Entrepreneurial orientation in turbulent environments: The moderating role of absorptive capacity

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Abstract

The literature on entrepreneurial orientation (EO) has confirmed the positive relationship between EO and firm performance and that relationship's dependence on several contingencies. The present study connects the resource-based view and its dynamic capability extension to introduce absorptive capacity (ACAP) as a moderator of the relationship between EO and firm performance. This theoretically derived research model is empirically validated using survey data from 219 small and medium-sized enterprises in Germany. Our empirical findings are that ACAP strengthens the EO–performance relationship in turbulent markets.

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1. Introduction

Entrepreneurial activity in both start-up and corporate contexts has been identified as a major engine for the generation of employment and the creation of economic growth and welfare (Wong et al., 2005). Accordingly, there is a strong interest in what entrepreneurial behavior looks like and in its antecedents and concrete consequences. In the corporate context, the literature has examined the construct of entrepreneurial orientation (EO), a strategic posture that reflects the specific processes, practices, and behaviors that allow a firm to act in an entrepreneurial way (Covin and Slevin, 1991; Lumpkin and Dess, 1996). In 1983, Miller introduced EO into the academic literature, conceptualizing the construct along three firm-level dimensions: innovativeness, proactiveness, and risk-taking. Since then EO has developed into one of the most established constructs in the entrepreneurship literature (Wales et al., 2011). A major tenet is that firms with strong EO outperform other firms.

However, while many studies and a meta-analysis (Rauch et al., 2009) largely confirm the positive performance contribution of EO, a few studies find no positive relationship between EO and performance (e.g., Ireland et al., 2003). Extant research is more consistent in showing that the strength of the EO–performance relationship depends on various contingencies (Lyon et al., 2000), including external conditions (e.g., Zahra and Covin, 1995) and internal variables (e.g., Covin et al., 2006). In terms of the latter, recent research finds that firm-level resources and capabilities, both tangible (e.g., financial resources; Wiklund and Shepherd, 2005) and intangible (e.g., leadership styles; Engelen et al., 2013a), moderate the EO–performance relationship, pointing out the general importance of firm-level resources and capabilities in facilitating the EO–performance relationship.

