that adopting EO not only enhances performance, but also that, for firms immersed in hostile environments due to conditions of economic decline and technological and market turbulence, adopting EO modifies the ways in which they improve performance. This allows them to more easily overcome difficulties imposed by the unfavorable conditions of the context in which they operate, thus increasing their capacity for survival. The following is thus hypothesized:

H1: EO, perceived as a combination of innovativeness and proactiveness, positively affects small businesses' performance.

H2: EO, perceived as a combination of innovativeness and competitive aggressiveness, positively affects small businesses' performance.

H3: EO, perceived as a combination of proactiveness and competitive aggressiveness, positively affects small businesses' performance.

H4: EO, perceived as a combination of innovativeness, proactiveness and competitive aggressiveness, positively affects small businesses' performance.

Methodology

Quantitative, transversal methodology was used to test the study's hypotheses. A questionnaire was applied in the form of a structured interview to 101 entrepreneurs of small craft businesses. Data collection was carried out from May to November 2011, in the Central Valleys and Southern Sierra regions of Oaxaca, Mexico.

Sample

The survey included 101 small businesses dedicated to the production of metalwork (14), wood carving (16), textiles (32) and pottery (39).

The sample was selected at random, applying the questionnaire to those who agreed to be surveyed. This is due to the distrust that the entrepreneurs have towards community outsiders. To avoid the bias implicit in such random selection, specific itineraries were established for each interviewer so that all of the businesses along the route had an equal probability of being selected. Of the 101 surveyed business, 80% are comprised of only family members (family business) and 20% are small workshops that contract an outside workforce in addition to family members. The average age of these businesses was 23 years. Of the respondents, 60% are men and 40% are women with an average age of 45 years. In terms of literacy, only 33% attended secondary school.

Measurements

Performance

Performance was measured with subjective measures. Therefore, performance is operationally defined as the entrepreneur's degree of satisfaction with the economic results and the benefits obtained from the sale of traditional crafts, as well as by the satisfaction with aspects related to traditional crafts activities. Entrepreneurs were asked to indicate on a Likert five-point scale from (1) very unsatisfied, to (5) very satisfied, his/her degree of satisfaction in respect to sales, production amount, cash flow, acquisition of household goods, achievement of personal goals and lifestyle.

Subjective measurement was employed in the present study for two reasons. First, the sample was composed of small businesses, which generally lack the conventional objective measures of performance used by established firms such as return on investment (ROI), return on equity (ROE), or return on assets (ROA). Moreover, these businesses are very reluctant to provide accounting information, as has been noted in the literature on small and medium firms (Kumar, Subramanian, & Strandholm, 2002). Second, the sample was composed of businesses dedicated to the production of traditional crafts; although these businesses have the objective of generating profit, they also greatly value intrinsic aspects such as personal satisfaction (Paige & Littrell,

2002). Furthermore, empirical studies in the field of strategic management that have used both objective and subjective measures have found a strong correlation between the two (Dess & Robinson, 1984). As such, in studies such as the present one where objective measures are not available, performance can be measured subjectively (Garg, Walters, & Priem, 2003).

Entrepreneurial Orientation

The present study adopted the multi-dimensional approach to EO (Lumpkin & Dess, 1996). This focus consisted of the utilization of three dimensions: innovation, competitive aggressiveness, and proactiveness.

The multidimensional EO approach, based on the inherent characteristics of craft businesses and the competition practices utilized by these firms, was adopted for the present study, in accordance with the literature available on the traditional craft context in Oaxaca. Risk-taking was not considered, given that during a crisis, entrepreneurs of small businesses act more prudently and avoid risks; autonomy was also not included, as traditionally, in small businesses, the owner is the principal entrepreneur, administrator, and decision-maker.

In order to measure EO variables, a scale based on that of Covin and Slevin (1989) and Venkatraman (1989), as adapted by Mendoza-Ramírez and Toledo López (2014) was used to identify the practices of innovativeness, proactiveness and competitive aggressiveness of subsistence entrepreneurs. Respondents were asked about entrepreneurial practices of innovativeness, proactiveness and competitive aggressiveness that they had implemented in 2010.

Innovativeness is defined operationally as the degree to which the entrepreneur implements changes and improvements in products and processes. In measuring innovativeness, entrepreneurs were asked to indicate the extent to which they implemented changes and improvements in products and processes, on a five-point Likert type scale ranging from 1: Not at all to 5: Very much.