The present study extends research on how EO interacts with firm-level capabilities to increase firm performance by arguing that dynamic capabilities play a central role in converting EO into improved performance. Dynamic capabilities differentiate from “ordinary” resources and capabilities, as they allow the firm to reconfigure its existing resource and capability base (Teece et al., 1997). We argue that, in order to implement inherently uncertain entrepreneurial activities smoothly, a reconfiguration of the existing resources or capabilities that dynamic capabilities can provide is necessary, as the inertia of stable, “ordinary” resources and capabilities may not allow the full potential of an EO to be realized (Eisenhardt and Martin, 2000). The strategic management literature discusses which capabilities qualify as dynamic and has largely agreed that the firm’s absorptive capacity (ACAP) is a major dynamic capability (van den Bosch et al., 1999; Floyd and Lane, 2000; Zahra and George, 2002). ACAP, which refers to “an ability to recognize the value of new information, assimilate it, and
apply it to commercial ends” (Cohen and Levinthal, 1990; p. 128),
is a dynamic capability that appears particularly relevant to EO since
a major obstacle in effectively and efficiently implementing
entrepreneurial activities is the handling of uncertain situations
in which typically established knowledge and information are miss-
( Lumpkin and Dess, 1996).
In order to develop a nuanced understanding of how EO and
ACAP interact, we also examine how the turbulence of the market in
which the firm operates is related to the interaction of EO and ACAP.
We argue that the facilitating role of ACAP on the EO–performance
relationship should be strongest in turbulent markets based on the
assumption that dynamic capabilities like ACAP are most valuable
in dynamic environments (Zahra et al., 2006). In these environ-
nments, the generation of new information and knowledge appears
particularly important for entrepreneurial firms, as does a timely
response to new circumstances.
In order to validate our theoretical arguments empirically, we
analyze survey data from small and medium-sized companies. The
empirical findings provide support for our core expectation that the
link between the interaction of EO and ACAP to firm performance
strengthens, as market turbulence increases.
We contribute to the EO and dynamic capabilities literatures
in two major ways. First, in terms of EO literature, we develop a
theoretical rationale for how EO interacts with ACAP as a major
dynamic capability that is required in order to increase firm perfor-
ance. In so doing, we link EO to the theory of dynamic capabilities
and address Miller’s (2011) call to embrace theories of related disci-
plines, such as strategic management, in order to clarify which
resources and capabilities foster a robust entrepreneurial process.
Dynamic capabilities, which have been conceptually expected to
be the “key means for linking EO to firm opportunity exploita-
tion and subsequent performance” (Covin and Lumpkin, 2011; p.
861), still require examination in this context. Second, we con-
tribute to the literature of dynamic capabilities. Barreto’s (2010)
recent review of the dynamic capability literature claims that it
is centrally important to determine whether dynamic capabilities
like ACAP lead directly to performance consequences and to under-
stand the dynamic capabilities’ boundary conditions. We establish
theoretical arguments and provide empirical validation that the
dynamic capability of ACAP interacts with a strategic posture (i.e.,
EO) in order to reap the full performance benefits of EO and that
the degree of market turbulence determines the strength of ACAP’s
role. In so doing, we add market turbulence as an important bound-
ary condition to the dynamic capability literature.
2. Theoretical background and research model
This study is based on Miller’s (1983) definition of EO as a strate-
gic posture that primarily applies to entry into new businesses. Miller
conceptualizes EO as the simultaneous presence of the three
dimensions of innovativeness, proactiveness, and risk taking (e.g.,
Wiklund and Shepherd, 2005). Innovativeness describes a firm’s
propensity to experiment with new ideas in order to activate a
process that results in new products, services, or technological
progress (Covin and Slevin, 1991). Proactiveness is characterized
by a high level of opportunity-seeking, ideally ahead of competitors
and combined with anticipation of future customer demands. Risk
taking refers to bold moves into unknown business areas and/or the
commitment of significant resources to business activities under
conditions of uncertainty (Lumpkin and Dess, 2001). EO is under-
stood as a firm-wide construct, so most, if not all, firm members
are involved in implementing this strategic posture (Wales et al., 2011).
There is also agreement that implementing EO is a complex task
that requires repeated trial-and-error and experimentation (Covin
et al., 2006).
A major interest in the EO literature has concerned how EO
improves firm performance. From a conceptual stance, Lumpkin
and Dess (1996) argue that entrepreneurial firms achieve superior
performance by recognizing new opportunities with poten-
tially large returns, by targeting the most promising premium
market segments, and by obtaining first-mover advantages. How-
ever, empirical tests of this performance-enhancing role of EO
reveal contradictory results. While most studies confirm the
performance-enhancing character of EO, a few studies could not
determine a positive relationship (e.g., Ireland et al., 2003). Extant
research on the EO–performance relationship has more consis-
tently identified various moderating variables that facilitate or
inhibit this relationship. Table 1 provides an overview of extant
empirical research on these moderators.
Whereas the first studies in the 1980s and 1990s focus on exter-
nal factors like environmental turbulence as moderators (e.g.,
Covin and Slevin, 1989), more recent studies examine the moderating role
of internal factors like strategic decision-making styles (Covin et al.,
2006; Chirico et al., 2011). Most recently, internal resources and
capabilities have gained attention and have been shown to impact
the EO–performance relationship, which is in line with Kreiser’s
(2011; p. 1026) view that entrepreneurial firms “are more depend-
ent on their ability to fully utilize resources than other types of
firms are.” These studies can be divided into research on tangible
resources like financial capital (e.g., Wiklund and Shepherd, 2005)
and intangible resources like leadership (e.g., Engelen et al., 2013a).
The reasoning on why internal resources and capabilities are
important for the EO–performance relationship is based on the
resource based view (RBV). According to the RBV, firms are
unequally distributed bundles of resources (Wernerfelt, 1984), cre-
ating resource heterogeneity that persists over time and provides
a basis for firm performance (Barney, 1991). The “strategic fit”
paradigm from strategic management states that, for each strat-
gegic posture (such as EO), there is a set of firm-level resources
and capabilities that facilitate the performance effects of the strat-
egic posture (e.g., Slater et al., 2006; Song et al., 2007; Desai et al.,
2005). In other words, firms should allocate their invest-
ments in resources and capabilities consistent with their strategic
postures (Teece, 2012). In keeping with this rationale, strategic ori-
entation (in our case, EO) describes what a firm strategically does,
and the capabilities capture how this strategy can be implemented
and deployed (Slater et al., 2006). In terms of EO, Habbershon
et al. (2010; p. 21) support the notion that an entrepreneurial firm
requires specific resources since “resources and entrepreneurial
orientation taken on their own are necessary but not sufficient con-
ditions for long-term success. Without resources, entrepreneurial
orientation lacks the means to be realized.”
However, research has recognized certain shortcomings of
the RBV, especially for firms that act in turbulent environments, which
is likely to be the case for many entrepreneurially oriented firms
(Covin and Slevin, 1989). Therefore, the dynamic capability per-
spective was developed to extend the RBV and to answer the
question concerning what changes or recombines the resource base
when the firm’s environment is characterized by constant change
(Teece and Pisano, 1994; Barreto, 2010). Central to the definition
of a firm’s dynamic capabilities are the organizational and strate-
gic routines by which its existing resources base is reconfigured
(Winter, 2003). However, these dynamic capabilities have largely
been ignored in EO research, an observation recently confirmed by
Covin and Lumpkin (2011), who speculate that dynamic capabilities

4 We identified this list of studies by first taking all studies of the meta-analysis
on the EO–performance relationship from Rauch et al. (2009) into account and then
studying the reviews on the EO literature from George and Marino (2011) and Wales
et al. (2013) to add more recent studies.
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