Proactiveness is defined operationally as the predisposition of the entrepreneur towards actions that have the objective of eliminating competition. The interviewees were asked to indicate on a five-point Likert type scale ranging from 1), Not at all similar, to 5), very similar, their perception of the similarity between themselves and their competitors, with respect to the practices that the business adopts to eliminate competitors, such as protection of information, third-party dealings and discrediting the competition.

Competitive aggressiveness is defined operationally as the frequency with which the entrepreneur implements actions to maintain or increase the business market share, even at the cost of profits. To measure competitive aggressiveness, the surveyed entrepreneurs were asked to indicate on a five-point Likert type scale, ranging from 1) almost never, to 5) always, the frequency with which they had implemented actions that implied a sacrifice of profits, for example price cutting and sales discounts.

Control variables

Two control variables were included in this study. First of all, in order to consider the effects of the level of completed studies on performance, the education variable was included in order to control for the extent to which a higher level of completed studies would favor a positive association with business performance. Education has been found to positively affect performance (Hausiu, 2006). Second, to consider the possibility that the businesses' type of organization was responsible for the impact on performance, a variable indicating each one included in the sample was used.

Analysis

Internal validity of the variables was assessed with a factor analysis incorporating varimax

rotation, Kaiser normalization, and reliability analysis with Cronbach's alpha. A Kaiser–Meyer–Olkin (KMO) sampling adequacy test to determine the pertinence of the EO factorial model used in the study was also included. The KMO test detects cross-loadings between items of different factors and its use, therefore, can demonstrate discriminant validity between different constructs. The KMO test results showed an acceptable value of .759 (Hutcheson & Sofroniou, 1999), which indicates the significance of the EO factorial model and therefore its validity is demonstrated.

For the performance variable, factor analysis results revealed that the scales used to measure performance loaded on three different factors. Factor 1, labelled as "business's economic results", groups the items related to financial issues. Factor 2 was labelled "benefits derived from the business", comprised of items related to business profitability. Lastly, factor 3, labelled as "attainment of professional and personal goals", is composed of items that reflect intrinsic aspects related to traditional craft activity.

Results

In order to fulfil the objective of this study, which aims to analyze the contingency effect of EO on performance, regression analysis was used to test hypotheses 1 through 4, which are based on the effect of the different combinations resulting from EO dimensions on performance. Regression analysis is the most commonly used technique to test the contingency effects, as it allows for interaction terms resulting from the combined effect of a number of variables (Covin, Green, & Slevin, 2006).

First, a regression analysis was run on the control variables (Model 1). Then, regression analyses were run on the four models resulting in a combination of EO dimensions, estimated as follows: innovativeness × proactiveness; innovativeness × competitive aggressiveness; proactiveness × competitive aggressiveness; and innovativeness × proactiveness × competitive aggressiveness (Models 2–5). The control variables were introduced in all of the EO models. In every regression the dependent variable was performance.

As the regressions included the interactions of more than two EO dimensions, multicollinearity was a preoccupation. To resolve this situation, a collinearity test was included, using the Durbin–Watson method to detect autocorrelation between the study's variables. Before running the regression, the zero-order matrix of correlations between variables was examined. The majority of correlations are modest. Moreover, the highest variance-inflation factor (VIF) value is 1.471, which is well below the usual cut-off value of 10 (Hair, Anderson, Tatham, & Black, 1999). This result reduces the concern of multicollinearity.

The results of the regression analyses are shown in Table 1. The control variable, education, was a statistically significant predictor in all of the models. Model 2, which is comprised of innovativeness along with proactiveness, shows the positive and significant effect of proactiveness on performance. Protection of information, as a sub-dimension of proactiveness, is significantly associated with performance ($\beta = .236$, $p < .05$). Innovativeness affects performance, but the effect is not significant. Even though the combination of innovativeness and proactiveness explains performance in 14%, the marginal association of innovativeness with performance suggests a partial support for H1.

Table 1 Regression results of EO variables

Variable	Model 1 Control	Model 2 Innovativeness Proactiveness	Model 3 Innovativeness Competitive aggressiveness	Model 4 Proactiveness Competitive aggressiveness	Model 5 Innovativeness Proactiveness Competitive aggressiveness
Literacy	.193**	.171*	.165*	.192**	.173*
Type of organization	.043	.092	.012	.018	.041
Innovativeness					
product innovation		.160	.182*		.178*
process innovation		.025	.010		.010
Proactiveness					
protection of information		.236**		.250**	.209*
third-party dealings		−.165		−.152	−.157
discrediting		.087		.063	.112
Competitive aggressiveness			−.153	−.107	−.130
Constant	25.609	18.446	25.102	25.032	21.276
R	.204	.383	.300	.362	.400
R^2	.042	.147	.090	.131	.160
F	2.133	2.286	1.874	2.363	2.186
Sig.	.124	.034	.106	.036	.035
DW value	1.708	1.949	1.800	1.959	1.968

Dependant variable: Performance
* $p \leq 0.1$; ** $p \leq 0.05$
Source: compiled by authors

Model 3, which combines innovativeness and competitive aggressiveness, shows a stronger positive effect of innovativeness on performance than model 2. Product innovation, as a sub-dimension of innovativeness, is significantly associated with performance (β = .182, p < .1). Competitive aggressiveness is negatively, although not significantly, associated with performance. The combined effect of innovativeness and competitive aggressiveness only explains 9% of performance. Thus, H2 is partially supported.

Model 4, which contains proactiveness and competitive aggressiveness, confirms the positive effect of proactiveness on performance shown by model 1. Protection of information, as a sub-dimension of proactiveness, is significantly associated with performance (β = .250, p < .05). The effect of competitive aggressiveness on performance remains negative and not significant, as in the case of model 3. The effect of proactiveness and competitive aggressiveness taken together significantly predicts performance, explaining 13% of it. These results support H3.

Finally, Model 5, which is comprised of innovativeness along with proactiveness and competitive aggressiveness, best predicts performance and supports H5. The combined effect of all three EO dimensions explains 16% of performance, the largest percentage explained by all the EO models. This model sustains the positive effect of product innovation as a sub-dimension of innovativeness on performance, shown by models 2 and 3 (β = .178, p < .1). The positive effect of protection of information as a sub-dimension of proactiveness on performance, shown by models 2 and 4 remains significant (β = .209, p < .1); and the negative effect of competitive aggressiveness on performance, shown in models 3 and 4, also remains not significant.

Results indicate that performance is determined by the combination of product innovation, a proactive posture focused on protecting product and market information,

and a reduced emphasis on price-based competition.

According to the results, craft business performance depends on the combination of entrepreneurial practices such as: i) an emphasis on product innovation through changes in size, shape, decoration and texture as well as improvements in design, shape, decoration, painting, finishing and quality; ii) a proactive behavior in order to conserve market share, such as discretion with the business' best-selling and most liked products and with prominent and foreign client information as well as not giving out the location of competitive businesses and other areas where artisanal crafts are made and not sharing best-selling locations with other entrepreneurs so as to prevent them from gaining market shares and making new designs out of sight in order to prevent copies. And iii) a slight decrease in price-based competition, by reducing heavy discounts and price cutting that could jeopardize profits.

In businesses where such a combination of practices is employed, entrepreneurs perceive better performance, as reflected by their satisfaction with the economic results of the business. Improving profitability provides the business entrepreneur and his family with a better life as it allows him to improve workspaces and access the goods that make his and his family's life more comfortable. Moreover, improved performance is not only manifested in material elements but also in emotional aspects, such as the satisfaction derived from a good reputation in the craft sector, leading to the owner's happiness with his work as an artisan.

One result of the present study that is worth highlighting, is the negative effect of competitive aggressiveness on performance. In contrast with studies suggesting that competitive aggressiveness may be beneficial in hostile environments (Lumpkin & Dess, 2001), our results indicate that the implementation of such entrepreneurial practices may be detrimental to performance. This result can be explained by the low influx of buyers into craft businesses. In the struggle with high market competition, caused by the hostile environment, entrepreneurs modify prices by cutting them; however, the scarce sales are not enough to recoup the investment in the business but only to barely to stay in the market.

Conclusions

The results of this study lead to the conclusion that the effect of EO on the performance of small firms immersed in a hostile environment depends on the combination between the different effects of innovativeness, proactiveness and competitive aggressiveness, more than the effect of those variables individually.

Innovativeness is a very common practice among craft businesses, and in an environment of economic decline, social turbulence, and natural events, an emphasis on the production of differentiated products with improved design and quality, can positively modify business performance. In addition, a proactive posture focused on protecting market share, by cautiously managing product and market information as well as the development and creation of new product designs, has beneficial results, as these practices positively affect business profitability. On the other hand, a reduction in price-based competition is recommendable, as very low prices and heavy discounts lead to very marginal earnings that barely allow for the recuperation of investment in the business. It is not surprising that craft businesses that implement a combination of these three practices are able to adapt to changing environment conditions and benefit from improved business results. Moreover, the entrepreneurs of such businesses perceive a greater sense of satisfaction with their work and lifestyle.

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